

**TWENTY-SEVENTH REPORT
COMMITTEE ON PUBLIC UNDERTAKINGS
(1986-87)**

(EIGHTH LOK SABHA)

**NOMINATION OF DIRECTORS BY FINANCIAL
INSTITUTIONS**

**(MINISTRY OF FINANCE—DEPARTMENT OF
ECONOMIC AFFAIRS)**



*Presented to Lok Sabha and
Laid in Rajya Sabha on 29 April, 1987*

**LOK SABHA SECRETARIAT
NEW DELHI**

April, 1987/Vaisakha, 1909 (S)

Price: Rs. 2.00

CORRIGENDA TO TWENTY SEVENTH REPORT OF THE COMMITTEE
ON PUBLIC UNDERTAKINGS (EIGHTH LOK SABHA).

<u>Page</u>	<u>Para</u>	<u>Line</u>	<u>For</u>	<u>Read</u>
(v)	4	3	IDBH	IDBI
1	1.3	10	finacial	financial
2	1.4	13	continued	continue."
4	1.10	11	KDBI, IPCI	IDBI, IFCI
4	1.10	13	FBI	IBFI
5	1.14	2	state	stake
15	1.42	19	as	is
16	1.45	8	In India	India
24	1.64	3	rested	vested
27	1.71	7	this	his
33	1.88	7	issued	issued to
40	1.110	1	The word 'used' may be deleted	
41	1.113	4	fater	after
53	2.18	1	were	where
53	2.18	2	training	training of

CONTENTS

	PAGE
COMPOSITION OF THE COMMITTEE ON PUBLIC UNDERTAKINGS	(iii)
COMPOSITION OF THE STUDY GROUP III OF COMMITTEE ON PUBLIC UNDERTAKINGS	(v)
INTRODUCTION	(vii)
PART—I	
A. General Policy of Nomination	1
B. Role of Financial Institutions in appointment of Chief Executives in assisted Companies	13
C. Official & Non-Official Nominee Directors	17
(i) Official nominee directors	17
(ii) Nominee Directors Cell	19
(iii) Non-Official Nominee Directors	22
D. Role and functions of nominee directors	26
E. Reporting by Nominee Directors	30
F. Coordination among Financial Institutions	38
G. Term of Nominee Directors	41
H. Training Programme for Nominee Directors	42
I. Role of Ministry	44
PART-II	
Recommendations/conclusions of the Committee	47

COMMITTEE ON PUBLIC UNDERTAKINGS
(1986-87)

CHAIRMAN

Shri K. Ramamurthy

MEMBERS

Lok Sabha

2. Chowdhry Akhtar Hasan
3. Shri Narayan Choubey
4. Shri Dinesh Goswami
5. Shri Harpal Singh
6. Shrimati Sheila Kaul
7. Shri Haroobhai Mehta
8. Shri Satyagopal Misra
9. Shri Braja Mohan Mohanty
10. Shri K.R. Natarajan
11. Shri Ram Bhagat Paswan
12. Dr. Sankta Prasad
13. Shri K. Ramachandra Reddy
14. Shri Chiranji Lal Sharma
15. Shri V.S. Vijayaraghavan

Rajya Sabha

- *16. Shri Jagesh Desai
17. Shri Krishna Nand Joshi
18. Prof. C. Lakshmana
19. Shrimati Ratan Kumari
20. Shri Santosh Kumar Sahu
21. Shri G. Varadaraj
22. Shri Jagdambi Prasad Yadav

*Elected w.e.f. 22-8-1986 in the vacancy caused by appointment of Miss Saroj Khaparde as Minister of State.

(iv)

SECRETARIAT

1. Shri N.N. Mehra —*Joint Secretary*
2. Shri G.S. Bhasin —*Senior Financial Committee Officer.*

**STUDY GROUP-III ON COCHIN SHIPYARD LTD.,
NOMINATION OF DIRECTORS BY FINANCIAL
INSTITUTIONS (LIC, GIC, IDBI & IFC); RURAL
ELECTRIFICATION CORPORATION LTD., INDIA
TOURISM DEVELOPMENT CORPORATION LTD.**

1. Shri Chiranji Lal Sharma—*Convener*
2. Shri G. Varadaraj—*Alternate Convener*
3. Shrimati Sheila Kaul
4. Shri Santosh Kumar Sahu

INTRODUCTION

I, the Chairman, Committee on Public Undertakings having been authorised by the committee to present the Report on their behalf present this Twenty-seventh Report on Nomination of Directors by Financial Institutions.

2. The Committee took evidence of the representatives of General Insurance Corporation of India on 27 and 28 January, 1987, Life Insurance Corporation of India on 27 and 28 January and 3 March, 1987, Industrial Development Bank of India on 29 and 30 January, 1987, Industrial Finance Corporation of India on 29 January and 2 March, 1987 and also of the Ministry of Finance (Department of Economic Affairs) on 4 and 5 March, 1987.

3. The Committee on Public Undertakings considered and adopted the Report at their sitting held on 24 April, 1987.

4. The Committee wish to express their thanks to the Ministry of Finance (Department of Economic Affairs) and GIC, LIC, IDBH and IFCI for placing before them the material and information they wanted in connection with examination of the subject. They also wish to thank in particular the representatives of the Ministry of Finance (Department of Economic Affairs) and GIC, LIC, IDBI & IFCI who appeared for evidence and assisted the Committee by placing their considered views before the Committee.

NEW DELHI;
April 27, 1987

Vaisakha 7, 1909(S)

K. RAMAMURTHY,
Chairman,

Committee on Public Undertakings

PART—I

A. GENERAL POLICY OF NOMINATION

Over the years, investment by public financial institutions (PFIs) in the private corporate sector has grown manifold. In the ten years upto 1982 the total outstanding assistance to the corporate sector by term lending institutions (IDBI, IFCI, ICICI and SFCs) increased from Rs. 532 crores to Rs. 4189 crores. Similarly, investment in shares of corporate sector by the all India financial institutions (including investment institutions) increased from Rs. 398 crores in June 1973 to Rs. 866 crores in December 1982. A significant portion of the assistance has been availed of by the private corporate sector and there are a large number of companies in which the financial institutions now hold substantial share-holding.

1.2 In order to ensure that the assisted units are run on proper lines a small number of institutional representatives have been nominated on the Boards to obtain feed back on their affairs. Although the financial institutions were appointing, even prior to 1971, their nominees on the boards of some of the assisted companies, particularly where the volume of assistance was large, the system got institutionalised with the issue of Government's guidelines on the subject of conversion of loans into equity in June, 1971. In terms of these guidelines, it became obligatory for the financial institutions to have their representatives on the boards of all assisted companies where (a) substantial financial assistance had been sanctioned and (b) convertibility clause was incorporated in the financial assistance agreements.

1.3 In consonance with the above position, the Government guidelines issued in 1971 prescribed as under :—

“The number of nominated representatives on the Board of any assisted concern should be judiciously determined by the institutions concerned, in consultation with the Industrial Development Bank of India, taking into account the nature and scope of the aggregate of institutional assistance and the importance of the projects. As it may not obviously be possible to nominate more than two or three directors on the Board of an assisted concern, the financial institutions should, where necessary

take appropriate steps within the law to see that the overall size of Board of any assisted concern is not so unwieldy as to unduly impair the strength and influence of the nominated directors."

1.4 Subsequently, a Committee appointed by Government in June 1981 made the following recommendation in Para 7.1 of its report:

"7.1. Obligation to appoint nominees:

The Committee is of the view that in keeping with the objectives of the guidelines issued by Government in 1971, the institutions should, as a rule, appoint at least one nominee on the Board of every company where the assistance is substantial. For this purpose, assistance exceeding Rs. 100 lakhs may be treated as 'substantial', keeping in view the fact that loans upto Rs. 100 lakhs do now attract convertibility stipulation. The present practice of not appointing more than two or three institutional nominees on the board of a company, unless so warranted by special consideration, may also continued.

1.5 In a letter dated 23rd November, 1981 from the Banking Division, the institutions were advised to take action to implement the recommendations of the above Committee. The limit of Rs. 100 lakhs was, however, increased to Rs. 500 lakhs vide Government guidelines issued in March 1984.

1.6 It is to be seen from the above that the Financial Institutions have been given the discretion to appoint or not to appoint nominee directors on the boards of the assisted companies. In practice the institutions normally appoint only one or two nominees. It has been stated that ordinarily if a company is doing well two nominee directors on its board, one appointed by the Development Institutions and another by Investment Institutions, are considered adequate to serve the purpose of obtaining feed back on the affairs of the company as observed from the proceedings of its board. At times even one nominee director appointed by either of two categories of institutions has been considered adequate. Where 'special circumstances' warrant, the number of directors has been increased from more than 2 or 3. "Special circumstances" warranting nomination of more than 2 or 3 directors on the boards of the assisted companies have been taken to mean cases where there are any problem areas or any conflict of interest between management and institutions.

1.7 As per guidelines issued by Government of India, the financial institutions are expected to appoint their nominees on the Boards of all assisted MRTP Companies. In respect of non-MRTP companies, the nominee directors are to be appointed on a selective basis, especially in cases where one or more of the following conditions obtain :

- (a) The unit is running into problems and is likely to become sick.
- (b) The institutional share-holding is more than 26%.
- (c) The institutional stake by way of loans/investments in the concern exceeds Rs. 5 crores.

1.8 As per information furnished by IDBI on 31st March 1986, out of 1300 assisted companies, nominee directors have been appointed by the institutions in 1070 companies only. A further break-up of these figures reveals that out of 324 assisted MRTP companies, nominee directors have not been appointed in 36 companies. Out of these 36 companies, 12 companies are incurring losses. From among 976 non-MRTP companies, nominee directors have been appointed on the Boards of 782 companies and out of 194 non-MRTP companies of which no nominee directors have been appointed, 81 companies are incurring losses.

1.9 The following statement gives details regarding the number of companies where the institutions have one or more nominee directors.

(Position as on March 31, 1986)

Land institution	No. of nominees appointed					Total No. of assisted companies
	1	2	3	4	5	
IDBI	250	148	26	5	3	432
IFCI	149	63	9	..	1	222
ICICI	173	101	11	3	..	288
IRBI	40	6	2	..	..	48
LIC	31	3	1	..	..	35
GIC	37	..	..	1	..	38
UTI	7	..	..	..	..	7
	687	321	49	9	4	1070

It would be seen from the above that in the case of 687 companies, institutions have nominated only one director each, in 321 companies

there are two nominee directors in 49 companies there are 3 directors, in 9 companies there are four directors and in 4 companies there are 5 nominee directors.

1.10 Asked about the policy of nomination, IDBI stated in a written note as follows :—

“Selection of nominees is made by the institutions after taking into account various factors like size of the project, total financial assistance granted by them, performance of company/group, composition of the Board, professional skills already available and those required to make the Board a cohesive and effective entity etc. Though each institution reserves the right to appoint a Nominee Director, ordinarily institutions prefer to nominate and not more than 2 directors, one representing the term lending institutions (KDBI, IPCI and ICICI) and the other representing investment institutions (LIC, GIC and UTI) unless the circumstances warrant otherwise. RBI also makes appointment of its own nominees in suitable cases. The nominations are generally made after mutual consultations. Nominee Directors are not appointed for any fixed period and can be withdrawn at any time at the discretion of the nominating institution.”

1.11 In the same context Chairman IDBI stated during evidence as follows :—

“All the institutions have a right to appoint a director. We normally have been appointing one, two or sometimes even three members. Where the need is felt, we have appointed upto five also. According to guidelines of 1981, we can appoint upto two or three. Institutions have been appointing only one member in most of the cases.”

1.12 On being asked whether directors in the Companies were appointed on the strength of shareholding, the witness replied in the negative. When asked as to what prevented the financial institutions getting their nominees elected on the basis of share holding, he replied :—

“We have not done it where we have a share holding. But in some cases we have certainly had our nominees through election.”

1.13 In this connection, GIC have in a written note stated as under :—

“So far as the Investment Institutions (LIC, GIC, UTI) are concerned, their shareholding in an assisted company comprises both of market purchases of shares (which do not constitute any assistance) and of shares subscribed through underwriting new issues. In both cases the Investment Institutions primarily look for the prospect of good returns and capital appreciation. Even when they come to hold large blocks of shares, they do not aim at acquiring control of the company, but lend support to the existing management as long as it functions well. It is only in special circumstances when a crisis situation develops and the need for interference is felt that the Institutions jointly assert their rights as majority share-holders and strive to change the management. There are a number of instances where such action has been taken by the apex institution.

It is in the background of the above investment philosophy that it has normally not been considered necessary to appoint directors on the Boards of assisted companies proportionate to the combined institutional shareholding, nor do the Government guidelines contemplate such a step. Even if the Institutions do not have proportionate number of directors on the Board the management cannot ignore them when they have more than 50 per cent voting rights, because the Institutions can have their way in the Annual General Meeting in the voting on any issue.”

1.14 The Committee pointed out that in terms of the loan agreements and the state of shareholding in assisted companies the institutions could appoint more nominee directors as against the practice of appointing only 2 or 3 nominees as at present. Asked whether there were any Government guidelines in this regard, the Chairman, GIC stated as follows :—

“There are no government guidelines on this.”

1.15 When asked as to what authority decided not to appoint more nominees on the Board of assisted companies, the witness replied :

“A decision is taken in the inter-institution meetings. There is a forum presided over by IDBI. They consider all these matters. It is a policy decision of the IIM.”

1.16 The Committee further pointed out that if the institutions have more nominee directors than their say in the managing the affairs of the assisted company would be more. To this, the Chairman, GIC stated :

“I accept your point.”

1.17 Asked about the views of LIC in regard to having full quota of nominee directors, Chairman, LIC stated as follows :—

“We will consider the advice of the Committee alongwith financial institutions and put it to the Government.”

1.18 On being pointed out by the Committee that at present financial institutions were playing a secondary role, he stated :

“It is because we feel that we should not take any responsibility and initiative of the promoter Group.”

1.19 However, LIC in a written note furnished after the evidence stated as follows :—

“The question of securing proportional representation on the Boards of assisted companies was considered in the Inter-Institutional Meetings in January 1977 and again in March 1980. Broadly, the consensus was that while the Institutions might retain the option to secure proportional representation on the Boards of assisted companies, the same should be exercised on the merits of each case, e.g. in the companies not properly managed.”

1.20 The Committee enquired whether the non-availability of suitable persons was the reason for not appointing the full quota of directors. The Chairman, LIC stated as follows :—

“We do not have far too many of them. The availability of such persons is not much.”

1.21 When the Committee enquired from IFCI about the reasons for not appointing nominee directors in proportion to institutions holdings, the Chairman IFCI stated as follows :—

“I am not able to recall any instruction from the policy angle whereby we have been prevented from having majority directors on the majority of 50% or more share-holding concerns. But as a matter of practice, wherever the Companies have

been doing all right, there have been no instances of any glaring mismanagement, the institutions have only been appointing two or three nominee directors according to their judgement and not controlling the Boards.”

1.22 Subsequently in a note furnished to the Committee, the rationale for not appointing the full quota of directors even in cases, where the institutions have more than 51% share of the equity capital, has been explained as under :—

“The cases where the shareholdings of the institutions amount to more than 51% of the share capital of the Company fall under 2 categories :

- (i) Cases where shares are acquired, under underwriting obligations or as direct subscriptions as a part of ‘project financing operations’.
- (ii) Cases where the investment institutions viz., LIC, GIC and UTI acquire shares through their market operations.

The term lending institutions do not purchase shares in the market.

As per the Guidelines issued by Government in 1971 ‘the number of nominated representatives on the Board of any assisted concern should be judiciously determined by the institutions concerned, in consultation with the Industrial Development Bank of India, taking into account the nature and scope of the aggregate of institutional assistance and the importance of the project. As it may not ordinarily be possible to nominate more than 2 or 3 directors on the Board of an assisted concern, the financial institutions should, where necessary, take appropriate steps within the law to see that the over-all size of the Board of any assisted concern is not so unwieldy as to unduly impair the strength and the influence of the nominee directors.’ Further it may also be mentioned that the ‘Committee set up by the Government of India to examine the role of nominee directors’ on the basis of whose recommendations the Government issued the relative guidelines in 1981, had recommended that the total number of nominees in a Company may be kept at 2 or 3 unless special circumstances warrant the appointment of a large number. It was mentioned in the Guidelines issued by Government in 1981 that the recommendations of the aforesaid Committee,

other than those covered under the Guidelines, will also be helpful in streamlining and strengthening the system of nominee directors and the institutions may take action to implement those recommendations also. The Institutions have been keeping in view the above Guidelines, while appointing nominee directors.

It may however be mentioned that there are no restrictions as such in appointing more nominees. In quite a few cases, the Institutions have more than 2 nominees. In the case of IFCI lead cases there were 13 companies where the Institutions had appointed 3 nominees, as on the 30th June, 1986."

1.23 When pointed out by the Committee that the Government guidelines do not restrict the institutions to appoint more than 2 or 3 nominee directors, the witness replied :

"It is the practice which has persisted and also there were Government's guidelines at a point of time to make a mention of two or three nominee directors, and I think there has been some kind of stamp on the practice."

1.24 The Committee also pointed out that since the financial institutions were not having the full quota of nominee directors, the assisted companies would not bother for institution's point of view. In this context, the Committee enquired whether by having full quota of directors, the institutions would not have their say in voting of Boards of the assisted companies. To this the Chairman, IDBI replied as follows :

"On most occasions, the functioning of the boards in companies goes by consensus. There is hardly any voting in the board meetings. Voting is there in the annual general meeting or extraordinary general meeting, where the role of the shareholding comes in, rather than the composition of the board. In most cases, there is no proportionate representation in boards, though there is a provision in the Company Law. Most of the boards are elected by majority. Discussion takes place there. The nominee directors make their points, and their minutes are recorded. If there is dissent, a record of the note of dissent is there. Their major role is that of reporting things. However, there are some crucial cases, especially when there are problems like internecine quarrels, dissension in boards etc. Where it comes to voting, the number of institutional nominees also makes a difference. That is why we have a large number of nominee directors."

1.25 On being further pointed out by the Committee that there must sometime be voting in the Boards of assisted companies and in such cases more the number of nominee directors, more effective role the institutions could play. To this the Chairman, IDBI reacted as follows :—

“There is hardly any voting in the Boards, except in some companies, e.g. in the South, there is a cement company. There are two groups of shareholders, who are constantly fighting and there is no amity. But we had a large number of nominee-directors because the board itself was not functioning. There is also another company there, having this problem.”

1.26 On the question of proportionate representation on the Boards of the assisted companies, LIC has submitted as under :—

“The provision in the loan agreements which empowers each participating institution to separately appoint nominee-directors on the Board of an assisted company is considered as only an enabling provision to be invoked as and when any necessity arises. Otherwise, as stated earlier, the basic objective of obtaining feedback on the company’s affairs is adequately served by having one or two nominee directors on its Board.

In addition, the Agreement empowers the institutions, whenever considered necessary, to appoint technical, management or other consultants, or Chartered/Cost Accountants to examine any aspect of the working of the company and its factory, to carry out technical, financial and legal inspections during the operation period of the project, to appoint wholetime nominee director(s) on the Board without being required to hold qualification shares or to retire by rotation, and to review the management set-up or organisation of the borrower and require him to restructure the same in a manner considered suitable.

It will thus be seen that even without the nomination of separate director(s) by each of the participating institutions, the loan agreements contain adequate provisions to safeguard their interests. Nomination of a large number of directors by financial institutions may in fact prove counter-productive by taking away the initiative as well as the responsibility to run the affairs of the assisted company from the promoter group. Moreover, it is necessary to keep the Board broad-based by giving

adequate representation to experienced and competent persons of various relevant disciplines.”

1.27 During the course of evidence of the representatives of Ministry of Finance, the Committee enquired about the rationale behind not appointing as many directors as financial institutions could appoint on the strength of their shareholding and in terms of loan agreements. The Secretary (Banking) stated as follows:—

“The endeavour is to appoint on the Board people who are competent whether they are nominees or non-nominees but I would like to assure you that the interests of the institutions are fully guarded. In the specific cases if IDBI finds that institutional director is not effective because he has not enough strength then we should have as many directors as possible and this has happened in a number of companies recently. As a general rule, if the institutions are satisfied with the performance of the company, then it is not necessary to appoint more than two directors.”

1.28 In reply to a question whether non-appointment of full quota of directors was due to the fact that there was shortage of persons with requisite qualifications, the Finance Secretary Stated:

“We have been finding it difficult to find the required numbers of Officers. We will examine your suggestion as to how to enlarge the circle but we should not try to go into small companies.”

1.29 When pointed out by the Committee that the institutions did not appoint more nominees even in sick units, the Secretary Banking Stated:

“We have now taken care to see that we do not wait. The moment the share-holding capital is eroded, the management can be changed.”

1.30 The Committee further enquired as to why the full quota could not be appointed even in some companies where the financial stake of institutions was more than 50 per cent. Finance Secretary stated as follows:—

“The shares are usually held by LIC, UTI, etc., and to some extent by the institutions; where as shareholders if they have a

combination of more than 50%, you will find many companies where virtually they have a large number of directors. If they have not got, we will look into. That is about shareholding.

But where loan agreements are involved, I think, if the quota is 3 or 4—even 2 or 3—they are able to fill the bill. But I think that will depend how the panel is constituted.

In the new Guidelines, certain responsibilities are given. He has to watch all this.”

He further added:—

“In respect of companies with more than 50%, I promise you that we will fill up the vacancies. In case of companies below 50%, we will endeavour to fill the vacancies within the available time. Normally these managements take into account the nominee director. Even if there is only one, his view is taken. There is a certain respect for institutions even if the number is only one because he always is heard.”

1.31 When pointed out that in the absence of requisite nominees of the institutions in the assisted companies, how it would be possible to watch the public interest, Finance Secretary stated:—

“It is for institutions to see that public interest is protected and if that can be protected by filling of the vacant positions, we should do that. That is why I said in the context of the shortage of panel, we first start with 50 and above and then in the other cases where there is a crisis, we will definitely fill up. We will look into this.”

He added:—

“We appreciate what you have said. We will see that wherever we can, we will try to fill up the vacancies in the companies in the first category. In the second and third categories, we will try to do that.”

1.32 It has been stated by IDBI that the basic objective of nominating directors in assisted companies is ‘to help build up professional management and facilitate effective functioning of Board of Directors as well as formulation of proper corporate policies and strategies to improve productive efficiency and promote long term growth of the assisted companies, keeping in view the overall interest of the shareholders and the community within the broad framework of Government Policies’. When asked as to what extent the above objective has been achieved, the IDBI stated as follows:

“Effectiveness of the system of Nominee Directors largely depends upon the composition and effectiveness of corporate Boards. Thus, the Nominee Director is not likely to be effective where for any reason, the Board itself is unable to or is not performing its task effectively. Institutions have met with a mixed situation in this regard. While some companies had professionalised Board and the members took active interest, other had Boards which were relatively passive. Non-submission or non-consideration of important policy and other matters was more or less a common feature. Boards were starved of information on vital issues; meetings were held infrequently and more as a statutory requirement than a need; sufficient notice of meeting was not given to outside directors; agenda papers were given to directors on or little before the date of the meeting; information furnished to the Board was superficial and important resolutions were rushed through. As a result of persistent efforts and persuasion by the institutions and their Nominee Directors, things have considerably improved. There is an increasing tendency towards professionalisation of Board/Management and a large number of companies have introduced proper Management Information Systems. There is now a more meaningful dialogue in many Boards on important corporate issues than before.”

In the same context, IFCI has suggested as follows:—

“The effectiveness of the Nominee Directors, to a large extent depends upon the composition and responsiveness of the Boards of the companies.

For this, it may be necessary that the composition of the Board may comprise not more than 1/3rd of total members representing promoters’ group and the remaining might consist of independent members who are professionals with expertise in finance, technical disciplines, marketing and the industry related areas etc. and the nominee-directors of the institution.

The above can be ensured by rigorous provisions under the covenants in the Loan Agreement entered into by the Institutions with the borrower companies or, if considered necessary and appropriate, by making suitable provision in the Companies Act.

The above suggestion will ensure that the strength, influence and effect of both the independent members and nominee-directors on the Boards of assisted concerns are not impaired.”

ROLE OF FINANCIAL INSTITUTIONS IN APPOINTMENT OF CHIEF EXECUTIVES IN ASSISTED COMPANIES

1.33 During evidence of the representatives of financial institutions, the Committee enquired whether the institutions had some role in the appointment of Chief Executives of Assisted Companies, particularly where the institutions were having more than 51% shares. The Chairman GIC stated as follows:—

“As chief executive we don't send our own people”.

About the role played by financial institutions, he stated:—

“The manner it happens is this, that the prime responsibilities are that of Board of Directors. Where we have 51% share holding, we have a very high voice there.”

1.34 On being pointed out by the Committee that when the institutions were not having their full quota of directors how they could have their say in appointment of chief executives of Assisted Companies, the witness replied:—

“In cases where we have 51 percent voting right, even if we do not have enough Directors, the management cannot run away from us. They know that if not at the Board of Directors meeting, at the Annual General Meeting they will be caught.”

1.35 The Committee further enquired as to why the financial institutions were not exercising their right. The witness replied:—

“I do not accept that proposition because they come to us with a panel of names and it has never happened that when we selected a particular person they rejected him. Sometimes it has also happened that we have told them that ‘we do not like any of the persons in the panel’, we have also gone out of the panel. We have also suggested the names of persons.”

He added: ,

“The decisions are taken in consultation with us.”

1.36 When asked as to who recommends the name of Managing Directors, Chairman LIC replied:

“The Board recommends it... it is done at the instance of the Board of Directors.”

1.37 When enquired about the role of Nominee Directors in this regard, the witness stated:—

“He consults the nominating institutions saying that they are thinking so and so.”

1.38 When asked whether the Nominee Directors always consulted the institutions regarding appointment of chief executives, Chairman GIC stated:—

“I cannot guarantee that this is done each time. But normally they do consult us.”

1.39 The Committee also wanted to know whether any minutes were maintained for such consultations, Chairman, LIC stated:

“We have not kept the minutes”.

1.40 Asked about the reasons for not appointing full quota of directors even in cases where the institutions were having more than 51% shares on account of which the institutions may be able to appoint their nominee as chief executive, the Chairman GIC replied:

“I accept your point. I can only say how we are operating at present. Whether it is correct or not is not for me to say.”

He further explained as follows:—

“The present practice is that we are not running the companies. These companies are run on their own by the Board of Directors. The present philosophy is that we should leave it to the company to run on its own through its Board of Directors. To the extent it is necessary—either by virtue of loan agreement or by virtue of share-holding—we should supervise; we should see that things are not going wrong. But the present practice is whether it is correct or not, you can come to the conclusion—even in companies where we are having more than 51 per cent share-holding, it is not that we will be running the company. We will in that case be doing only back-seat driving. This is the present approach.”

1.41 When the Committee enquired whether there were any formal guidelines regarding appointment of chief executive in Assisted Companies, the witness stated:—

“There are no formal guidelines. We accept the panel which the Board puts forward to us”.

1.42 Explaining the role of financial institutions in the matter of appointment of chief executive of assisted companies, GIC and LIC have further stated in identical notes as follows :—

“Under the Companies Act, the power to appoint the Managing Director of a company vests in its Board of Directors. But the Board can appoint to the Office of Managing Director only a person who is already a Director elected as such in the Annual General Meeting. In other words, no person who is not a Director can be appointed to function as a Managing Director. The Companies Act further provides that in the case of a Public Company or a Private Company which is a subsidiary of a Public Company, the appointment as Managing Director shall not have any effect unless approved by the Central Government.

Apart from control thus exercised by Central Government, the financial institutions who have given substantial assistance to a Public Company also play a role on different occasions in the matter of appointment of its Chief Executive. While considering the proposal for grant of assistance, one of the important aspects examined by the lead institution as the management set-up including the existing Chief Executive, his background and capability to run the company from the stage of implementation of the project onwards, and the desirability or otherwise of continuing him in that capacity. On the expiry of the term of the incumbent, his reappointment or appointment of another person in his place has to be with the approval of the lead institution. The suitability of the person concerned for appointment as Chief Executive is invariably considered in consultation and dialogue with the lead institution. In the recent past, in three cases, the lead institution in consultation with other participating institutions did not agree to the continuance of the existing incumbent, in two cases where the existing incumbent was due for retirement, the institutions appointed Chief Executives of their choice, and in five cases where the companies were facing certain problems or showing adverse results, the institutions insisted on a change in the management set-up and got Chief Executives of their choice, appointed.

There are no specific norms laid down for selection of person for appointment as Chief Executive. The choice is made with reference to the circumstances in each case and what is taken into

account is his background and suitability to manage the concerned company considering its size and the problems faced by it. Decision in this regard is taken at the level of the consortium of All India Financial Institutions with IDBI as the apex.

It may be stated that whenever the financial institutions have felt the need to intervene in the matter of appointment of Chief Executive, their choice has never been questioned by the assisted companies."

1.43 The Committee also wanted to know whether consultation by financial institution with the administrative Ministry was necessary before supporting a candidate for Chief Executive in Assisted Companies. Chairman IDBI replied in negative. He added, "I do not think IDBI is answerable to the Ministry on this."

1.44 However, in reply to a further query of the Committee, the witness admitted :

"Some discussion, of course, takes place."

1.45 During the course of evidence of the representatives of Ministry of Finance, the Committee wanted to know their views on the appointment of Chief Executives in assisted companies particularly in cases where financial institutions were having more than 50% share. The Secretary (Banking) stated as follows :

"They are always done in consultation with institutions. They are not done by the institution because the Chief Executive is appointed by the Board of the Company. In India Cement, for example, the Board had nominated a Managing Director in consultation with financial institutions because the percentage is more."

1.46 On being asked by the Committee whether there should be some guidelines on the subject, the witness replied:

"It is very difficult to formulate."

He added :—

"It is not possible. It is a matter of judgment based on past record, past performances and ability to run the organisation."

1.47 The Committee drew attention to some specific instance of appointment of the Chief Executives of assisted companies from among the persons who were neither the nominee of the financial

institutions nor their names had appeared in the panel maintained by financial institutions. Asked about the reasons for such appointments, the Finance Secretary stated as follows :—

“IAS officers have been appointed in other Companies. I want to clarify one point. I was appointed as chief executive of SPIC and serving for nearly six and a half years. Mr. Moosa Raza was successful in running GSFC. There are so many instances.”

1.48 On being asked by the Committee whether any person could be appointed as Managing Director without being appointed as Director, the witness stated :

“This has been the practice where the Government has much larger interest in the functioning of the Company. They look to the people who are competent enough to run the company. They look forward to people who have a stake in Government so that they can take action especially in the case of Companies where the holding is more than 50 per cent. We have appointed Rajaraman to run the Cement Industry in one of the units. He has been highly regarded for his efficiency. That is why we had put him there.”

C. OFFICIAL & NON-OFFICIAL NOMINEE DIRECTORS

(i) *Official Nominee Directors*

1.49 Official nominee directors are appointed from out of senior technical and financial officials of the institutions. According to Government guidelines, no official is normally appointed in more than four assisted companies. The officials so appointed are required to discharge this function in addition to their normal duties. This limit does not apply to officials in the Nominees Directors cell whose inclusive and whole time function is to represent the institutions on the Boards of the Companies on which they are nominated.

1.50 Asked whether Government have issued any guidelines in regard to Grade/level of officers of financial institutions who can be appointed as nominee directors IDBI replied in a written note as follows:

“The Government has not specified the grade/level of officers of financial institutions who can be appointed as Nominee Directors except in case of Nominee Directors’ Cell which is expected to consist of only Senior Officers of the institutions.”

1.51 The following table shows the level of officers appointed as official nominee directors by IDBI and IFCI.

Designation	IFCI No. of officers	IDBI No. of officers
Chairman	1	..
Executive Director	1	5
General Managers	5	16
Dy. General Managers	7	51
Asstt. General Managers	19	..
Deputy Managers	38	95
Asstt. Managers	22	78
Loans Officers	15	..
	108	245

The position in respect of GIC is given below:

Designation/Grade	No. of executives	No. of companies
(1) Chairman	1	1
(2) Chairman-cum-Managing Directors	4	9
(3) Managing Directors	2	4
(4) General Managers of GIC & Subsidiaries	18	28
(5) Asstt. General Managers of GIC & Subsidiaries	8	9
(6) Manager in charge of Nominee Directors' Cell	1	5
Total	34	56

Similar details of LIC are as follows:—

Designation	No. of Executives	No. of Companies on which nominated
1. Chairman of LIC	1	4
2. Managing Director	1	4
3. Executive Directors and Officers of equivalent cadre	8	25
4. Zonal Managers and Officers of equivalent cadre	18	32
5. Dy. Zonal Managers and Officers of equivalent cadre	14	16
6. Divisional Managers and officers of equivalent cadre	4	5
	46	86

1.52 It would be seen from the above tables that besides the Senior Officers, Chairman of LIC, GIC, IFCI and in case of GIC & LIC, CMD and Managing Directors are also working as Nominee Directors in assisted companies. During evidence of the representatives of Ministry of Finance, the Committee pointed out that since the reports of nominee Directors are reviewed by financial institutions and in case Chairmen were appointed as nominee directors, the review of their reports would not be possible. To this Finance Secretary replied as follows :—

“As a general rule, he should not be in any company I agree with you.”

He added :—

“We agree Sir. I would like to review it in the light of what you say.”

(ii) *Nominee Directors Cell*

1.53 Following the revised guidelines issued by Government of India in March, 1984 financial institutions have set up separate Nominee Directors' Cell consisting of senior officers. Unlike other officers, the officers from the Nominee Directors' Cell are exclusively functioning as Nominee Directors and are normally nominated on the Boards of companies where exposure of institutions is large or the affairs of the Company require closer attention. While the other officers of the institutions are also expected to discharge their normal duties in addition to functioning as Nominee Directors, the officers from Nominee Directors' Cell exclusively attend to this function and are, therefore, in a position to devote more time to the affairs of the assisted companies where they are nominees. Officers working in the Cell can be appointed in 15 companies. The Committee enquired as to what extent the creation of Nominee Directors' Cell was an improvement over the earlier system. LIC in a written note stated as follows :—

“With the creation of the Nominee Directors Cell the work relating to the appointment of nominee directors, scrutiny and follow-up of their reports has been systematised. A greater awareness of the role and functions of nominee directors has been brought about. The Companies have also recognised the need for consulting informally the nominee directors of the institution on important issues.”

1.54 In regard to the functioning of Nominees Directors Cell, the Executive Director of IDBI stated as follows:

“In the Nominee Directors Cell we have eight senior officers. We have separate administrative set up in the Nominee Director Cell which looks after receipt of report from non-official Director and keeps check on what is happening. We have in IDBI official Directors of the rank of Deputy Managers upto General Managers. Reports submitted by Deputy Managers and General Managers come to the Executive Director. He passes it on to the dealing officers. We have a regular Section for post appraisal work. This section looks after and monitors the individual projects. The reports submitted by Nominee Directors go down to this section after the same are seen by the Executive Director and the General Manager. The report submitted by officers of rank lower than those of Deputy General Manager are seen by the General Manager. We have three such General Managers in Bombay. They send the report for necessary action to dealing officer in the section. This is the actual monitoring done for Official Directors.

The report received from the non-official Directors are seen by the General Managers. If there is anything of importance that is sent to me. Otherwise action to be taken is indicated and it is passed on to the concerned officer who deals with the project. That is the system of monitoring that we have got. The senior officers who are now posted in what we call Nominee Directors Cell are quite distinct from staff in administrative cell. These are very senior officers who have been given ten to fifteen cases each of nominee Directorship and they attend to that work exclusively. All senior officers reports come to me.”

1.55 During evidence of representatives of Ministry of Finance the Committee pointed out that Nominee Directors Cell was formed in financial institutions in terms of Government guidelines issued in 1984 and enquired whether any review has been undertaken by the Ministry to assess the usefulness of the cell, the Secretary, Banking replied as follows:—

“We have not got a formal review of it. We are having very close inter-action with the institutions. They are working

well. We have not carried out a formal comprehensive review of it.”

He added:

“We will do it after three years. This year we will carry out a formal review.”

1.56 It has been stated by IDBI that though each institution reserves the right to appoint a Nominee Director, ordinarily institutions prefer to nominate not more than 2 Directors, one representing the term lending institutions (IDBI, IFCI and ICICI) and the other representing investment institutions (LIC, UTI and GIC), unless the situation warrants otherwise. The nominations are generally made after mutual consultation. Co-ordination in the matter of appointment of nominee directors is reportedly maintained in the following manner —:

- (i) For empanelment of non-officials for appointment as nominee director, the candidates are first screened by a Screening Committee consisting of representatives of all financial institutions and then further considered by a Committee of senior executive of all Institutions.
- (ii) At the time of consideration of the proposal for assistance at a meeting of senior executives of financial institutions, one of the Development Institutions (IDBI, IFCI or ICICI) is appointed as the Lead Institution to consider all aspects such as appraisal of the proposal, documentation, security, disbursement, follow-up etc., as well as to appoint its nominee on the Board of Directors.
- (iii) The matter regarding appointment of nominee representing Investment Institutions (LIC, GIC and UTI) is considered at a meeting of these Institutions, where various factors such as respective institutional assistance, their holdings, location and size of the assisted company, nature and degree of control required to be exercised etc., are taken into account.
- (iv) As and when a Nominee Director is appointed, all the participating Institutions are informed of the appointment. The Institutions also exchange their respective lists of nominee directors on quarterly basis.

(iii) *Non-official Nominee Directors*

1.57 Besides officials, institutions appoint non-officials as nominees on the Board of their assisted companies. IDBI informed the Committee in a written note that, as far as possible, the institutions appoint their own officials as Nominee Directors. Generally, the non-officials are appointed as additional nominee i.e. in addition to the official nominee of at least one of the institutions. Normally, they are selected on the basis of their experience and special expertise required to broad-base and strengthen the Boards of assisted companies.

1.58 As per guidelines issued by Government in June, 1971 IDBI in consultation with other financial institutions was required to prepare a panel of suitable persons of good reputation for appointment of nominee directors. Non-officials nominees are drawn from this panel after their names have been jointly screened by the institutions. This panel was being approved by the Government till March, 1986. But now this panel is cleared by all the financial institutions.

1.59 Asked who are the persons who are included in the panel, IDBI stated in a note as follows:—

“The panel broadly consists of retired officers of Government, financial institutions/banks, persons specialising in one or more fields of industry, Chartered Accountants, Cost Accountants, Solicitors and Senior technical and financial officials of public sector undertakings.”

1.60 The appointment of non-officials is from the panel maintained by IDBI. They are selected on the basis of special skills acquired to broad-base and strengthen the Boards of assisted companies. The empanelment of professionals/experts/specialists in different disciplines is done in accordance with the following criteria after screening by a Committee of representatives of all Institutions and further consideration by a Committee of senior executives of all Institutions:

1. *Chartered Accountants*

- (i) 15 years' of industrial experience or in case of practising Chartered Accountants, 15 years of practice.
- (ii) The Chartered Accountant's firm with which he is associated should have audit of minimum 15 public limited companies (not applicable to management/tax consultant).

2. Cost Accountants

- (i) Minimum 10 years' experience as practising Cost Accountant.
- (ii) Having Cost Audit, on a retainer basis, of at least 5 public limited companies.

3. Solicitors/Legal Advisers

- (i) Minimum 15 years' standing in the legal profession.
- (ii) Having at least 15 public limited companies as clients on a retainer basis.

4. Persons Specialising in Labour Relations

- (i) Minimum 15 years' standing as industrial relations adviser.
- (ii) Having position as industrial relations adviser of at least 5 public limited companies.

In all these cases, due weightage is given to persons possessing experience of serving on the Boards of public limited companies.

The upper age limit for empanelment is 63 years so that a person appointed at that age can serve for at least 2 years before reaching the retirement age of 65 years.

1.61 The following table gives an idea of the persons appointed as non-officials on behalf of IDBI:

1. Wholtime Private Sector executive	Nil
2. Academician (Professor)	1
3. Wholtime public sector executive	3
4. Retired Government officials, Civil Secretary and retired public sector executives.	37
5. Retired people from Commercial Banks and RBI	45
6. Retired private sector executive	10
7. Consultants	5
8. Professionals	3
9. Wholtime Government official	1
	105

Similarly in GIC there are 31 non-officials working as nominee directors out of which 28 are retired employees of GIC. Again in the case of LIC out of 42 non-officers 41 are retired officers.

1.62 When the Committee enquired whether IDBI which coordinates the work regarding formulation of panel writes to different

associations like association of Chartered Accountants and Cost Accountants for forwarding suitable names for the panel, Chairman IDBI stated as follows:—

“I would admit straight way that we have not written to all the associations. Many time people themselves write by saying that is my bio-data, I have done this and I understand that you maintain a panel, please give me a chance. This is the largest category which we have received.”

He further added:

“Secondly, there are people who are suggested by various people, who are eminent men and they suggest that these are the people who are known to them and these people should be considered.”

1.63 During evidence of the representatives of Ministry of Finance, the Committee pointed out that most of the non-officials were either the retired employees of the financial institutions or retired employees of banks etc. and persons from the specialised fields like Chartered Accountants, Cost Accountants, Solicitors were very few and there was none from labour specialisation field. Asked about its reasons, the Secretary Banking replied:

“Because they have greater reliability on them. It is not a bad thing that you have some retired officer who is contributing on behalf of the institution. He knows the institution and the institution knows him. He is not in private business or industry. So, there can be no conflicting interest. He keeps on sending the report.”

1.64 The Committee pointed out that if serving persons working as nominee directors were allowed to continue nominee directors after retirement they might develop vested interest. To this witness replied:

“We agree where there are specific instances we should take care to remove them.”

In the same context, Secretary Finance suggested:

“I think it will be all right if after two terms they should be considered for another company rather than the same company.”

1.65 The Committee further pointed out that the Government had been approving the panel till March, 1986 and enquired as to why this practice had been dispensed with. The Secretary Banking replied as follows:—

“The reasons for dispensing with this arrangement are:

- (1) that the new instructions where by the officers of the institutions were supposed to be the representative of the institutions here the role of the outside nominee directors became much smaller. Earlier, what was happening was that the outside director was representing the institutions exclusively. After this change, the officials of the institutions are acting as the role of the second director and the role of the outside director became very small.
- (2) What we found was that in terms of the delegation giving the right to the institutions as a part of the management, in that we were not adding anything else. Suppose if the institution has a list of 500 people. And say, if the Government approves this list. Either we must go through the normal procedure of verification through IB, or Excise or Customs or Income Tax which will take a very long time. We have not other independent means of verification. So, why should we put a Government seal of approval on the list which we cannot check? So, it is the responsibility of the institutions to have the best persons. They are responsible. They cannot come and say that you approved this man. Normally, when the Government appoints somebody, Government must take some responsibility. If I start checking 1500 people, then I will be doing nothing else. We said to the institutions, you decide, these are the criteria; these are the guidelines. They are given the responsibility to choose X or y. This is the good rationale.”

1.66 The Committee were also informed by the Ministry of Finance that where there are no chances of conflict of interest, even private sector executives are considered for appointment as nominee directors. Asked about the rationale behind appointing private

sector executives as nominee directors, the Finance Secretary replied as follows:—

“Nominee directors have to have some relevant business experience. Therefore, in some cases they have taken experienced people from other industries. I think this is a good thing, as long as they do not have a conflict of interests.”

1.67 When pointed out by the Committee that nominating private executives as nominees was not within the criteria laid down for empanelment for non-official nominees, the witness stated:—

“Private executives have been taken only in two cases and one of them has been withdrawn. But I am making a general point that cross-fertilisation of people from one undertaking to another will be useful. He is also to bring to bear the experience of the other organisation.”

1.68 In reply a further question whether there were some Govt. guidelines in this regard, he stated:—

“I think the Government have not laid down any criteria.”

1.69 On being further pointed out by the Committee that the criteria fixed for non-official nominees should be adhered to strictly, the witness stated:—

“In general we should try not to take the chief executive in the private sector companies as nominee directors. But if there is some expert we should take advantage of his services. Subject to this, I agree we should implement the guidelines strictly. We should not take private sector executives as a rule.”

D. ROLE AND FUNCTIONS OF NOMINEE DIRECTORS

1.70 The guidelines for use of nominee directors have defined the role of nominee director as follows:—

“The Nominee Directors on the Boards of assisted companies are intended not only to safeguard the interests of the institutions but also to serve the interests of sound public policy. Since, however, the interests of financial institutions, shareholders and of the company basically converge, interests of institutions will be well served only when the project is implemented within the estimated cost and time schedule and

is run on sound commercial principles within the policy framework of Government. A Nominee Director by taking active interest in the deliberations of the company at the Board level is expected to see that these objectives are fulfilled.

A Nominee Director should be vigilant and if any undesirable practice prevalent in the assisted companies including any abuse by the promoter group of its powers and privileges, comes to his knowledge, he should promptly bring this to the notice of the Board and his nominating institution. He should take up the matter effectively at the Board/Chief Executive level and get it thoroughly investigated, and see that suitable steps are taken to prevent recurrence of such practices. The Nominee director is also expected to provide adequate feedback to the institutions on the affairs and operations of the companies on which he is represented.

The Nominee Director should make such suggestion as would be conducive to better management practices. Effective functioning of the Board, improvement in productive efficiency and continued growth of the assisted company. He is expected to keep himself acquainted with the policies and current developments in the industry in which the assisted company is engaged and to see that the company is run on sound lines within this dynamic set-up. It goes without saying that the Nominee Director as well as the other directors on the Board are expected to have high degree of probity and independent approach."

1.71 Explaining the role of nominee directors further, Chairman GIC stated during evidence :

"The most important function for which we appoint a nominee director is to have effective feed-back. We must know what is happening in the company. The nominee director acts as a very vital link between us and the company. Through this reports we come to know what is happening in the company.

The second role of a director is that he is an outsider. Normally in these companies the family groups prevail. Seriousness is brought into the functioning of the Board by the presence of an outsider."

1.72 The Committee enquired as to what extent the nominee directors have performed their role. IDBI replied in a written note as follows:—

“The Nominee Directors have played useful role in bringing about improvements in the functioning of corporate boards and also introduction of proper Management Information Systems, besides inducing corporate managements for an open discussion on important issues like performance reviews, corporate policies plans for expansion/diversification etc. They are also providing regular feed-back to the nominating institutions.”

1.73 Asked whether any study had been undertaken by the financial institutions to assess the role of nominee directors, IDBI stated in a note as follows:

“IDBI had conducted a departmental study in the later half of 1979, on the role of Nominee Directors which was based on its own experience and the comments received from other institutions. It was observed that “by and large, majority of Nominee Directors, especially official nominees, had played a useful role and have been helpful in safeguarding the interests of assisted units to a large extent. They also provided timely feed-back to the institutions about the progress and problems of assisted companies. In some cases, the nominee have been successful in prompting the management of assisted companies to introduce suitable Management Reporting System and also in bringing about the desired level of administrative and financial discipline in the units.

There have also been instances where nominees have helped the company's management in resolving difficult issues with their bankers and also in better understanding of the various covenants stipulated by the institutions for their assistance, thereby facilitating early compliance with such covenants and consequent speedy disbursement of sanctioned assistance. The contribution of Nominee Directors in revival of some of the sick units has also been significant.”

The above study had also revealed:

“However, the performance of all nominee directors has not been uniform. As for reporting, while the official nominees

of the institutions, have given, well in advance, the signals of impending sickness and/or the leave-much-to-be desired behaviour of recalcitrant managements, the feed-back from the non-official nominees has been rather inadequate. The decision of the institutions, about two years back, to reimburse the cost of secretarial expenses upto Rs. 1000 P.A. to non-official nominees has also not improved the position much. It is necessary that the institutions insist on timely submission of reports and the cases of nominees who do not submit such reports, despite reminders, are periodically reviewed."

1.74 Subsequent to the above study, Pai Committee set up by Government to examine the role of Noninee Directors submitted their Report in 1981. In regard to the role of nominee directors, Pai Committee had inter-alia observed as follows :

"The nominee directors are expected to provide regular and meaningful feed-back to the nominating institution. In practice, while the official nominees, as a rule, submit written reports after each board meeting, the non-official nominees are not so regular, despite the fact that the institutions are reimbursing the expenditure incurred by non-official nominees on 'secretarial assistance' upto a maximum of Rs. 1000 per annum per unit. While some non-official nominees prefer to meet the senior executives of the institutions to keep them acquainted with the affairs of the companies, some other provide no feed-back at all either through written reports or through informal discussions. The Committee is of the view that the very purpose of appointing nominee Directors will be defeated if there is no meaningful feedback to the institutions and, while informal discussions between the nominee and the Senior Executives in the institutions would often prove very useful, they cannot be a substitute for written communications on a regular basis. It is, therefore, essential to insist on all nominee directors furnishing written reports to the nominating institutions after each board meeting. Such of the nominees who have not been providing any feed-back should be requested to send written reports on a regular basis. If some of them do not find it possible or convenient to do this, the institutions should not hesitate to withdraw their nominations."

1.75 The Narsimhan Committee which consisted of some of the Chairmen of financial institutions also as members of the Committee, submitted their Report in December, 1983 and made certain recommendations to make the nominee directors institution more meaningful. The recommendations were being implemented by the financial institutions.

1.76 Asked as to what extent the objectives for appointment of nominee directors have been achieved, Chairman GIC stated as follows :

“These objectives are being fulfilled. I do not say that everything is perfect. Certainly there is room for improvement.”

He added :

“The system needs improvement.”

1.77 In the same context, LIC also stated in a written note as follows :

“By and large, a majority of nominee directors, especially official nominees, are playing a useful role and have been helpful in safeguarding the interests of the assisted units as well as the Institutions. The system can, however, be improved further by arranging more frequent briefing, particularly of non-official nominee directors more systematic evaluation of the performance of nominee directors, and organising seminars and training courses to facilitate exchange of views and experiences among themselves and with the Institutions and improve the standard of reporting. Necessary steps in this regard will be taken in consultation with other Institutions.”

E. REPORTING BY NOMINEE DIRECTORS

1.78 Financial Institutions have not prescribed any format for submission of reports by Nominee Directors but has only given an illustrative list of items which should be placed before the board of assisted companies. This list forms part of ‘Guidelines for use of Nominee Directors’.

1.79 In regard to a number of reports which the institutions receive from the nominee directors, IDBI replied in a written note that the Nominee Directors were expected to submit a report after attending each Board/Committee meeting. These reports are expected to summarise the deliberations at the meeting on important issues and

also the Nominee Director's views thereon. The periodicity of these reports depends upon the frequency of Board/Committee meetings convened by the assisted companies.

1.80 The Committee pointed out that there are large number of nominee directors and even more number of assisted companies. Asked as to how the institutions ensure that reports/are received from all nominee directors in time, IDBI stated in a written note as follows :

"The Nominee Directors are required by nominating institutions to submit their reports regularly and in cases where such reports are not received, they are reminded by the nominating institutions. In IDBI, this function is being monitored by the Nominee Cell. Incidentally, it may be mentioned that IDBI received reports on as many as 87% of the Board/Committee meetings attended by it Nominee directors in 1985-86."

1.81 During evidence of the representatives of the financial institutions the Committee enquired whether there was any systematic method of evaluating the reports of nominee directors. The Chairman, IDBI stated as follows :

"I would like to say that we have not made any detailed guidelines so far as to how the reports should be evaluated."

1.82 Asked about the present system of evaluation, the witness replied :

"These reports are evaluated at the different level by different people."

1.83 Explaining the system further, IDBI stated in a written note as follows :

"The Nominee Directors' reports are submitted directly to the Executive Director in charge of Project Finance and Rehabilitation Finance Departments in the case of officers in the rank of Deputy General Managers and above, and to the respective General Manager in the case of other officers. Similarly, the reports of non-officials are received at the General Manager's level. After the Executive Director/General Managers have gone through the reports, they are passed on to the concerned officer dealing with individual projects, for necessary follow-up action on the points mentioned therein together with specific instructions where considered necessary. All material reports are also sent to the Chairman and Managing Director through the Executive

- Director. Thus, Nominee Directors' reports are first seen at the senior management level and passed on to the operational departments for follow-up action. General Managers bring to the notice of Nominee Cell such cases where the frequency, adequacy or quality of feed-back is not satisfactory. These facts are brought to the notice of concerned Nominee Director and he is counselled suitably."

1.84 Asked whether the present system of follow up action on nominee directors reports was adequate, Chairman, GIC replied :

"I will admit that our present system of follow up action needs to be strengthened."

1.85 When asked as to whether some selected nominee directors' reports are discussed in the Boards of Financial institutions, the witness stated :

"I must admit that the reports of the nominee directors are not discussed in the meetings of our Board of Directors. But that does not mean that the reports are not acted upon. These are discussed at the inter-institutional meetings where professional people are present. Our feeling is that discussions at the inter-institutional level are perhaps more useful than the discussions in the meetings of the Board of Directors."

1.86 The Committee also pointed out that as per the guidelines for 'Nominee Directors' they have the right to inspect the books of accounts of assisted companies.

Asked whether this has even been done, particularly where the nominee directors have found laxity in financial control or siphoning of funds, Chairman, IDBI stated as follows :

"I must admit that they have not inspected the books of accounts."

He added :—

"The word siphoning is not there in nominee directors reports. They report it as a financial laxity. I have already admitted that they have not inspected the books. Wherever he mentions about the financial laxity, we have appointed a concurrent audit with direct reporting relation with IDBI."

1.87 The Committee also enquired about the action taken against the nominee directors who do not submit their reports regularly. Chairman IDBI replied :

“Eleven people have been removed because of not submitting report as also for poor reporting.”

1.88 When asked whether there have been instances where important matters were brought before the board of assisted companies at the instance of the Nominee Directors, IDBI, in a note, stated as follows :

“There are several instances where important matters were brought before the Boards of assisted companies at the instance of Nominee Directors. Specific guidelines have been issued the Nominee Directors for discussing certain matters at the Board level, particularly the following—

- (a) Position regarding clearance of dues to financial institutions/banks.
- (b) Position regarding clearance of dues to Government on account of excise, corporate taxes, and also statutory dues such as Provident Fund, ESI, etc.
- (c) Yearly budget for revenue and capital expenditure.
- (d) All advances to/investments in associate companies.
- (e) Proposal for expansion/diversification/modernisation of the unit.
- (f) Investments in shares, particularly in companies in the same group.
- (g) Reports on foreign tours of Managing/Whole-time Directors or Chief Executives of assisted companies.”

1.89 Guidelines for nominee directors provide that in the context of growing sickness in industrial units, the nominee directors are expected to play a more active role in keeping a watch over the progress of units so that they can sound an early warning if things are not going along properly. Similarly nominee directors are also expected to monitor closely the erosion in net worth of Companies. As soon as 25% of the net worth is eroded, the fact should be specifically brought to the notice of the nominating institutions so that they can keep a closer watch on such companies. Asked whether the nominee directors have given reports about the sickness and erosion in net worth of assisted units the Chairman IDBI replied during evidence .

"The nominee directors give us reports after the board meeting. At the board meeting they seek information on what is the progress of the project scheduling and also whether the cost budgeting is being adhered to or not. In many cases there is a management committee also. It takes a closer look in these things. Our nominee directors are also members of such management committees and we get reports from them also. Besides that we also get reports from the companies. When the Company is in operation, we receive many times signals of sickness and we have taken action many times. In fact I can mention 40 cases for which we got advance signals of sickness and apart from this in 42 cases we have been able to revive them completely. Nominee directors have played a very important role."

In regard to siphoning of funds, he stated :

"In fact for putting up the cash flow, our nominee directors have been insisting that such information comes to the Board. This information has not come to the Board in 100% cases but the situation is improving and we are getting more and more information."

In reply to a further query he stated :

"All that I can say is that there is scope for improving the flow of information."

1.90 Asked about the action taken by financial institutions on feed back regarding laxity in financial control, the witness replied :

"The appointment of the concurrent audit takes place because the nominee director has given feed back to us that such a step is necessary."

1.91 The Committee also enquired whether there was any system for briefing of directors by the financial institutions. Chairman IDBI replied :

"As far the official directors are concerned, there is thorough briefing in the existing system. In all companies where a crisis situation is there, our dialogue with the nominee director and Company's dialogue is a regular feature Sir. Generally we meet these people and discuss these things with them. But I cannot say that it is happening in all the cases."

1.92 In the same context, Chairman GIC stated as follows :—

“A system exists that our nominee Directors send us reports of their participation/and what happened at the Board Meetings which they attended. We analyse these reports. There is a continuous flow of exchange of briefings and exchange of information between the nominee Directors and ourselves. Whenever we want to know more about the findings of the nominee Directors, we ask them to give those details. Whenever they are in doubt, they come and consult us. I must very honestly admit that it is a system which is ‘evolving’. It is not a system which has come to perfection. I am the last person to claim that everything is perfect. We are trying to improve the system as we go along.”

1.93 Asked whether the whole agenda of assisted company is discussed by the nominee directors with the nominating institution, the witness stated :

“When he receives the agenda, I would not say that the items are discussed in detail. But if there is any important issue which requires briefing he does it.”

1.94 On being pointed out that as per the present practice it was upto the nominee directors whether they thought a particular matter important or not, the witness replied :

“That lacuna we will accept, that is only when he feels the importance he comes to us.”

1.95 Stressing the need for improving the system, Chairman IFCI stated :

“As far as mechanism to judge the effectiveness of the nominee director is concerned, I do hope it requires to be strengthened adequately. We have started giving considerable attention. On our side we get the reports from field offices as to whether the nominee directors, who are representing us on the boards, are submitting their reports, that is, how many are submitting reports. This practice has been in force in this Corporation for the last ten long years.”

He added :

“This part has very frankly come into sharp focus recently and all attention is being devoted to it. It is a fact that it has not received adequate attention as it should have.”

1.96 The Committee pointed out that there were some official directors and some non-officials. Asked whether any comparison has been made to judge the performance of these two, Chairman IFCI replied :

“Officials are better enough quick in building their two way communication and officials carry messages as situations warrant more timely and more effectively, but this does not mean that those who do not belong to the organisation, but represent the organisation on the Boards of assisted enterprises are not as effective as the officials are.”

1.97 When asked as to how the performance of non-official directors could be improved, the witness replied :

“Every non-official director must go over to the institution and must be invited to come to the institution for necessary briefing on the problems and prospects of the present and futuristic role as far as a particular concern or enterprise is concerned.”

1.98 About the prevention of sickness in the Companies, Banking Secretary stated :

“A very important measure was moved by the Government year before last and the Bill was passed by Parliament last year. It is an important measure which would change the character of the problem in future. After share capital and reserve of the company has been eroded to the extent of 50%, he has to report this fact to the shareholders and seek a fresh mandate for management. If 100% of the share capital and reserves are eroded, then he has to go before the Board of Industrial and Financial Reconstruction. Most of the present sick units have eroded their net worth 3 times or 4 times. Today, we have a very important measure whereby the management will not be allowed to continue unless the Board decides so. If its networth is exhausted to attack the problem of sickness, then we cannot only rely on the nominee directors. We hope that this provision would strengthen both monitoring aspect and prevention aspect of sickness.”

1.99 The Committee wanted to know whether there have been some instances where the nominee Director did not comply with the directions and guidelines given by the nominating institution, Chairman, IFCI stated as follows :

“The question of a nominee director not carrying out our directions has not come to our notice. But we have come across

instances where nominee Directors are not able to make their presence felt in the decision-making process. In the last two years, we withdrew and replaced four such nominee Directors from the Board of Directors."

1.100 Asked about the other measures taken for improving performance of assisted companies, IDBI stated in a written note as follows :

"In many large or financially weak cases, institutions have asked the assisted companies to constitute compact Management Committees (as Sub-Committees) of the Board, to oversee their operations and the Nominee Directors is invariably a member of such Committees. The institutions have also recently required the companies having paid-up capital of Rs. 5 crores and above to constitute Audit Sub-Committees of a few independent non-whole-time directors (including the nominee of the lead institution) to have an inter-face with the internal and statutory auditors of the Company. The formation of such Committees introduces the senior executives of the Companies to Board culture, and helps in professionalising the set-up at both Board and Management levels."

1.101 During the evidence of the representatives of Ministry of Finance the Committee pointed out that one of the objectives of appointing nominee directors was to see that the companies do not become sick. Asked as to how the Ministry was ensuring that large number of companies did not become sick, the Finance Secretary replied as follows :—

"It is best entrusted to the institution and we should monitor the institution. Nominee Director can only say when the unit is going to become sick. I was put incharge of a sick unit for six years. Nominee Directors comes once in three months to a Board's meeting. He can only say that things are going wrong. It is only through quality of the Management that sickness can be prevented."

1.102 In the same context Secretary (Banking) also stated :

"After 1984 a very major change was made in the institution and the functioning of the Nominee Directors—that the first Nominee Director will be an officer of the Institution. This

is to meet this problem that the institution officer will be responsible to the institution and he would look after the institutional interest. Earlier periodical reporting was not with that much of efficiency. You are only in touch with the company indirectly as reported by the Narsiman Committee. So, this is the major change in the institution of Nominee Directors. It is not that he is an outsider. Now the Nominee Director is supposed to be directly responsible to the institution, Board of Directors and others. I think this will improve the system of functioning of the Nominee Director. After considerable study we found that the institution of the Nominee Director while it can perform the most useful role in giving advance warning, the responsibility for reporting sickness must be squarely put on the unit itself. What was happening earlier was that all the early warnings were not given due attention, with the result that the entire share capital was eroded. It kept on borrowing money, otherwise the unit would close down. Therefore, sickness became a precedent and no corrective action was taken."

F. COORDINATION AMONG FINANCIAL INSTITUTIONS

1.103 The Government has specifically assigned the coordination work relating to Nominee Directors exclusively to IDBI. The role and functions assigned to IDBI in this regard are given below:

- (a) To prepare a Panel of suitable persons of good reputation for appointment as non-official Nominee Directors.
- (b) To lay down drills feeding the Director and feed-back to themselves so that institutional participation in management of assisted companies particularly on policy-making level develops into a meaningful reality.
- (c) To determine the number of Nominee Directors to be appointed on individual assisted concerns by other institutions, taking into account the nature and scope of aggregate institutional assistance and importance of the project.

1.104 In keeping with the above directives, IDBI has been coordinating all matters relating to selection and appointment of Nominee Directors by Central Financing Institutions & providing necessary feed-back to the Government from time to time.

1.105 Asked whether IDBI found some constraints in performing the role of coordination, IDBI stated in a written reply:

“The present system is in vogue since 1971 and is reviewed from time to time. The system has been functioning smoothly. IDBI has not experienced any constraints in performing the coordination role assigned to it by the Government.”

1.106 The Committee wanted to know as to how the coordination is maintained between the financial institutions for selecting the nominees in assisted companies from different institutions. IDBI stated in a written reply as follows:—

“The selection of nominees is made by the institutions independently keeping in view the size of the project, magnitude of assistance and professional expertise required by the assisted company to strengthen its Board of Directors. Normally, one of the three term lending institutions viz. IDBI, IFCI and ICICI is designated as lead institution to look after all matters relating to sanction and disbursement of assistance and follow-up of credit. And the lead institution so designated appoints a nominee on behalf of term lending institutions. The decision regarding appointment of nominee by investment institutions viz. LIC, GIC and UTI is taken at their joint meeting. In important cases, the selection of nominee is made jointly at Inter-Institutional Meeting/Senior Executives Meeting or through oral consultation. In certain cases where the working results are not satisfactory or there are some problems, the institutions appoint more than 2 directors and decision to appoint more than 2 directors is normally taken at Joint Institutional Meetings. Thus, there is a proper coordination among all the institutions in this regard. The nominee of Government of India, Ministry of Finance is, however, not associated with such meetings.”

1.107 When asked whether there is any formal coordination Committee having representatives of all financial institutions, LIC replied in a written note:

“There is no structured coordination Committee of Senior Executives of all financial institutions including a representative of Ministry of Finance.”

1.108 Asked about the system of coordination among the nominee directors of various institutions, Chairman, LIC stated during evidence:

“There is SEM where all the institutions are represented. At the IIM all the institution are represented. Then it may be very important matter regarding giving some more assistance by way of debentures. All this is discussed and on the basis of discussion and interaction, the nominee directors are apprised by the respective institution as also as to what is the stand they have to take. This is, by and large, working satisfactorily.”

1.109 When asked about views of other institutions about role of IDBI as a coordinating body Chairman, IFCI stated as follows:

“While IDBI's role is satisfactory, I expect that improvement is necessary. I still believe in strengthening.”

1.110 On enquiry used about the area, which needs to be strengthened, IFCI stated in a note furnished after the evidence as follows:—

“Two way communication between the Institution and nominee directors, specially, non-official nominee directors for better appreciation and closer monitoring of the affairs of the assisted Companies needs to be strengthened. The Institutions are continually reviewing the drills in this regard. It is, however, suggested that the lead Institution might consider meeting each of its nominee directors once in a half year and discuss with him various aspects of the assisted concern's operations on the Board of which he is a nominee director. In such a meeting the Lead Institution could brief in detail the nominee director about the assisted concern's affairs and dealing with, the Institutions, developments pertaining to the concern, the perceptions of the Institutions regarding the future approach and overall operations of the concern. Such a meeting will also provide an opportunity to the Lead Institution to get a detailed account of the assessment of the concern's affairs from the nominee director, apart from the feedback given by him in his reports. Further, it would also provide an opportunity to the lead institution to evaluate the extent of the understanding of the concern's affairs by the nominee director and his performance effectiveness. Any corrective steps need to be taken by him could also be advised to him.”

1.111 Within the present framework the project appraisal evaluation is being done by the lead institution. Asked whether the lead institution concept was working satisfactorily, Chairman, IFCI stated as follows:

“As far as the lead institution concept is concerned, I think this has evolved itself, and I would be one who would say that it is working reasonably well. If anything that is required is, there is need for giving greater push to this concept. As far as the nomination part is concerned, where we wish to see that the nominees play a part, where we are getting signals not only in time but preventing and dealing with sickness in a manner which is consistent with the need of the hour, I think that may be certainly dealt with as an area where degree of streamlining, re-enforcing, strengthening and system approach is called for.”

1.112 The Committee also enquired from the representative of the Ministry as to whether they were satisfied with the role of IDBI as a coordinator. Finance Secretary replied as follows:

“I feel that the IDBI is performing a coordinating role which should be strengthened further.”

G. TERM OF NOMINEE DIRECTORS

1.113 In regard to term of nominee directors IDBI has stated in a note that nominee directors are not appointed for any fixed period and can be withdrawn at any time at the discretion of the nominating institution. Normally, the nominee directors are withdrawn after a period of around 3 years. In the case of non-officials, the nominees are normally withdrawn on reaching the age of 65 years.

1.114 Asked whether there have been cases where nominee directors had their term beyond 3 years, IDBI replied in note as follows:

“There are no specific guidelines on this aspect. However, the institutions have been following the practice of withdrawing a non-official nominee director from a company after a period of around 3 years, except in cases where their continuity is considered useful. In the case of official nominees, a somewhat longer period is allowed. This practice is observed more closely in the recent past. Out of the existing 105 non-official nominees, only 5 have continued beyond 3 years. Similarly, out of 245 official nominees, only 31 have been there beyond 4 years.”

1.115 However, from the information furnished to the Committee, it has been noticed that in some case nominees continued on the Board of same assisted companies even upto 8 years.

1.116 Asked whether any review is undertaken to judge the performance of nominee directors, Chairman IDBI stated as follows:—

“We review the performance of all directors on a three-yearly basis. We review whether they have submitted any reports or not and what sort of reports they have submitted. There were instances where we have not continued with a person after three years period.”

1.117 On being pointed out that at present performance of directors is reviewed after three years and by that time some companies could become sick, the witness stated:—

“If we find that he has really done something which should not have been done, we certainly remove him.”

1.118 In the same context another representative of IDBI stated as follows:

“Every quarter there is a review of nominations made by us. We will not rotate them. If there are any indications that the Department is not satisfied with their performance, the nominee directors are at times replaced.”

1.119 Asked whether the directors can be removed before 3 years, the witness stated:

“We don't continue him beyond three years. While going through the quarterly review, if we are not getting the feedback and reports, even the period of three years is not allowed to be completed. We have instances where we have discontinued their services even earlier.”

H. TRAINING PROGRAMME FOR NOMINEE DIRECTORS

1.20 The Committee enquired whether institutions conduct any orientation or training programme for nominee directors, Chairman, IFCI stated as follows:

“There have been but not as regular and as systematic as they are required.”

He added:

“There should be every six months incisive discussions between the institution and the nominee director about not only what he has done, but what he is required to do in future in view of the situation prevailing in a particular enterprises. I would, however, add that this is an area that requires strengthening, streamlining and to be organised on a firm footing.

1.121 When asked whether it was not the responsibility of the institutions to give guidance to nominee directors, the witness replied:

“I must say that there is a greater need for systematizing it and it is not that it is not happening, but it has to happen in a more systematic manner and it is this part which I am emphasizing. A greater degree of regularity and systems approach is called for to which all of us have started addressing ourselves.”

He further explained:

“In the overall effort to prepare nominee directors to play a role which is useful and meaningful, official nominee directors or non-official nominee directors can go through continuous programme of updating them, educating them by holding seminars from time to time, calling them at various centres, asking them to go through the programme where they cross-fertilize the kind of culture, they are confronted or they function within. I think all that, according to me, is also a suggestion which is to be carried forward.”

1.122 In a written note furnished after the evidence IFCI have stated:—

“An opportunity for the nominee directors to interact amongst themselves and exchange views which may help in cross fertilising experiences and improving their effectiveness, may also be provided by arranging seminars for them from time to time. The role of the nominee directors, the aspects of their accountability, and ways and means of making their functioning effective could be reviewed and better understanding and appreciation developed through such programmes.”

1.123 Explaining the need for training programmes Chairman, LIC also stated:

“Sir, one of the things we will have to do is to brief, instruct and educate our nominee directors vigorously. We are having

a national insurance academy. The quality of nominee director could be improved by giving them more knowledge and more briefing. Second, there could be better liaison with other institutions. This is an area where we should pay more attention. Thirdly we may bring nominee directors together pertaining to one category of industries for discussion. This may improve the effectiveness of our nominee directors."

I. ROLE OF MINISTRY

1.124 During course of evidence of the representatives of Ministry of Finance, the Committee enquired about the role of Ministry in regard to working of nominee directors Finance Secretary replied as follows:—

"The institutions are the agency which nominate the directors and we deal with those institutions and not with the nominee directors. If we try to interact directly with the nominee director then the Government's task will be more difficult."

1.125 On being pointed out by the Committee that panel of nominee directors was approved by the Ministry in 1986 and the Ministry should have at least monitored the overall performance of the working of nominee directors, the witness stated:—

"Sir, I believe that on the question of monitoring, the philosophy of the Ministry of Finance is that the institutions should be entrusted with this responsibility and if we start interfering with them, they will throw back the ball on us. This is our general policy."

1.126 The Committee further pointed out that nominee directors reports were not discussed in Board of financial institutions. Asked as to why Ministry's nominee in the Board of financial institutions do not insist on discussing some selected reports, Finance Secretary replied as follows:

"I think the point which you have raised is important. Our nominee on the Boards, the Additional Secretaries and others, do not insist on specific reports of nominee Directors being considered.

It is the responsibility of the institution to look at nominee directors reports and what they try to do is, they insist on finding

out the total position of the sick industries. When that is discussed, the nominee Directors will also come. You are right that it is not the practice to review the nominee Directors reports. A periodic review of the nominee Directors' functioning into all the institutions under the Finance Ministry is taken."

1.127 In regard to improving the functioning of nominee directors, IDBI and other institutions have suggested before the Committee that changes may be made in the Companies Act covering certain matters relating to functioning of Boards, specifying:

- (1) (a) The notice period (of at least 7 days) for Board meeting;
 - (b) sending agenda items and background papers in advance to the members of the Board;
 - (c) periodicity of Board meetings be increased to once in 2 months and minimum 6 meetings in a year;
 - (d) submission of quarterly working results and annual capital and revenue budgets before the Board regularly; and
- (2) Formation of Audit Sub-Committee of the Board should be made compulsory through the Companies Act, at least in large companies having paid-up capital of say Rs. 5 crores and above.
- (3) In addition to the above suggestion, IFCI has suggested that it may also be made incumbent on the companies to submit to the Board periodically certain minimum management information reports covering critical areas of overall performance, key indicators for the same, financial position and operations; the system and formats for the purpose may be evolved by the Institute of Chartered Accountants of India.

IDBI has further suggested as follows:—

"Section 30A of the IDBI Act provides that "the director appointed by IDBI shall not incur any obligation or liability by reason only of his being a director or for having done or omitted to be done in good faith in the discharge of his duties or anything in relation thereto". Of late, in some cases particularly sick companies, the nominee directors have also been prosecuted for defaults by the companies in payment of P.F., ESI dues etc. The defaults in these cases were due to stringency of funds arising out of losses, and not deliberate. The nominee directors are, therefore, helpless in these matters though they try their best to meet such liabilities wherever and whenever

possible. The nominee directors should, therefore, be given full protection against such prosecutions for anything done or omitted to be done in good faith in discharge of their duties as a director. Accordingly IDBI has suggested that a suitable legislative measure may be framed to extend protection from prosecution to nominee directors of financial institutions for any lapses defaults etc. committed by the concerned companies. This measure may be qualified by providing that no prosecution against the nominee directors could be started except with the prior approval of the Central Government."

1.128 The Committee wanted to know whether the Government have ever thought of amending the Indian Companies Act with a view to bringing improvement in working of nominee directors particularly on the subject of formation of management committees, formation of Audit Committees, increasing frequency of Board meeting and supply of information of audited accounts in quarterly basis etc. Secretary (Banking) replied:

"We will examine your suggestion."

1.129 When asked about the suggestion of Ministry about improving the functioning of nominee directors, Secretary (Banking) stated as follows:—

"You have asked for a review to be made on the functioning of the cell and that on Audit Sub-Committee should be set up. I feel that with the new legislation and the changes that we have made in the functioning of the nominee directors particularly making them in house, i.e. the nominee directors should act as the official agents of the institutions, I think, it should fulfil what we expect from this particular institution. It may take a little time. We have to improve our monitoring. I think the institution itself had taken right decisions. I hope, we will find that there would be a substantial improvement in the functioning of the institution. The problem from the industry side, which is coming and the former Finance Minister had a meeting with the industrialist and had an open-house and what they were saying was that those agreements were so comprehensive, that the director can do anything which no self-respected person can sign. But, we have reviewed it and stuck to it and we could see a substantial improvement in the functioning of this institution."

PART—II

RECOMMENDATIONS/CONCLUSIONS OF THE COMMITTEE

2.1 Financial Institutions, having sizeable stake in the industrial concerns have been appointing their nominees on the Boards of assisted companies who *inter alia* serve as a useful tool for effective project monitoring and follow up. The nominee directors on the Boards of the assisted companies are intended not only to safeguard the interests of the institutions investing money in them but also to serve the interests of sound public policy. The right of financial institutions to nominate such directors flows from the contractual obligation entered into between the assisted companies and institutions as also the relevant provisions in the statutes of the latter. Although the financial institutions were appointing even prior to 1971 their nominees on the boards of some of the assisted companies, the system got institutionalised with the issue of Government's guidelines on the subject in June, 1971. These guidelines were revised and amplified first in 1981 and again in 1984. The guidelines presently in operation stipulate that the financial institutions should nominate their representatives on the Boards of all assisted companies where substantial financial assistance has been sanctioned and where the convertibility clause has been incorporated in the financial assistance agreement. In other cases, the financial institutions have been given the discretion to appoint or not to appoint nominee directors on the Boards of the assisted companies. The Committee's review of the system of appointment of nominee directors, the way in which they have been functioning and the success achieved in achieving the objectives for which nominee directors are appointed, has revealed several deficiencies and weak points which need to be remedied. The Committee's findings and their recommendations for making the system really effective are set out below.

2.2 As per guidelines issued by Government of India, the financial institutions are expected to appoint their nominees on the Boards of all assisted MRTP Companies. In respect of non-MRTP companies, the nominee directors are to be appointed on selective basis. The Committee are concerned to find that as on 31st March,

1986, out of 1300 assisted companies, nominee directors have been appointed by the institutions only on 1070 companies. A further break-up of these figures reveals that out of 324 assisted MRTP companies, nominee directors have not been appointed in 36 companies even though 12 of these companies are incurring losses. Similarly, in 194 out of 976 non-MRTP Companies nominee directors have not been appointed although 81 such companies are incurring losses. The Committee do not find any valid reason for not appointing nominee directors on such a large number of losing companies which could certainly jeopardise the security of the advances made. Unless the Financial Institutions get timely authentic reports from their nominees on the companies, it may be too late when the ultimate result is brought to notice as a *fate accompali*. The Committee, therefore, desire that nominee directors should invariably be appointed in all MRTP companies and in the case of non-MRTP companies, no Board of any Company incurring losses or otherwise running into problems should be without representation from the financial institutions.

2.3 Another interesting fact which this study has brought to the fore is that Financial Institutions are normally appointing one or two nominee directors only even in cases where their share holding is large, say 51% and above and have virtually left the management of such companies in the hands of private promoters. The reality is that representation of financial institutions on the boards of the assisted companies bears no relationship to the total holdings of the financial institutions in the form of share capital or investments in the form of term loans. Therefore, except for the institutional nominees the boards of almost all the companies are composed entirely of promoters and their nominees irrespective of the extent of the share holding of the promoter group. The in-equity in the present arrangement whereby the interests of institutional and other share holders remain un-represented or inadequately represented on the boards is so glaring that it needs immediate rectification. The Committee are of the firm opinion that the degree of the institutional involvement in management decision making should bear a reasonable if not exactly proportional relationship with their share-holding and investment in a company. This is all the more so as the agreement with the company or the share holding clearly vests this right in the financial institutions making the investment. The Committee recommend that financial institutions should exercise their rights as share-holder or investor of funds to appoint nominee directors in assisted companies

in proportion to their share-holding and/or in terms of loans agreements. As agreed to by the Finance Secretary, full quota of Directors in cases where any financial institution singly or in conjunction with any other financial institutions is having more than 51% shares but had not nominated proportionate number of directors, should be filled up forthwith. Similarly in companies where the institutional holdings is less than 50% the representation may be in proportion to the total holdings and wherever the actual number of nominees is less than the entitled quota, the deficiency should be made up quickly.

2.4 The Committee feel that the institutional say in the management of assisted companies is more than justified on the ground that the financial institutions normally finance 80 to 90 per cent of the project cost, whereas the promoters' financial participation is only very limited. Accordingly in cases where the share holding is more than 51%, the institutions should have a greater say through loan covenants in the selection of Chairman, Managing Director, wholetime directors and other directors. Where no loan is involved (as it often happens in the case of Investment Institutions) more effective use of voting strength should be made on the basis of share holdings.

2.5 In case where the institutions have no loans outstanding but only hold shares, a convention should be built up whereby the Company should be persuaded to elect nominees of the institutions on their Boards of Directors. This in Committee's opinion would ensure proper representation of the institutions on the Boards of such companies, even after they have repaid the term loans.

2.6 The Committee find that under the terms and conditions governing the sanction of financial assistance, the assisted units are required to broadbase their boards of directors in consultation with and to the satisfaction of the financial institutions. However, the financial institutions have not been taking requisite interest in this direction. The Committee recommend that while determining the composition of the Board of a company, the financial institutions should ensure that the board is truly broadbased, with representation from various relevant disciplines and there is no undue weightage in favour of promoters. For this it may be necessary that the composition of the Board is determined in such a manner that it comprises of not more than 1/3rd of the total number of the representatives of the promoter's group and the remaining 2/3rd consist of independent

members who are professionals with expertise in finance, technical disciplines, marketing and the industry related areas etc. and the nominee directors of the institutions. In Committee's opinion that can be ensured by making suitable provisions under the covenants in the Loan Agreements entered into by the institutions with the borrower companies or, if appropriate, by making suitable provision in the Companies Act.

2.7 The Committee find that the nominee directors of financial institutions are either officials of the institutions or non-officials drawn from a panel maintained for the purpose. It seems to be the common experience of all the financial institutions that in the matter of providing regular and meaningful feedback to the nominating institutions, the performance of the official nominees is much better as compared to the non-official nominee directors. The Committee, therefore, desire that there should be at least one official nominee director on each company and non-officials should be considered for appointment only as additional nominee i.e. in addition to the official nominee of one of the institutions. This will mean that the first nominee director will always be an officer of the Institutions.

2.8 The Committee also feel that as far as possible only officials may be appointed as their nominees by the Institutions on the Boards of the assisted MRTP Companies and in such of the non-MRTP Companies where the stake of the institutions is very high.

2.9 It has been brought to the Committee's notice that shortage of Officers of requisite qualification and experience was one of the reasons for not appointing more than one or two nominees on the assisted companies. This is an area which needs to be looked into. The minimum that needs to be done is that cadre of Official nominees should be suitably strengthened.

2.10. The Committee find that in the case of IFCI, GIC and LIC, the Chairman as also the Managing Directors of the institutions have been appointed as nominee directors in some companies. The Committee do not consider it to be a salutary practice. If the top man of a financial institution is already on the Board of Company, that could by itself be a cause for the institution not asking for any further information about the functioning of such a company from their own Chairman or Managing Director and that may weaken the vigil the financial institution has to exercise. The Committee, therefore, feel that the

Chairman and Managing Directors of the institutions should not be nominated as directors on the Boards of assisted companies.

2.11 The Committee have observed that although the institutions are reviewing the nominations of both officials and non-officials after a period of 3 to 4 years, in some cases nominee directors have continued for as long as 8 years on the boards of the companies. No doubt exceptions can be there in rare cases but the Committee recommend that the nominations of both officials and non-officials should be reviewed more frequently and the nominee directors should not be continued on the board of companies for very long periods as that could develop vested interests. As a guiding principle, nomination initially for a period of 3 years followed by an extension of upto 3 years should be considered desirable.

2.12 The Committee find that financial institutions have set up Nominee Directors' Cell and the Officers attached to these cells, who function only as nominee directors, are being appointed on as many as 15 Companies each. The Committee are doubtful whether an officer will be able to do full justice if he is on the boards of 15 companies at a time. The Committee, therefore, recommend that the number of nominations should be restricted maximum to not more than eight or ten companies each and the Nominee Directors' Cell should be strengthened accordingly.

2.13 From the information made available to the Committee, it is seen that the present panel of non-officials, consists mostly of retired officers of Government, Public Sector Undertakings, Financial Institutions and Banks. Out of 105 non-officials appointed on behalf of IDBI as many as 82 nominees are retired officials. Similarly, in GIC, there are 31 non-officials working as nominee directors out of which 28 are retired employees of GIC. Again in the case of LIC out of 42 non-officials 41 are retired officers. The Committee feel that the panel of non-officials should be enlarged with a view to include more professionals like experienced engineers, Chartered Accountants, Cost Accountants and people with experience in handling matters relating to labour. With this end in view the institutions should approach the professional bodies viz. the Institution of Chartered Accountants and the Institution of Cost and Works Accountants to suggest the names of their members for empanelment as non-official nominees.

2.14 The Committee have been informed that Nominee Directors Cells have been set up by financial institutions in terms of the Government guidelines issued in March 1984. Even though the financial institutions have maintained that these cells have been working satisfactorily, no formal review to find out their effectiveness has so far been undertaken either by the institutions or the Ministry of Finance. The Committee desire that as promised by Banking Secretary during evidence, a review should be undertaken with a view to pin-point the shortcomings in the present system and necessary remedial measures in the light of its outcome.

2.15 The Committee are convinced that financial institutions should improve the system for evaluation of the reports received from nominee directors so that more prompt and timely action could be taken on the advance signals thrown by the nominee directors based on the information which comes to their notice. The Committee also recommend that the performance of the nominee directors should be evaluated more frequently and closely and in-effective nominee directors both official and non-official should be removed/replaced without any hesitation.

2.16 Admittedly there is need for better communication between the financial institutions and their nominee directors. The Committee, therefore, recommend that two way communication between the institutions and nominee directors, especially in case of non-officials for better appreciation and closer monitoring of the affairs of the assisted companies should be strengthened. The institutions should hold meetings of the non-official nominee directors more frequently say at least once in a quarter for overall review of the affairs of the Company and exchange of views on the strengths and weaknesses of the project and the systems obtaining in the Company. Similarly, there should be regular exchange of views with official nominees. The institutions should also keep the nominee directors informed of all important decisions relating to the companies on the boards of which they have been nominated as nominee directors. Institutions should also insist on proper feedback from the nominee directors.

2.17 The Committee have been informed that the nominee directors on the Board of assisted companies are intended not only to safeguard the interests of the institutions but also to serve the interests of sound public policy. It came out during examination of financial institutions that although the role and functions of nominee directors

are defined and understood clearly, yet the need for improving and streamlining the systems and procedures regarding the selection and appointment of nominee directors had been felt both by the institutions as well as the Ministry. The Committee desire that an in-depth study should be undertaken with a view to streamlining the system so as to ensure that it provides an effective monitoring and control mechanism for overseeing, the working of assisted companies and particularly the sick units.

2.18 The Committee find that an area of great importance were the financial institutions have been lacking was that the training nominee directors. Admittedly there have been very few training programmes although the need has been felt for the same many a time. The Committee feel that since there are more than a thousand nominee directors, the institutions should give more attention to this aspect IDBI, which is working as a coordinating agency should find ways and means for having in-house training facilities in association with other financial institutions. It must ensure that necessary training is imparted to all the nominees by rotation.

2.19 The Committee desire that an opportunity for the nominee directors to inter-act among themselves and exchange views which may help in cross-fertilizing experiences and improving their effectiveness may also be provided by arranging seminars and symposia for them for time to time. The role of nominee directors, the aspect of their accountability and ways and means of making their functioning effective, could be reviewed and better understanding and appreciation developed through such programmes. For better inter-action among nominee directors it will be worth-while to have an association of all the nominee directors which can provide a forum for more frequent inter-action

2.20 The financial institutions have given certain suggestions to the Committee for improving the functioning of nominee directors. These suggestions *inter alia* include the following :

- (i) Prescribing a minimum period of 7 days notice for Board meetings;
- (ii) Sending agenda items and background papers well in advance to the Members of the Board;
- (iii) Periodicity of Board meeting to be increased to once in 2 months instead of once in 3 months as presently obtaining;

- (iv) Submission of quarterly working results and annual capital and revenue budgets before the Board regularly and a system of presenting to the Board the half yearly audited accounts to be introduced;
- (v) Need to make it incumbent on the companies to submit to the Board periodically certain minimum management information reports covering critical areas of overall performance, key indicators for the same, financial position and operations. (The system and formats for the purpose may be evolved by the Institute of Chartered Accountants of India);
- (vi) Compulsory formation of Audit Sub-committee;
- (vii) Legal protection to nominee directors from prosecution for matters connected with assisted companies.

The Committee find merit in the above suggestions of financial institutions and desire that the Ministry should examine in detail the pros and cons of each of the above suggestions in consultation with financial institutions for taking appropriate action. The Committee may be informed of the action taken in the matter within next six months.

NEW DELHI:
April 27, 1987
Vaisakha 7, 1909 (S).

K. RAMAMURTHY
Chairman,
Committee on Public Undertakings