

Test for independence

An exam for independent directors is not enough

MOHAN R LAVI

In the past, if there were corporate governance lapses, questions were raised on the competence of companies and their auditors. These days, however, the questions during such cases are on the competence of companies, auditors and their independent directors. Despite having a separate code of conduct for independent directors in the Companies Act, 2013, there have been situations wherein their independence has had to be questioned. Never one to give up on regulations, the Ministry of Corporate Affairs (MCA) has just thought of another solution — an online proficiency self-assessment test for independent directors. They have even enacted The Companies (Creation and Maintenance of Databank of Independent Directors) Rules 2019.

Clause 3 of the Rules requires the Indian Institute of Corporate Affairs (IICA) to maintain an on-line databank of independent directors. The databank will contain all information about the director, including any pending criminal proceedings that may have been initiated against him. The concept of a databank for independent directors' is not new; a few private bodies already have a database that cost around ₹17,500 to enlist on. The IICA states that it will also have the freedom to charge for enlisting independent directors on their database.

The next rule provides information about the online self-assessment test — it will cover company law, securities laws, basic accountancy and other areas relevant to the functioning of an independent director. The IICA has also been tasked with the job of preparing basic study material and online lessons for these tests. There is an eerie and needless proposal that companies must disclose the marks scored by independent directors in their annual report.

While the intention of the MCA is laudable, an online assessment may not be the solution. Independence

is basically a state of mind that one has to exhibit in a limited time-frame (such as objecting to an entity giving a loan to a subsidiary at zero rate of interest and with no repayment terms, in the limited time of a board meeting) which cannot be taught in an online course. The IICA appears to be thinking that some level of knowledge of company and securities laws and accountancy should suffice for an independent director. What is possibly more necessary, however, is a list of things that companies cannot do under various laws that would apply to that entity.

Also, various professional courses in India are proof that just passing a theoretical exam does not necessarily translate into performing correctly in the course of doing one's duties. Whatever be the structure and content of the examination, chances of it transforming the

present set of independent directors into an agile set of people who can smell and catch wrongdoing in an instant are limited.

Instead of an exam, the IICA should mandate training for independent directors every year. Since laws keep changing, a training programme designed on live situations is the need of the hour. Almost all corporate governance violations can be traced to lapses by the management or those charged with governance. Hence, these training programmes should also focus on the ability to say no and show dissent in writing. The MCA should ensure that just to meet the quorum requirements of women directors and independent directors, companies should not choose family and friends with no qualifications to merit that appointment.

The Companies Act, 2013 casts tremendous responsibilities on independent directors through the Code of Conduct; it should ensure they are also remunerated adequately. If an independent director is paid well and is guilty of compliance with governance lapses, he should be penalised.

The writer is a chartered accountant

Monetary policy's blinkered view of credit

It should take an integrated view of both bank and non-bank credit channels. Immobilisation of trade credit has hit MSMEs

BHAWARIAL CHANDAK

The RBI's frequent shifts in policy relating to bank lending rates over the last 25 years — starting with the PLR in 1994, the BPLR (2003), Base Rate (2010), the MCLR (2016), and now, external benchmarking — reflect policy rate uncertainty. Leaving aside the market rates, even banks' lending rates remain at variance with monetary policy intents. Growing financial sector instability/vulnerability, growth uncertainty, credit-constrained MSMEs, low farm prices, surplus liquidity with banks as against unprecedented liquidity constraint with businesses and a high level of cash in the economy despite digitisation reflect poor monetary policy outcomes.

How did we get to such adverse conditions? Why is the financial sector more vulnerable now than ever before, despite the experience/expertise gained by the RBI over the last 25 years, the advent of monetary-model based policy analysis and economic forecasting, and Big Data analytics?

One of the key reasons lies in the bank-centric monetary policy framework. It misses out on the systemic role of the trade credit channel in defining monetary policy transmission (MPT). A guess-timate of working capital requirement based on the turnover of 94.3 lakh firms which filed income tax/ service tax returns for FY14, the outstanding working capital of banks and miniscule bank working capital flows to the unorganised sector show that banks meet less than one-third of the aggregate working capital needs of businesses. A monetary policy architecture which built on a narrow, bank-centric base cannot be stable and sound.

A partial view of MPT can lead to erroneous/deceptive conclusions about the working of the monetary policy. Anecdotal, the RBI's assertion of bank liquidity in surplus is deceptive when businesses are reeling under an unprecedented liquidity crisis. Non-bank credit, es-

pecially trade credit, is the predominant source of working capital across businesses. Trade credit is an equally, if not more, important channel of MPT as a bank.

Credit channel

Trade credit is the largest credit intermediary — far bigger than the banking network. World over, trade or B2B credit sales are the single largest common source of short-term business credit. In terms of credit volume, reach and supply chain financing, trade credit is far bigger and inclusive than bank credit. It provides market, funding and transactional liquidity.

According to the Association of Chartered Certified Accountants, London, trade credit supports almost half of B2B transactions globally. Dun & Bradstreet's study of 9,600 companies in India shows that these companies' account payables and short-term bank credit to total liabilities ratios were 12.3 per cent and 8.6 per cent respectively for FY11.

The RBI's annual sample studies of financials of non-government, non-financial public limited companies' sundry creditors and short-term bank credit to total liabilities ratios averaged 12 per cent and 10 per cent, respectively, during the 1991-2010 period.

Only 5-10 per cent of MSMEs have working capital from banks. Pre-dominance of certain business communities in trade and industry is due to trade credit financing.

Trade credit re-intermediates bank credit and suppliers' credit by creating a credit intermediation chain. The World Bank advocates trade credit as an important tool for channelling credit by large /liquid firms to MSMEs.

Bank working capital ultimately transforms into trade credit; the two form interdependent and inter-locked functional links along the supply chain financing network. The transaction financing role of trade credit is similar to that of currency and bank demand deposit.



Bank-centric policy The systemic role of trade credit is overlooked ISTOCKPHOTO

A firm's bank credit need is greatly determined by volume and tenure of its receivables and payables. Bank credit growth, its multiplier and the effectiveness of MPT crucially depend on the working efficiency of the trade credit system.

Policy transmission

Inclusion of the trade credit channel in the monetary policy framework helps in better understanding of the response of output/demand to policy measures and complexities of the MPT working mechanism.

Agglomerative effects of millions of day-to-day trade credit transactions, as well as their role as last-mile links in credit creation and distribution on macro credit aggregates, are very large.

Trade credit influences the total volume of liquidity flowing to the business sector and its allocation across firms. Market interest rates are also to a great extent determined by its demand and supply.

and disturbances in the payment system.

The fear of delay/default, the need for hedging against uncertainty in cash flows and the risk of credit rollover lead to higher liquidity hold-back. These further aggravate the liquidity crisis. Over the years, the growing trust deficit, the weakening of trade credit practices/conventions and changes in the credit culture — from being ethically committed to honour debt commitments to indifferent, opportunistic behaviour — and a decline in perceived reliability/credit-worthiness in general add on to this crisis. Lower business confidence and capex follow. All these aggravate the economic crisis, despite sound macro fundamentals and monumental reforms.

The monetary policy should take an integrated view of both bank and non-bank credit channels. Greater understanding of the trade credit network's role in MPT, manifestation of its behaviour under the financial crisis and the role of trust and confidence channels in aggravating the liquidity crisis are needed to analyse the growth-impacting factors. Without attending to trade credit issues, it is difficult to solve the problem of the liquidity squeeze.

Restoring the full circularity of informal/unaccounted business funds by formalisation is necessary. This is a practical solution to the large-scale liquidity gap across businesses. Rationale and framework for this are discussed in my previous article (see *BusinessLine*, February 10).

We need to identify the hurdles/gaps in the credit flows and devise trade finance interventions to prevent disruptions in supply chain financing. Trade credit's role as the lender of last resort needs to be strengthened to provide financial stability to un-banked firms. Emphasis on bank liquidity/credit flows alone can be an oversimplified and inadequate response to the crisis.

The writer is a former DGM of SIDBI

5 THINGS to WATCH OUT for TODAY

■ **The new** Passenger Terminal Building at Dera Baba Nanak in Punjab will be inaugurated by Prime Minister Narendra Modi, formally opening the Kartarpur Corridor across the India-Pakistan border for pilgrims. Modi will also attend the 550th birth anniversary celebrations of Guru Nanak organised at Sultanpur Lodhi.

■ **The BJP's** Central Election Committee is likely to meet to finalise the names of the candidates for the Jharkhand elections. The five-phase Jharkhand polls are set to be held on November 30, December 7, 12, 16 and 20.

■ **Allahabad Bank**, Ashok Leyland, Bank Of Baroda, Bharat Forge, Crisil, D-link (India), Eicher Motors, Elgi Equipments, Equitas Holdings, GAIL (India), IDBI Bank, IDFC Ltd, MRF, Nestle India, Novartis India, and Rane Holdings Tata Communications, Tata Investment Corporation and Tata Power are scheduled to declare their financial results for the September quarter.

■ **The Central** Board of Indirect Taxes and Customs has directed its officers that from today, no search authorisation, summons, arrest memo, inspection notices and letters can be issued in the course of any enquiry without quoting a computer-generated DIN.

■ **CII Connect**, Tamil Nadu's annual information, communication and technology conference and exhibition will resume in Chennai. On Day 1, Chief Minister E Palaniswami said the TN government will soon release a policy on electronic hardware manufacturing to woo investors.

A THOUSAND WORDS



Energy dilemma A man at Ottapidaram village in Thoothukudi district of Tamil Nadu carries home firewood to meet his daily needs N RAJESH

EASY

ACROSS

01. Be a distinguishing mark of (12)
08. Thing left out (8)
09. Girdle, band (4)
11. Consumed (5)
12. Assembly of cathedral canons (7)
13. The racing world (4)
15. Stupid with senility (4)
19. American flower genus (7)
20. Meat served in rashers (5)
22. Island (4)
23. Gift of money or goods (8)
24. To trifle, dally (6-6)

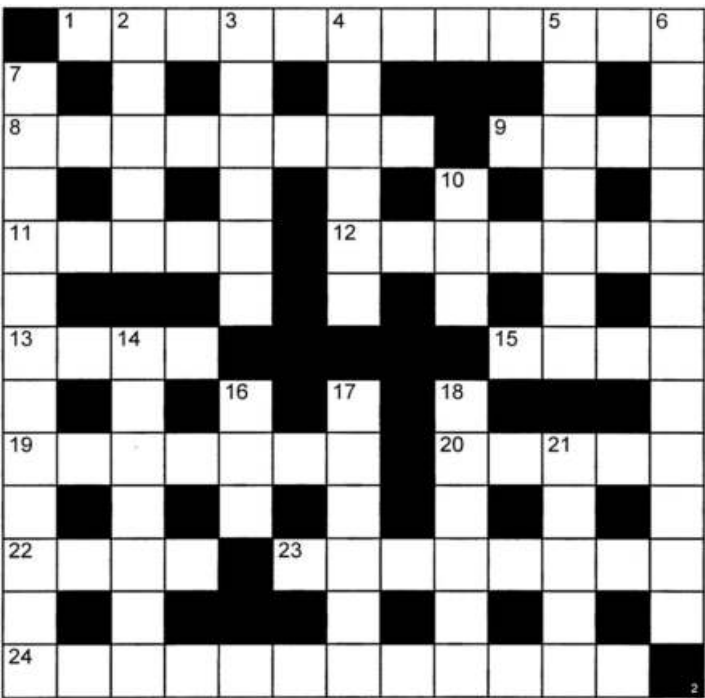
DOWN

02. Lift, heave upwards (5)
03. Begrudge (6)
04. Bend low, legs doubled (6)
05. Inertness (7)
06. Acting as host (12)
07. Meets with reverse, mishap (5,2,5)
10. Honeycomb material (3)
14. Aged, marked by debauchery (7)
16. Pen for swine (3)
17. Denouement (3-3)
18. In a ship, railway train (6)
21. Make cold (5)

SOLUTION: BL Two-way Crossword 1481

ACROSS 01. Scared 08. Exist 09. Manhood 11. Remember 12. Steam 15. Ages 16. Ask 17. Aria 19. Gnash 21. Footpath 24. Earlier 25. Laser 26. Fettle
DOWN 02. Chant 03. Rehearse 04. Door 05. Fever 06. Limb 07. Star 10. Devastate 12. Soap 13. Gauntlet 14. Mash 18. Spark 20. Spell 21. File 22. Oust 23. Half

BL TWO-WAY CROSSWORD 1482



NOT SO EASY

ACROSS

01. Put their carcase another way to give distinctive quality (12)
08. It's left out if religious settlement has nothing ahead (8)
09. Drive very fast to the zone (4)
11. Having dined, took each half with half a score (5)
12. Book division made up of canons (7)
13. Grass growing from fruit one had left (4)
15. Silly old Georgia appears twice (4)
19. Got idea of planting out something like evening primrose (7)
20. Flesh cured and saved by one escaping from difficulty (5)
22. That of Dogs is late at quitting it (4)
23. A gift will do if the country makes it (8)
24. Trifle with violin, having fed lad for a change (6-6)

DOWN

02. In the army one may give one a lift (5)
03. Consider it an injury not to begin now (6)
04. Get down low right in the grass (6)
05. Lack of movement made one retain it anyhow (7)
06. It is amusing, having guests (12)
07. GI forces me to change and meets with disaster (5,2,5)
10. Bees make it in a fit of rage (3)
14. It's right it may have led Dad to be worsened by debauchery (7)
16. Remain without a place to put a pig in (3)
17. The outcome will justify itself without a hyphen (3-3)
18. In a ship will make a bar do for it (6)
21. Coldness requires one to be hot stuff (5)