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Independent boards for all agencies
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Independent boards for all agencies

Just as in private companies, it is crucial for government agencies and regulatory authorities to have a majority of independent directors on their boards

BOARD COMPOSITION OF SELECT INDIAN SRAs

	Executive members (WTMs)*	Non-executive members (WTMs)	Government/ ex-officio members (PTMs)*
Telecom Regulatory Authority of India	Up to 2 WTMs	Up to 2 PTMs	
Securities and Exchange Board of India	3 WTMs	2 PTMs	3 PTMs
Insurance Regulatory and Development Authority of India	Up to 5 WTMs	Up to 4 PTMs	
Insolvency and Bankruptcy Board of India	3 WTMs	2 PTMs	4 PTMs
Airports Economic Regulatory Authority	2 WTMs	Statute does not provide for PTMs	
Pension Funds Regulatory and Development Authority	3 WTMs	3 PTMs	
Competition Commission of India	2 - 6 WTMs	Statute does not provide for PTMs	
Central Electricity Regulatory Commission	3 WTMs	Statute does not provide for PTMs	

*WTM stands for whole-time members and PTM for part-time members

A lot of Indian thinking on organisations, whether by design or default, is grounded in the great person theory, where organisations are supposed to work well when the right person is in charge. Thus, all success (or failure) is attributed to one person. This is surely a poor theory of the world. The working of institutions is shaped by the rules of the game, which establish the rules of information, incentives and power. Only in rudimentary organisations is all power concentrated in one person, and success or failure is attributable to one individual.

The essence of good organisation design is to reduce the concentration of power, to draw in many minds and many interests to shape all decisions and thus obtain a steady clip of better decisions. When many minds are at work, the ideas are better, and mistakes are minimised. Such good organisation design also takes us from individuals to institutions: Where people come and go, but the basic institutional design delivers good performance over decades.

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That is the larger context within which we should see the recent speech of the governor of the Reserve Bank of India (RBI), which drew attention to the importance of good quality boards to supervise Indian banks. He emphasised the need for honest, independent, qualified and competent members for the board of directors of banks. He explicitly clarified that this independence is not only vis-a-vis the management but also vis-a-vis the controlling shareholders.

We have come a long way in India in our thinking on good governance for such organisations. Three big ideas are now well accepted: (1) What kinds of distance qualify as independence? (Independence from the management and from controlling shareholders). (2) How many independents do we need? (A majority, which can then hold the inside directors accountable). (3) Should the CEO be the chairperson? (No, one of the independent directors should be the chairperson, so as to reduce concentration of power and strengthen the hand of the independents vis-a-vis the managers).

Each of these ideas seemed outlandish in the 1990s when they emerged into the policy discourse, but they are now well-established principles, forming the mechanisms of state regulation of firms through the Companies Act and through the Securities and Exchange Board of India (Sebi) regulations for listed companies. The governor is right to emphasise governance aspects, as these three principles will undoubtedly help banks work better.

All these elements of good hygiene are equally applicable to government organisations. These same three principles are the lens through which we can examine and improve the governance of all government organisations, ranging from Isro and NHAI to Sebi and RBI.

The second and third principles directly extend to government organisations. What about independence? How would we define independence in the context of a government-controlled organisation? In the exact same spirit: “Independent of management and independent of controlling shareholders”. Thus, an independent director for a government-controlled organisation must be defined as one who is not part of the Indian state apparatus in any fashion. For example, as the National Institute of Public Finance and Policy (NIPFP) is a grant-in-aid institution of the Department of Revenue of the Government of India, an academic at NIPFP would not be considered independent of the government.

Most Indian regulatory authorities are created by law with specific objectives and a board to secure those objectives. The table shows the importance of whole-time members (WTMs) on the boards. WTMs are deferential to chairpersons and thus most of the boards in the table are deferential to the chairman. This constitutes an excessive concentration of power with the chairperson, which is not conducive to good debates and better decision-making. Additionally, the low number of independent directors (termed part-time members or PTMs) also hinders these checks and balances. The Telecom Regulatory Authority of India and Pension Fund Regulatory and Development Authority stand out as having a better balance of power, as their statutes provide for the appointment of the same number of outsiders and insiders.

The table shows many different solutions to these questions in different organisations, reflecting the quirks of the legislative drafting process. It would be better if a single set of principles were applied to all these organisations. An important part of regulatory governance reform is, thus, to construct a single law (on the lines of the Indian Financial Code recommended by the Financial Sector Legislative Reforms Commission) that covers all financial agencies, where a single set of principles of good governance are brought about for all financial agencies.

The table does not include the RBI. The RBI’s primary function of monetary policy is now carried out by the Monetary Policy Committee (MPC), consisting of three RBI insiders and three outsiders. In the event of a tie, the governor has a casting vote. The other key regulatory functions of the RBI are discharged through the Board for Financial Supervision (BFS) and the Board for Payment & Settlement Systems (BPSS), where again the insiders constitute a majority. Good governance principles for RBI thus need to be applied at all its four components: The main board, MPC, BFS and BPSS.

Armed with this toolkit, we can establish a sound board. But the journey to good governance of government agencies does not end there. The next issue to confront is the role of the board. In some organisations, power currently rests solely with the chairperson and the board does not matter. This is the second component of good governance: To not only establish a well-structured board in terms of composition but to also give it the correct role.

In every organisation, whether for-profit private entity or a government one, the board must have oversight of organisation design and processes, and have enough teeth to hold the management accountable through establishing targets and running the budget process. In addition to this, with statutory regulators, there is another crucial role — to directly run the regulation-making process, so as to avoid the fundamental constitutional law concerns about unelected officials writing laws.

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