Experts wary of exams for directors

Say online proficiency tests for independent directors may be counterproductive and some may not want to take it

RUCHIKA CHITRAVANSHI
New Delhi, 27 October

Independent directors will soon have to return to the books to qualify for a seat on the board of companies. Come December, the government will start giving them an online proficiency self-assessment test meant to ensure better standards in the overall corporate governance.

However, experts feel the move may be counterproductive since it can shrink the already low pool of independent directors. "It might become an academic exercise just to tick a box. Many independent directors may not want to take a test," Shriram Subramanian, managing director, InGovern Research Services, said.

According to the National Stock Exchange database, there are over 5,500 individuals who hold 7,066 posts of independent directors. Since 2006 more than 8,000 directors have given up office either due to the end of term or by their own choice.

The Companies Act requires independent directors to be trained every year and sensitised about new topics in their sector. Company Law, Securities Law, Basic Accountancy and other relevant areas are likely to be part of the online proficiency self-assessment test though the exact format is yet to be announced. The board of companies will have to disclose the results of these tests in their annual reports.

"I have taken many tests in my life, this one cannot be tougher. If a requirement has been placed by the government, one has to take the test. We are waiting for the details," said Vibha Rishi, who has served on various boards including PepsiCo, and Max India, among others.

The test could also cover topics, including risk management, succession planning, insolvency and bankruptcy law, corporate governance in family-managed companies, international corporate governance practices, judgment of the court dealing with rights, duties and responsibilities of directors and senior management. "Corporate trainings, workshops, interaction with directors and senior management on practical," said Gaurav Pingle, company secretary.

TURNING ON THE HEAT ON DIRECTORS

- Test is being designed by Indian Institute of Corporate Affairs
- Each person will have to score a minimum of 60% to qualify
- No cap on number of attempts an individual may take for passing
- Boards will have to disclose results of these tests in annual reports
- Directors will have to apply for renewal within a period of 30 days from the expiry of their term

The test is being designed by the Indian Institute of Corporate Affairs (IICA). Each person will have to score a minimum of 60 per cent to qualify. There is no cap on the number of attempts an individual may take for passing such test.

Besides, an individual who has served as director in a listed company or an unlisted public company having a paid-up capital of ₹10 crore or more, for a period of not less than 10 years, need not qualify the test.

"India is perhaps the only country to have introduced an exam for its directors. Why not a test for managing directors and chief executives who run companies? The one challenge that still needs to be addressed is ensuring independent directors are truly independent," said Ankit Singhi, partner, Corporate Professionals.

However, the preparation and the test itself could be helpful for the professionals with non-accounting background. "They will be more aware of their roles, responsibilities, duties and importance of each document placed before them at board meetings, audit committee meetings or remuneration committee meetings," said Pingle.

Recent corporate scams have turned the heat on company directors, who the government feels have failed to detect any signs of trouble. The current law requires all listed companies to have a third of their board members as independent directors. Their role is to ensure that the interests of minority shareholders are protected and act as overseers outside the influence of the firm.

The government may be way off the mark if it wants to improve corporate governance by putting independent directors to test, experts say. "India needs to liberalise the takeover code. We need to create a market for corporate control. If a promoter is not performing well there should be incentives for others to take over who can better manage the company," a legal expert said.

The IICA at Manesar in Haryana has been notified as the institute to create and maintain a data bank containing names, addresses, qualifications of persons who are eligible and willing to act as independent directors, for the use of the company making such appointments.

The proficiency test would have to be taken only once after registration and the independent directors will have to apply for renewal within a period of 30 days from the date of expiry of their term.

Recent data indicates that the rate of resignation of independent directors from the boards of listed companies has increased significantly in comparison to previous years. A total of 606 independent directors resigned from NSE-listed company boards during the calendar year 2018. In comparison, 412 independent directors resigned between January 1, 2019, and July 22, 2019.

Let's dwell on brighter notes

EXIM MATTERS
T N C RAJAGOPALAN

Deepavali or Diwali, the festival of lights, is a time when we forget our anxieties and problems and look at the positives to enjoy the day, sharing our happiness with others. So, let us look at the encouraging developments in recent days.

The cuts in income tax rates for corporate entities have shored up the bottom line of many companies. And, brightened the prospects for increased investment in the coming years. That has buoyed sentiment in the equity markets. Consequently, many investors feel richer and will hopefully spend more, contributing to revival in demand for goods and services.

Rain has been good this year, raising the prospects of a bumper kharif harvest. With sensible procurement and trade policies, the income of farmers can go up, boosting rural demand for consumer durables and farm implements. The festive season has also added to the demand for consumer goods.

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Businesses have offered attractive discounts to lure more buyers and reduce inventory. With lower prices, abundant liquidity in the system and lower interest rates, the fall in demand might be arrested, at least in the short run. The short vacation in some parts of the country in the coming days is likely to help the tourism sector.

Interest rates have been brought down significantly, which means cheaper loans for housing, consumer durables and fresh investment. The lower outgo on interest is expected to show up in more profits for businesses, even if top-line growth does not go up by much.

Exporters who have got used to the documentation requirements under the Goods and Services Tax (GST) regime are happy that their refund of taxes paid on export are now automatic and quick. That has significantly improved their working capital. Even the refund of unutilised credit, involving manual intervention, has been speeded, although at some cost for exporters. The government has announced that this refund will also be dealt with online, reducing the need for manual intervention.

The GST law has been suitably amended to allow input tax credit to the extent of 20 per cent of the eligible credit during a period, even in the case of invoices that are not uploaded by suppliers. This is a lot better than not allowing credit till the invoice details appear in the returns uploaded by the supplier. A committee of officers is looking at ways to improve the GST regime.

The Directorate General of Foreign Trade (DGFT) has decided not to impose late cuts on applications under the Merchandise Exports from India Scheme where the original application could not be processed due to system problems and had to be resubmitted after activation of the shipping bill. Similar facilitation measures are being regularly taken by the Customs and DGFT.

India's ranking in the World Bank's latest 'ease of doing business' report on 190 countries has gone up by 14 notches, from 77 to 63. There are significant improvements in the resolution of insolvencies, dealing with construction permits, trading across borders and registering of property.

This comes on the back of similar improvement by 23 and 30 places, respectively, in the past two years.

Overall, the second half of this financial year promises to be better than the first half. On that note, let me wish you all a Happy Diwali.

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'Slowdown hasn't hurt small finance banks'

ESAF Small Finance Bank, which began operations in March 2017, saw an over threefold jump in its net profit to ₹90 crore in 2018–19. Managing Director and Chief Executive Officer **K PAUL THOMAS** tells **Somesh Jha** that small finance banks (SFBs) are robust and have not been impacted by the economic slowdown. Edited excerpts:

The regulatory deadline to launch an initial public offering (IPO) for some SFBs, including ESAF Small Finance Bank, is approaching. How are you preparing for it?
Our deadline is July 2021 since we crossed net worth of ₹500 crore in July 2018 (so it should be three years from that time). We have started internal preparations and hired a merchant banker.

When we had last met in December 2017, you said you were looking to raise money from foreign players too. How has it progressed?
We raised two rounds of capital in 2018 totalling ₹364 crore, mostly from domestic insurance companies, including PNB Metlife, Bajaj, ICICI Lombard and a few high-net-worth individuals. So, we found good opportunity in domestic investors.

Do you need further capital this financial year?
At present, we are well placed and our capital adequacy is at 26 per cent. We don't require additional funding this year. Anyway we are planning to go to market and will raise money through the IPO. Before that, we haven't decided on capital and we are comfortable on the assets side.

We have seen a credit slowdown when it comes to commercial banks. What happened in the SFB segment in the last one year?
All SFBs are growing on the credit side also. We saw a credit growth of 30 per cent last one year. SFBs have multiple options for liquidity mobilisation so the sector remained unaffected. Most SFBs transformed from micro finance institutions so majority of the books remain small ticket in nature and non-performing assets are low.

What about recent months?
We have been disbursing monthly loans of ₹450-500 crore on an average. In July and August, few districts in Kerala saw impact because of floods and similar was the case in parts of Madhya Pradesh and Maharashtra. Good monsoon will help the rural market. I was in Coimbatore recently, interacting with farmer group companies who were optimistic about crop output because of good rains this year compared to last year. As a result, in another six months, rural demand will improve.

The Reserve Bank of India (RBI) gave you nod in December 2018 to operate as a scheduled bank. What has changed?
The advantage is that we will be able to reach out to registered trust and societies. In July 2018, the RBI permitted us to access NRE (non-resident external) deposits which gave us momentum in terms of retail deposits. In 15 months, we crossed ₹1,000 crore in NRE deposits which is a big achievement. Otherwise, 90 per cent of our deposits of ₹6,150 crore are small ticket.

How will a cut in corporation tax benefit you?
We will see a 3 per cent increase in profitability as we are a start-up bank and will fall in the 25 per cent bracket.

The RBI has issued draft guidelines for on-tap licence for SFBs recently. How do you see the move?
Barring the minimum capital requirements — which was ₹100 crore when we applied and now it has been changed to ₹200 crore — nothing much has changed. Further, promoters' stake has to be brought down, over a period of 15 years, to 15 per cent, in line with the draft norms. In our case it stood at 25 per cent. Otherwise, I haven't observed much of a change.

So are you bracing for competition in the sector?
Even today, there are non-banking financial companies (NBFCs), co-operative banks, micro-finance institutions to compete with. Competition was prevalent when we had launched too. Though the RBI has allowed urban co-operative banks to convert into SFBs but none of them has done it so far. A new bank will take 1.5-2 years to set up and by that time, our customer base will be stronger. In India, there is a huge market opportunity as a large number of low- and middle-income segments, which account for around 600 million people, are still underserved.

How are you seeing recent developments in the financial sector?
There are some uncertainties in financial services sector. When you talk about NBFCs, small and medium-sized ones, which were not totally dependent on market funding, were not impacted. For large NBFCs, structural issues still persist and it may take some time for them to get out of it. In the past, we have seen failure of co-operative banks but not at this scale. I hope and expect that there will be stricter regulations for co-operative banks in future.

Do you think converting co-operative banks into SFBs can be a viable solution?
It is a viable solution but I doubt how they will be able to meet the criteria while being co-operative in nature.

HC notice to govt, GST Council over refunds

INDIVJAL DHASMANA
New Delhi, 27 October

The Gujarat High Court has issued notices to the union government and the GST Council over the alleged breach of refund norms by field officers under the goods and services tax (GST) regime.

Under the Rule 92 of the Central GST (CGST) Act, the claim of the refund has to be made in the RFD 04 form. Thereafter, the officer concerned can accept or reject the claim after his investigations.

If the claim is accepted, he would issue refund in the form RFD 06. In case the refund is required to be adjusted, the officer would withhold it in the form RFD 07. If the refund is not admissible, partly or wholly, this would be communicated through the form RFD 08.

If the amount is rejected, it would be credited to the government account under the Rule 93 of the CGST Act, but for that, due process of RFD forms has to be followed.

A petitioner moved the high court, saying the field officer concerned rejected his claim of refunds without resorting to RFD forms. He reversed it under the Rule 93, which, he argued, could not be done without following the due process.

Abhishek Rastogi, counselor of the petitioner and partner at Khaitan & Co, said many petitioners were keen to move the court over the lapses. "The law provides that the denial of the refund has to happen only after compliance with the procedure laid down. We have challenged the rejection order, which has not followed the due process of law," he said.

STATSGURU

Low income returns on the rise

THE TAX DEPARTMENT HAS RELEASED the data on the source-wise collection of income tax and corporate taxes for the assessment year 2018–19, which pertains to direct tax revenue collected on incomes earned in the financial year 2017–18. It offers some interesting insights.

Direct taxes, as a share of total tax revenue, rose to 55 per cent, close to its average level in the last few years (*Chart 1*). This ratio had declined for a brief period due to a higher collection from excise duties on petrol and diesel. More and more direct tax is now deducted directly from the income account of the individual (*Chart 2*). Advance tax collection has settled at a lower normal of 40 per cent.

The share of direct taxes as a share of the economy is now at an 11-year high of 6 per cent (*Chart 3*). The rise in part is also due to slower indirect tax collections, especially the goods and services tax (GST). Buoyancy in direct taxes has remained above one for three year now (*Chart 4*), or in simple terms, taxes grew 1.21 times faster than GDP in 2018–19, and 1.59 times in 2017–18.

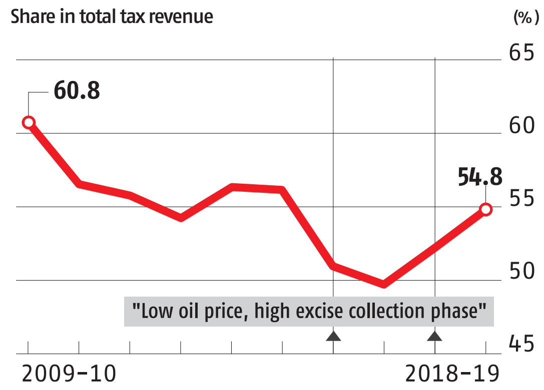
But more importantly, income tax returns (I-T returns) that declared incomes below ₹ 2.5 lakh per year grew for the first time in many years in 2017–18 (*Chart 5*). Number, as well as incomes declared in the bracket below this level, was reducing till 2016–17.

But in 2017–18, average income among a group of individuals earning less than ₹ 2.5 lakh per year, rose 8 per cent, after consistently contracting for at least three years (*Chart 6*). Yet, average incomes among all individuals filing I-T return rose at 2.4 per cent, the slowest pace in the past four years (*Chart 7*).

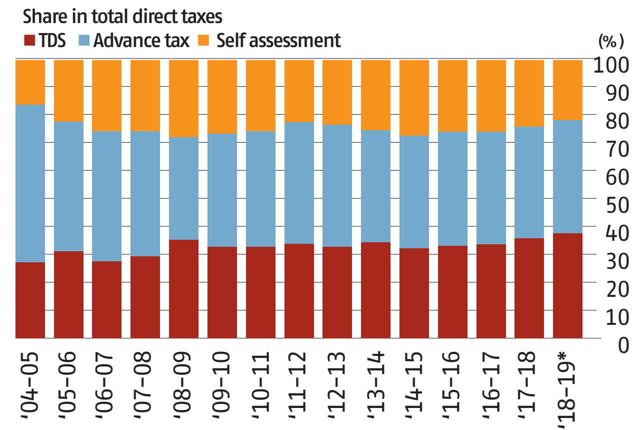
Drastically lower nominal growth at 8 per cent in the first quarter of 2019–20 now pose a serious threat to growth in government's revenue through income taxes.

ABHISHEK WAGHMARE

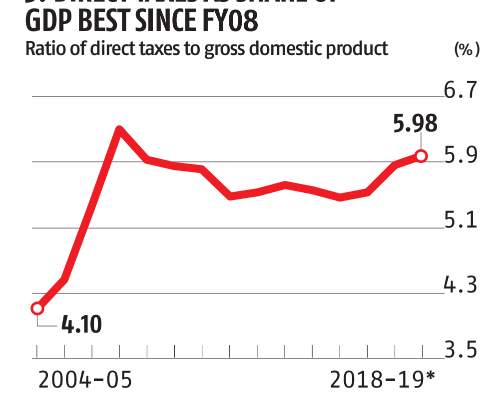
1: DIRECT TAXES ASSUME GREATER IMPORTANCE AFTER GST
Share in total tax revenue



2: MORE TAX COLLECTED AT SOURCE
Share in total direct taxes



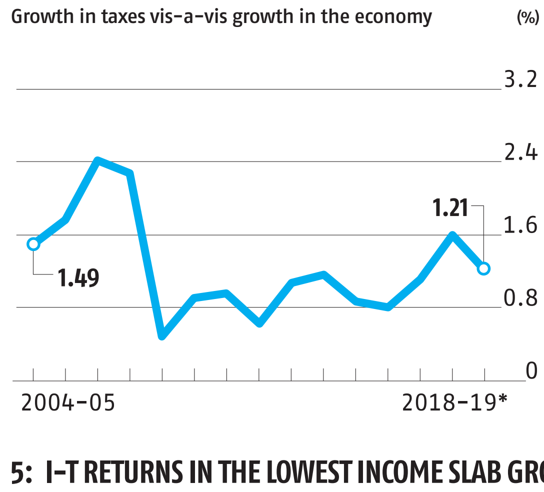
3: DIRECT TAXES AS SHARE OF GDP BEST SINCE FY08
Ratio of direct taxes to gross domestic product



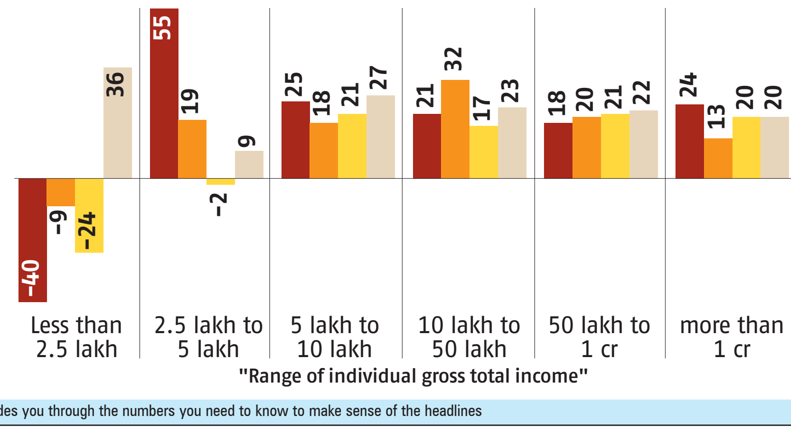
Note: * Provisional data

ILLUSTRATION: AJAY MOHANTY

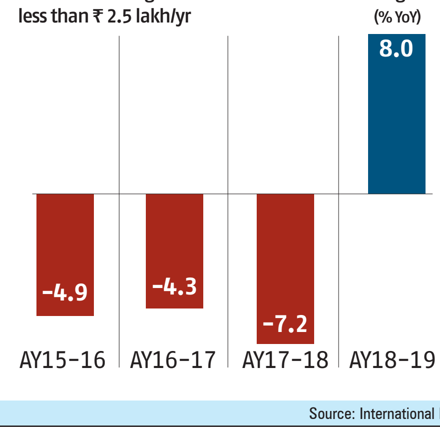
4: BUOYANCY OF DIRECT TAXES REDUCES
Growth in taxes vis-a-vis growth in the economy



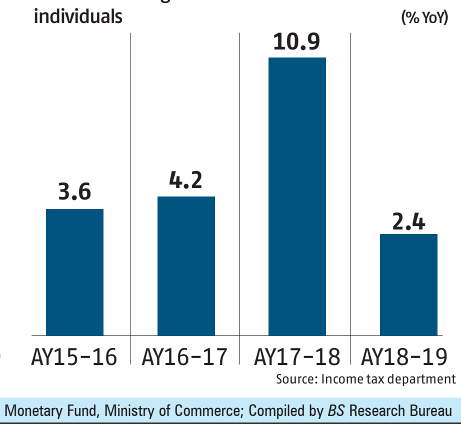
5: I-T RETURNS IN THE LOWEST INCOME SLAB GROW
Growth in number of returns



6: INCOMES IN LOWEST SLAB REBOUND
Growth in average income of individuals earning less than ₹ 2.5 lakh/yr



7: OVERALL AVERAGE INCOMES GROW SLOW
Growth in average income of all individuals



Source: Income tax department

StatsGuru is a weekly feature. Every Monday, *Business Standard* guides you through the numbers you need to know to make sense of the headlines

Source: International Monetary Fund, Ministry of Commerce; Compiled by *BS* Research Bureau