



From despots to institutions

Reliable performance over the long term requires shifting focus from individuals to institutions

The Tata group was a pioneer in shifting away from family management and dominant shareholding. Now the group is showing the way in the complexities of board governance. These messy conflicts are integral to dispersion of power away from an autocratic CEO. This is the future of Indian business. We in India have to learn how to go from dictatorial firms to the modern arrangement, of dispersal of power in the firm.

Many people personalise the working of complex organisations. There is a tendency to personalise a government around the name of a prime minister. There is a tendency to personalise a firm around the name of a CEO. We create a cult of personality around these powerful individuals.

There are two problems with a powerful leader. Any large organisation works better by harnessing the minds of numerous people. No one person is smart enough to make all the choices, so dispersion of power improves the outcome. And, when power is concentrated in one person, this is a short term solution. Concentration of power makes succession more difficult. When a firm with concentrated power works well, there is a looming crisis in the problem of succession.

Every family business dreams of a succession process that yields an Anand Mahindra. But the landscape is littered with failed successions. This is similar to the experience with governments. For every successful dictator like Lee Kuan Yew, the world has

seen dozens of shabby dictators who delivered bad outcomes. When power is concentrated, the identity of the CEO matters greatly, and narrowing the field of candidates to family members hurts.

Reliable performance over the long term requires shifting focus from individuals to institutions. Look back at the China vs India story. Some investors were giddy about China: Concentrated power in the hands of a clear CEO who gets 10 years to rule the country. When financial investors were getting excited about “the China model” from 2000 to 2010, people of an intellectual bent were warning that 1,000 years of history teaches us otherwise. The complicated and messy process of democracy in India works better. On a 25 or 50 year view, India is the better bet, because of the institutions of democracy.

Barring a handful of exceptions, the great corporations of the world have dispersed shareholding and a powerful board. They deliver sound performance for decades across multiple changes of the guard. They are institutions; they are not dictatorships. India is at the early stages of this journey. This will require learning the intricate checks and balances of a dispersed shareholding company. For most autocratic companies, this is as hard as China learning how to do democracy.

There are three dimensions of dispersion of power away from the CEO. The first is the establishment of formal processes to reduce the role for discretion in more decisions and in increasingly important

ones. The second is to increasingly shift discretionary power away from the CEO to lower levels in the organisation. The third is the establishment of a powerful board. These three shifts of power are the milestones of the development of a capable institution.

There is little experience and knowledge with the working of boards in India, as yet. The board is like the legislature of a company. It hires the top management, i.e. the executive. The board is the principal and the management team is the agent. The board initiates projects for designing/amending processes, and approves processes. It is intimately involved in setting strategy, determining budgets, and designing the organisation structure. It establishes performance reporting and holds the management accountable. It is an interesting blend of members who are full-time managers, checked by a majority of non-executive directors including a non-executive chairman. We in India have to learn how to build and operate such boards.

This reasoning has implications for business families and for financial investors. All business families think about succession. By now, there is ample experience with successions that did not work out. Business families should also evaluate steering towards a dispersed shareholding corporation. Perhaps the next generation will be better off as shareholders and board members. It is better to repeatedly hire CXOs with fire in the belly, in their 40s and 50s, and to sack people when things don't work, instead of being stuck with family members for decades.

Converting from an autocratic firm to an institution yields greater predictability of performance and cash flow. This yields higher valuations on the stock market. The business families that are able to successfully navigate this transition will do better in converting their control of a firm into greater wealth. This is a safer strategy, than the vagaries of a transition from one family member to another.

This reasoning also matters for financial investors. When we look at a firm, we should recognise and value the fact that an organisation like Infosys is an institution with greater dispersal of power, even though its performance today appears troubled when compared with Wipro, where power is more centralised. Wipro will go through greater problems of succession, and the complexities of dispersing power, in the coming decade.

Investors should be more willing to buy long-term instruments – i.e. shares and long-dated bonds – of firms that are institutions. An autocratic firm that is faring well today can only be trusted on the horizons of its present CEO, and it is better to stick with investing in near bonds.

It is fashionable, in the world of Indian business, to take pride in the decisive actions of an autocratic business, to look down upon the bureaucracy and politics that is found in institutionalised organisations such as Hindustan Lever or the government. It is fashionable to look down upon weak CEOs. We should rethink these notions. The real greatness lies in the way almost all great firms of the world are institutions. They cannot make a decision quickly, their CEOs have reduced power, they have complex internal politics, but they lumber on for decades and outperform the solo flyers.



SNAKES & LADDERS

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