

ICICI Bank Ltd. - Quintessence of Corporate Governance Failure and Board Ineffectiveness

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Abstract

The case study emerges from a controversy in which Chanda Kochhar, ICICI Bank's former CEO, was alleged to have violated related party transactions at the behest of her husband, Deepak Kochhar. The bank had granted various loans to an associate of Deepak Kochhar, who in turn extended certain favors to Deepak Kochhar during Chanda Kochhar's tenure as CEO. Do the loan approvals in banks have any ethical dilemmas attached to them? What is a conflict of interest? What is an enforceable quid-pro-quo? What are internal financial controls, and if these controls are robust, can they mitigate risk in an organization? This case study sought to answer these questions. Finally, the court found Chanda Kochhar liable for all allegations against her, marking a historic moment in Indian banking history.

Keywords : corporate governance, board diversity, ethics, banking, women director

JEL Classification Codes: G21, G30, G34, G39

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ICICI Bank Ltd.'s share prices fell by 17% in the March quarter of 2018, but it recorded its worst-ever drop to nearly 6% and lost USD 1384.46 million in market capitalization on April 1, 2018 ("ICICI Bank shares tank," 2018). This was considered as a market reaction to the findings of the investigation into the bank's CEO Chanda Kochhar's conflict of interest and code of conduct charges, in which she was found guilty of a criminal scheme, deceiving and abusing one's official position for having endorsed advances by disregarding the company's credit policy (Rajput & Rebello, 2019).

ICICI Bank Ltd. approved six loans totaling USD 248.34 million to Videocon Group firms between June 2009 and October 2011, with the Kochhars receiving USD 8.48 million in remuneration ("ED attaches Rs 78-cr assets," 2020). In 2016, an activist shareholder addressed the matter by writing a letter to the Prime Minister of India, the Governor of the Reserve Bank of India, and the board of directors of ICICI Bank Ltd., expressing concerns about Chanda Kochhar's potential conflict of interest as the bank's CEO (Unnikrishnan, 2020). How could the bank guarantee substantial compensation in different exchanges, including its key

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managerial personnel ? What revelations should be made in order to ensure objectivity, responsibility, and transparency in financial transactions ? What should the inhabitants of good governance be, as monitored and supervised by a private banking company's board of directors ? What role do women directors have in risk management and environmental preservation ? Is there an issue with control or auditing ?

Corporate Boards and Women Directors in Banks

The board of directors of a company collectively exercises strategic oversight over business operations as well as supervises, measures, and rewards executive performance. The board must certify statutory compliance, ensure financial accounting and reporting, create robust and effective internal controls, look after auditors' independence, protect minority shareholders' rights, and create a premium over their investments. They should be objective while exercising their discretions and powers. The tenants of corporate governance should ensure that all decisions are within legal, ethical, and behavioral norms. In India, companies are registered and regulated majorly by the Companies Act, 2013 ("ICICI Bank board supports," 2018). This enactment demonstrates the focal point of controllers toward improving the obligation and responsibility of boards. A board's composition is one of the main factors determining its viability.

A board should have an appropriate balance of internal and independent members with a diversity of expertise and key competencies in addition to the required number of directors. A board structure with executive directors and independent non-executive directors may provide a competitive advantage due to the executive directors' strong understanding of the subject area and the non-executive/independent directors' breadth of experience. As per the Securities and Exchange Board of India, Listing Obligations and Discourse Requirement, 2015, the composition of all listed companies and banks is as follows (Securities and Exchange Board of India, 2015):

- ✎ The board of directors must have at least 1/3 independent directors if the chairperson is a non-executive director.
- ✎ If the chairperson is not a non-executive director, independent directors must make up at least half of the board of directors.
- ✎ If the chairperson is a promoter of the listed company and a non-executive director, or is linked to any promoter, at least half of the board of directors must be independent.
- ✎ At least 50% of the non-executive directors should include at least one woman director.

A provision in the Indian Companies Act, 2013, recognized the importance of gender diversity by requiring the appointment of at least one woman director in listed and other specified classes of companies.

SEBI LODR Amendment Regulations, 2018 stipulated that the top listed 500 companies should have at least one independent female director by April 1, 2019, and the top-listed 1,000 entities by April 1, 2020. By March 31, 2020, about 10% of the 125 listed companies missed the deadline set by SEBI to appoint women as independent directors on their boards (National Stock Exchange, 2020). In 2019, women directors in India increased to 15.2% from 10.9% in 2014; whereas, the global average increased to 20.6%. Further, in 2019, the female representation in key managerial positions increased to 8.5% from 6.9% in 2016 (Credit Suisse, 2019). This was far behind the Philippines, Thailand, Australia, and New Zealand at 34%, 28%, and 25%, respectively. However, India fared better than South Korea and Japan, which had only 4% and 3% senior executive female representation. In 2019, India had 2% chief executive officers (CEOs) and 1% chief finance officers (CFOs).

From 2009 to 2016, India's financial sector best manifested gender diversity, where out of 11 banks, nine had women directors, and two had women CEOs. The first top position as woman chairman of SBI (2013 – 17) was

Arundhati Bhattacharya in the 208 years old history of the bank. Other women who rose to be on top positions in banks in India were Shikha Sharma, Managing Director and Chief Executive Officer, Axis Bank (2009–18); Naina Lal Kidwai, Chief Executive Officer, HSBC India (2007–08) and Chairperson, HSBC India (2009–2015); Kalpana Morparia, CEO India of J. P. Morgan (2008–present); Usha Ananthasubramanian, MD and CEO, Allahabad Bank (2017– 18) and first woman chairman of Indian Banks' Association (IBA) (2017–18); and Chanda Kochhar, MD and CEO (2009–18) of the largest private sector bank in the country, that is, ICICI Bank (Open Naukri, 2019).

In terms of the Institute of Chartered Accountants in England and Wales (ICAEW), diversity is essential for the below-mentioned reasons:

- ✍ It enhances effectiveness.
- ✍ It helps in social acceptability.
- ✍ It strengthens the understanding of the business.
- ✍ It enhances rigor in business operations.

It is appraised that companies with diverse boards outperform those with male-dominated boards on different parameters. Companies with at least one woman on the board of directors have a higher return on equity, lower debt-to-equity ratio, higher price-to-book value ratio, and superior average growth, according to a research of 2,400 companies conducted over a period of six years from 2010 – 2016 (Keelery, 2020a). This is due to a more inclusive strategy, which helps boards become more successful and accountable. Companies have a tendency to gain a deeper understanding of their customers and stakeholders, as well as to open up to new viewpoints, new and innovative ideas, and to capitalize on them (KPMG, 2017).

ICICI Bank Ltd. Under Chanda Kochhar

During Kochhar's tenure as CEO and MD of ICICI Bank Ltd., she made sure to visit bank branches without any prior announcements and conducted informal meetings on a monthly basis with 20 employees of the bank randomly picked. The monthly meetings provided an amicable atmosphere for employees to express themselves freely and create an inclusive work environment. The 'May I Help You' desk at all bank branches was assigned to the most experienced employee to attend the bank customers and clients compared to other junior staff, reposing faith amongst its various stakeholders towards effective relationship building by the bank.

Kochhar ensured growth, profitability, and risk management as a core to strategy building for the bank. She added credit growth along with the bank's other strategies like credit quality, cost and capital conservation, and current and savings account deposits (CASA). The growth was diversified across retail, housing, car loans, new projects, working capital loans, and so on. According to Kochhar, the risks in the banking business had to be managed, understood, and quantified and not avoided. Her efforts helped increase the net interest margins, helping the bank soak up added risk. In early 2000, Kochhar took the bank's retail business to 60% of the book, making it the bank's main business apart from housing and car loans. She took advantage of technological improvements to provide a rich and smooth banking experience by placing together all the banking interfaces on digital platforms such as mobile internet banking, tab banking, 24×7 completely automated touch banking, banking on Twitter (ICICI Bank Pay), and digital wallet. It is significant to note that the bank's cost-to-income ratio improved to 36.8% from 38.2% in 2015 as a result of lower total operating costs.

Moreover, the bank employed Facebook and Twitter as social media channels. Customers could, in a jiffy, send money to anyone in the country who had a Twitter account, check account balance, see the latest three

transactions, and recharge prepaid phones. Its iMobile app offered more than 100 services like transaction alerts, notifications, customer query resolutions through chat, and direct cash withdrawals. In April 2015, the bank recorded transactions worth USD 707.66 million on its mobile banking platform. The bank also focussed on its retail loan portfolio and used its digital platform presence to boost this vertical. In March 2015, the retail portfolio increased to 42.5% of its total loan book compared to 39% in March 2014, indicating a positive output (Shukla, 2016).

The Complaint

Arvind Gupta, an activist and a shareholder of ICICI Bank Ltd., questioned deals between Videocon Group and NuPower Renewables Ltd. in 2016. In a letter addressed to the Prime Minister of India, the Governor of the Reserve Bank of India, and the bank's board, Gupta accused Kochhar of conflict of interest and corporate misbehavior by demonstrating a direct link between these loans and consideration received by Deepak Kochhar, the owner of Nupower and Chanda Kochhar's husband. This complaint received no attention ("Why whistleblower Arvind Gupta," 2018). The complaint was resurrected in 2018 when the charges were published in the newspaper following an inquiry. In the same year, the bank was accused of inflating profits by at least USD 1.3 billion between 2008 and 2016 by delaying provisioning for 31 non-performing assets, according to another whistleblower's complaint. According to the complainant, top bank executives were accused of knowingly breaking guidelines. The bank was charged with deferring provisioning for non-performing assets (NPAs) from loans worth at least USD 3 billion, and if management had not postponed impairment, the bank would have declared losses in various quarters during the last eight years (Laskar & Sood, 2018).

In December 2008, Videocon chairman Venugopal Dhoot, his family, and allies possessed a 50% share in NuPower Renewables Private Limited (NRPL), with the remaining 50% held by Deepak Kochhar and Pacific Capital, which Kochhar's brother and father held. Dhoot resigned as NRPL's director in January 2009 and sold his 24,999 shares to Deepak Kochhar for USD 33,112. NRPL was also given a loan of USD 8.48 million in March 2010 by Supreme Energy Pvt. Ltd., a firm owned by Dhoot with 99.9% equity shares. The loan was made in the form of a fully convertible debenture, which is a debt security that can be converted into equity shares at the issuer's discretion. Following that, shares were transferred from Dhoot to Deepak Kochhar, Pacific Capital, and Supreme Energy in a series of transactions. By March 2010, Supreme Energy Pvt. Ltd. substantially owned 94.99% of NuPower, while Deepak Kochhar owned merely 4.99% of NRPL. Dhoot surrendered his full 99.9% ownership to his friend Mahesh Chandra Punglia in November 2010. Punglia transferred these shareholdings to Pinnacle Energy Trust, where Deepak Kochhar was the managing trustee for a measly USD 11,920 between September 2012 and April 2013 (Tonk, 2012).

In 2010, NRPL received an investment of USD 8.48 million through a cluster of Videocon Group companies which had got subsumed by Pinnacle Energy Trust. In 2017, almost 84% (USD 372.17 million) of the Videocon loan account was declared as a non-performing asset. In 2010, NRPL received a whopping amount of USD 37.22 million from Essar Group, which was channeled through Matix Group and its holding company, Firstland Holdings Ltd., domiciled in Mauritius. In 2010, ICICI Bank Ltd. gave the Essar group a loan of USD 430.45 million (Kumari & Pattanayak, 2014). It is worth noting that Nishant Kanodia, the company's owner, is married to Smiti Ruia, Essar Group Vice-Chairman, Ravi Ruia's daughter. ICICI Bank Ltd. was declared a non-performing asset in 2013 as it was the principal bank of a consortium of banks sanctioning USD 520 million loans to Essar Steel Minnesota in 2010 ("Here's all that finally," 2019).

Avista Advisory Group, a firm headed by Chanda Kochhar's brother-in-law, Rajiv Kochhar, brother of Deepak Kochhar, was allegedly recruited by ICICI Bank Ltd.'s debtors, Jaiprakash Associates and Jaiprakash Power Ltd. Avista Advisory Group was contracted by the Videocon Group, GTL Infrastructure Ltd., and Suzlon Ltd., among

others, for debt restructuring. ICICI Bank Ltd. provided the majority of the funding for these businesses. The bank never hired Avista Advisory Group for any services (“ICICI-Videocon case: 20 questions,” 2019).

In 2018, the bank's board did not heed the complaint; rather, it commended the leadership of Kochhar and the entire management team for their hard work and dedication. In 2017–18, the bank's board comprised of six independent directors, five whole-time and executive directors, and one government nominee director (Jagannathan & Suresh, 2017). The executive directors were Kochhar, N. S. Kannan, Vishakha Mulye, Vijay Chandok, and Anup Bagchi. Kochhar was the CEO and MD of the bank. An inquiry committee headed by former Supreme Court Judge, B. N. Srikrishna, was set up by the bank's audit committee in June 2018, with Chairman, Mr. Uday Chitale, and an independent director Mr. Radhakrishnan Nair to probe the allegations against Kochhar. The Srikrishna inquiry report investigated all transactions from April 1, 2009 to March 31, 2018. The Srikrishna report found Kochhar guilty of violating the bank's code of conduct policy, engaged in transactions with an apparent conflict of interest, breach of fiduciary duties, a lack of vigilance on yearly filings in accordance with the bank's own disclosure standards.

Based on the reports' findings, the board terminated Kochhar's employment with the bank under 'Termination for Cause' in compliance with the bank's policies and practices. The board also revoked all of her present and future perks, including any unpaid bonuses or increments, unpaid amounts, unvested and vested but unexercised stock options, and medical benefits, as well as clawing back all bonuses paid between April 2009 and March 2018 (“Full Text: ICICI Bank,” 2019). In April 2018, the Central Bureau of Investigation filed the First Information Report (FIR) against Kochhar for criminal conspiracy and fraudulent transactions (“CBI registers fraud case,” 2019). She was stepped down from the board on October 4, 2018, and her position was assigned to Sandeep Bakshi from October 15, 2018 (Rajpurohit & Rijwani, 2020). The rest of the board composition remained the same apart from the change in government nominee twice during the same financial year (ICICI Bank, 2019).

What should the bank have done to obviate such a fiasco? Could any of this have been avoided if the bank had taken the whistleblowers' complaint seriously for the first time? What should be construed as objective decision-making while giving loans by banks? Should the arm's length principle be followed in law or spirit? Was this an internal financial control issue? Is this a reputation risk?

Teaching Notes

Synopsis

The case is based on a conundrum in the ICICI Bank Ltd. wherein its erstwhile Chief Executive Officer, Chanda Kochhar, was alleged to have violated related party transaction norms at the behest of her husband, Deepak Kochhar. This was concerning various loans granted by the bank to an associate of Deepak Kochhar who had in return passed on certain favors to the former that the bank approved during Chanda's tenure as the CEO of the bank. Did the loan approvals in banks have any ethical dilemmas built around them? What is a conflict of interest? What is an enforceable quid-pro-quo? Why is a violation of related party transactions a failure of good corporate governance? What are the internal financial controls? If these controls are robust, can they mitigate risk in an organization?

Teaching Objectives

The teaching objectives of this case may include the following key aspects:

- ✎ To understand ethics, fiduciary relationships, and the position of the board of directors.
- ✎ To understand the duties of the board of directors.

- ✎ To understand the tenants of good governance.
- ✎ To understand the concept of conflict of interest, related party transactions, and the arm's length principle.
- ✎ To understand the concept of internal financial controls and risk management in an organization.

Potential Audience

Graduate and post-graduate students, mid-level executives, and anyone interested in studying business ethics, legal aspects of business, and corporate governance are the potential audience.

Relevant Programmes and Number of Teaching Sessions Needed

This case is primarily intended for MBA-level courses like business ethics, legal aspects of business, corporate governance, internal financial controls, and risk management.

This case can be discussed in one 75-minute class using the following suggested structure:

Issues	Duration
Discuss issues in ICICI Bank as per the board plan.	15 minutes
Discuss facts and align them with various concepts in an organization, like the relationship between its shareholders, CEO, and board.	20 minutes
Discuss ethical dilemmas in decision-making.	15 minutes
Introduce concepts of related party transactions (RPTs) and the arm's length principle.	15 minutes
Discuss the role of the board.	10 minutes

Authors' Analysis of Each Question Raised

(1) What are Business Ethics?

The instructor should commence the session by emphasizing the importance of business ethics and introducing important business ethics theories. After this, each theory should be assessed with the facts of the case, and the class must build perspectives on why people decide differently under diverse scenarios.

A part of applied ethics is business ethics. As Andrew explains it rightly, it is often believed that Crane's business ethics is the study of business circumstances, activities, and decisions in which concerns of right and wrong are addressed. Raymond C. Baumhart once opined that business ethics is primarily equivalent to responsibility ethics. The businessman must guarantee that he will not intentionally cause harm. Various theories emphasize diverse issues relying upon a diverse decision-making style, such as foreseeing the conclusion and subsequent duties to others. The tenets of the ethics theories are :

(i) Egoism Theory. According to egoism theory, what determines whether something is good or terrible, right or wrong, is whether it satisfies one's wishes or needs. The underlying criteria of this theory is self-interest, and one should pick the behavior that best realizes or promotes one's self-interest.

(ii) Utilitarianism Theory. Jeremy Bentham propounded the theory. According to this idea, what determines whether something is good or bad, right or wrong, is whether it provides the greatest amount of pleasure (or the

least amount of misery) to the greatest number of people. The “Greatest Happiness Principle” is the central tenet of this approach.

(iii) Deontological Theory. The basic aspect of this view is that what determines whether anything is good or terrible, right or wrong, is whether it complies with some (rational) duty. Its primary premise is that when performing duties toward oneself or others, one should choose the action that best conforms to one's acknowledged responsibilities. The most significant discrepancy in these responsibilities was uncovered and comprehended primarily through logic or sound common sense.

(iv) Virtue Theory. Aristotle and Confucius both proposed this viewpoint. According to Aristotle, the virtue of man likewise will be the state of character that makes a guy good and makes him accomplish his work properly. Something must embody or encourage culturally acceptable qualities or vices in order to be good or evil, right or wrong. As a result, the full potential of fully human existence has been achieved to some extent (“Different banks in India,” 2015).

(v) Teleological Theory. According to teleological theory, the aims or effects of an act decide whether an act is good or wicked, also known as consequential ethics. People in business frequently consider purposeful action and management by objectives. All stakeholders in a business decision, including management, employees, customers, the country, humanity, shareholders, and the environment, are included in the teleological analysis of business ethics.

(2) What are the Ethical Responsibilities of Key Managerial Personnel(s) and the Board of Directors of a Company?

Shareholders invest their equity in a company that is managed by the management of a company by exercising powers vested in them by the board of directors. The management is supervised and monitored by the board of directors on behalf of the shareholders. Hence, the management reports to the company's board, and the latter reports to the shareholders and is accountable to them directly. Directors are not appropriately trustees of the company, but their position is similar to that of trustees. Even though the director institution is not similar to a trustee, but they stand in a fiduciary relationship, that is, the relationship of good faith and trust with the company. In the case of trusteeship, there are three parties: (a) author of the trust, (b) trustee – manager of the trust, and (c) the beneficiary.

Like trust, where there is a legal and ethical relationship with the beneficiary, the directors have this relationship with the shareholders in a company. Directors, according to Palmer, are not only agents, but they are also trustees in some senses and to some extent. However, their status differs significantly from that of ordinary trustees, and the rigorous standards that apply to such trustees do not apply to directors in all aspects.

Another critical issue is whether directors are trustees to the company or the shareholders. In *Percival v. Wright*, it was held that directors did not have a fiduciary relationship towards shareholders. The directors are not bound to disclose premature negotiations. However, in *Coleman v. Myers*, the courts observed that the directors owed a fiduciary duty towards the shareholders. In India, the duties of directors were first stipulated under Section 166 of the Companies Act, 2013. This provided a statutory framework to the fiduciary obligations of the directors. Some critical attributes to perform these duties are honesty, good faith, care, diligence, and disclosure of interest. According to Section 166 (4) of the Companies Act, 2013, a director shall avoid any conflict of interest that may arise because of his interest in a matter over that of the company's interest in the same transaction. If the director has any conflict of interest, then it is likely that the director's interest will prevail over that of the company, thereby at a disadvantage to the company and subsequently its shareholders.

The position of a director is accentuated to the position of agents of the company with consequent duties. A decision in *Allen V. Hyatt* held that directors, like agents, are required to disclose their interest, if any, in any transaction of the company to avoid a conflict of interest. The company's directors should not try to acquire an unfair advantage or profit for themselves, their relatives, partners, or colleagues.

(3) What is the arm's length principle? Why is it an important facet of good corporate governance?

The arm's length principle is cardinal to good corporate governance. When a company gets incorporated, it becomes a separate legal entity. Its equity should be invested only for its resources and operations. It should be at arm's length with all its stakeholders, including the promoters, key managerial personnel like Kochhar, and the board of directors, which means that it must share resources with them in the same manner as if they were not a related party and ensure there is no conflict of interest within the contracting parties.

According to Article 9 of the OECD Model Convention, if conditions are made or imposed between two enterprises in their commercial or financial relations that are different from those that would be made between independent enterprises, any profit that would have accrued to one of the enterprises but for those conditions may be included in that enterprise's profits.

This means that a level of fairness should be reflected in the price or the consideration of contracts, concessions availed by a party, the ease of availability of a loan (especially about this case), the conditions on which the contract depends, and so on.

(4) What ICICI Bank's board have done differently?

In March 2016, the whistle was blown by shareholder activist Arvind Gupta against the ICICI-Videocon case, though the board of the bank failed to react to the complaint. Afterward, in 2018, the bank received another whistleblower grievance alleging a charge for increased income by USD 1.3 billion from 2008 to 2016 by delaying provisioning for NPA accounts. With these allegations captured released in the newspaper in 2018, the complaint raised by Arvind Gupta in 2016 also resurfaced. Since the case had already drawn media attention, the board reacted to this subject by making the following announcement, which reads as follows ("ICICI Bank board supports Chanda Kochhar," 2018):

The Board has full confidence and reposes full faith in the Bank's MD & CEO, Ms. Chanda Kochhar. The Board also commends the entire management team under the leadership of the MD & CEO for their hard work and dedication. We would urge you not to be misled by these rumors, which are being spread to malign the Bank and its top management. (para 17)

The board response was misleading, ambiguous, paradoxical, and in complete support of their CEO. A bank beholds within it the responsibility of securing 'trust,' and its stakeholders believe it follows the letter of the law. The bank might have responded quickly to safeguard its brand and stakeholders' interests as soon as it was made aware of the situation. Nonetheless, its unsatisfactory comments almost two years later suggest that the bank was taken off guard. Many of the comments seemed to be smoke and mirrors, such as "she made all the disclosures as per company's act," "it was a consortium loan," and "ICICI Bank has never appointed Avista." All of these remarks pointed in one direction: the CEO had successfully seized control of the bank's board of directors, leaving independent directors as mere spectators (Keelery, 2020b).

Instead of releasing this statement, the board could have reassured its stakeholders that these series of transactions of non-adherence to code of conduct, conflict of interest, and quid pro quo by Kochhar would not

have any detrimental effect on the bank financials. Also, the bank could have indicated an independent inquiry that would cover all the related matters to bring the matter to the final close and how it would ensure high standards of governance in the future. Moreover, factually speaking, Rajiv Kochhar, Chanda Kochhar's brother-in-law and CEO of Avista Advisory Group, does not qualify as a 'relative' under the Companies Act, 2013. The board attempted to conceal itself behind this technicality. Rather than this absurd response, any independent director on the board, as well as any member of the risk committee, audit committee, or any other committee deserving of these titles, may have raised this issue during the board meeting and noted it in the minutes of the meeting.

Authors' Contribution

Surbhi Jain, Dr. Rashmi Aggarwal, and Dr. Teena Bagga conceived the idea and wrote the case. All three authors wrote the teaching notes considering different aspects of the case and reviewed the final case study.

Conflict of Interest

The authors certify that they have no affiliations with or involvement in any organization or entity with any financial interest or non-financial interest in the subject matter or materials discussed in this case study.

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