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CONTENTS

ARTICLES /CASES

1. INFOSYS SAGA – ISSUES IN CORPORATE GOVERNANCE*

Dr. Asish K. Bhattacharyya

Infosys Limited, which is a global leader in IT technology and consulting, is in the news after the founder-shareholders, who together hold around 13 per cent of the outstanding equity shares, voiced their concern over certain corporate governance issues. A whistleblower has raised same issues in a letter to the SEBI. They relate to alleged overpayment in the acquisition of Panaya, in which Hasso Plattner, who is the cofounder of SAP (the company in which the CEO of Infosys Mr. Vishal Sikka worked earlier), had 8.33 per cent shareholding; and unusually high severance pay of Rs 17.38 crores (actually paid Rs 5.2 crores) to the erstwhile CFO (Rajiv Bansal), who, according to the whistleblower, initially was not in agreement with the acquisition of Panaya. According to N R Narayan Murthy, the highly respected founder of the company, the high severance pay could be 'hush money' to silence Mr. Bansal. Other issues raised by the founders are the significant pay-hike of Mr. Sikka, departure of a former compliance officer David Kennedy with significant severance pay and appointment of Punita Kumar Sinha, who is the wife of a minister in the central government.

Across the globe outside blockholders (large shareholders who do not occupy a position in the board or executive management) monitor the performance of the board and directly intervene, for example, by writing letters to the chairperson communicating suggestions and concerns or raising issues in general meetings. Therefore, intervention by the founder-shareholders of Infosys is not a surprise. The use of the public forum (e.g. Media) to raise issues is.

The allegation that the board had approved payment of 'hush money' to the former CFO in the form of unusually high severance pay is a very serious allegation. The board on its part got the issue investigated by a highly reputed law firm (Cyril Amarchand Mangaldas), which did not find any wrongdoing or cover up of wrongdoing. Ostensibly, the founders were not satisfied with the investigation. If founders believe the high severance pay was 'hush money', they should have taken recourse to options available in the Companies Act. For example, they could call EGM for removing the chairman of the board and chairman of the nomination and remuneration committee from the board. Indicting the board for wrong doing and pressurizing the chairman to resign by making noise in the media is an undesirable shareholder activism, which harms the company more than benefitting it.

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* Drawn from *Business Standard* (March 13, 2017) with the permission of the author.

Excessive compensation to the CEO and members of senior management is always an issue in corporate governance. The board has the responsibility to critically examine the employment contracts with them before approval. The Infosys board has indirectly accepted that high severance pay to former CFO was an error. This is definitely a failure of the nomination and remuneration committee. Founders had expressed concern about the increase in the ratio of CEO salary to the median salary. Although it is generally believed that the high ratio reflects poor corporate governance, there is no norm. High ratio of CEO's pay to median pay is not always against the principle of 'fairness to all employees'. An independent board should apply its judgement based on the demand and supply of capabilities that are required for different positions/jobs for strategy implementation. Usually the board benchmarks salary with salary levels in comparable companies. For example, as Mr. Sikka has an opportunity to work for a global company in a similar position in USA and he is allowed to operate from USA, his compensation should be comparable to a CEO in a global IT company operating from USA. On the other hand, salary of employees located in India should be comparable to salaries in global IT companies operating from India. It could be the reason that the ratio of Mr. Sikka's compensation to the median compensation in Infosys has exceeded the earlier normal. It goes without saying that if the SEBI finds truth in the whistleblower's allegations of unethical practice, the board should be held responsible. On the other hand it would be a mistake to hold Infosys hostage to its founders' original approach to business. A 'way of doing business' is not the same thing as 'core values' like a commitment to integrity and ethical standards, mutual respect and fairness to all stakeholders. The latter should certainly not change. But to raise a certain way of doing business to the same status as these fundamental values can only do a disservice to the company and leave it without the ability to adapt to changing business contexts.

2. THE PARADOX OF CHOICE*

Dr. Prasanna Chandra

In modern societies people have a wide range of choices in almost all areas of life: consumer goods, education, career, friendship, parenting, religious observance, entertainment, and so on. Undoubtedly, choice improves life. Without choice, life can be very suffocating. The autonomy and control that choice provides are very powerful, liberating, and positive.

However, as the number of choices multiples, the effect required for making a good decision increases. There is a cost to having an overload of choice. We are enamoured of freedom, self- determination, and variety and we want to cling tenaciously to the profusion of choices. This leads to bad decisions, stress, anxiety, and dissatisfaction.

As Barry Shwartz put it, "As the number of choices grows further, the negatives escalate until we become overloaded. At this point, choice no longer liberates, but debilitates. It might even be said to tyrannize."

In his book *Development as Freedom,* Nobel laureate Amartya Sen examines the nature and importance of freedom and autonomy. He argues that instead of being fetishistic about freedom of choice, we should ask whether choices nourish us or deprive us. While freedom is essential to self- respect, not all choice enhances freedom. The increasing choice with respect to goods and services may indeed diminish freedom by absorbing time and energy that can better be devoted to other matters.

Barry Shwartz says that the expanded choice available available to Americans has diminished their satisfaction. This now seems to be true in most other countries including India. The experience of choice as a burden rather than privilege is due to a complex interaction among various psychological processes which include, in Barry Shwartz's words, "rising expectation, awareness of opportunity costs, aversion to trade- offs, adaptation, regret, self- blame, the tendency to engage in social comparisons, and maximizing."

What Can We Do

What can we do to mitigate the sources of distress? Barry Schwartz offers the following suggestions:

1. **Choose When to Choose** For each decision we face, the benefits of having options are obvious, but the costs are subtle and, more important, they are cumulative. Hence, it is not that a particular choice that creates the problem. Rather, the cumulative burden of all the choices tends to be onerous.

   To cope with the problem of excessive choices, we must focus our time and energy on those choices in our lives that really matter.

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*Adapted from Barry Schwartz, *The Paradox of Choice*: *Why Less is More* Harper Collins

2. **Be a Chooser, Not a Picker** A "chooser" is a person who decides after reflection and, if the existing options are not satisfactory, explores the possibility of creating new options. A "picker" is a person who passively selects from whatever is available.

   It is better to be a chooser than a picker. To have the time to choose more and pick less, we must make some decisions automatic by relying on rules, habits, norms, and customs. This will conserve time for the decisions that matter the most. As Barry Schwartz put it, "Good decisions take time and attention, and the only way we can find the needed time and attention is by choosing our spots."
3. **Satisfice More and Maximize Less** In a culture that provides too many choices, maximizers suffer the most. As Barry Schwartz put it, "It is maximizers who worry most about regret, about missed opportunities, and about social comparisons, and it is maximizers who are most disappointed when the results of decisions are not as good as they expected."

   By accepting decisions that are "good enough" we can simplify decision making and increase satisfaction. While satisficers may not do well than maximizers in terms of certain objective standards, they usually have better subjective experience.

   Since maximizing about everything is impossible, we must learn to embrace, appreciate, and enjoy satisficing, rather than being simply resigned to it. As Barry Schwartz put it, "Becoming a conscious, intentional satisficer makes comparison with how other people are doing less important. It makes regret less likely. In the complex, choice- saturated world we live in, it makes peace of mind possible."
4. **Think About the Opportunity Costs of Opportunity Costs** When we make a decision, it makes sense to thinks about the alternative that we will pass up in choosing our most- preferred option. If we ignore these "opportunity costs" we are likely to overestimate the value of the most preferred option. However, the more we think about opportunity costs, the less will be the satisfaction we will obtain from whatever we choose. So, the trick is to reflect on opportunity costs to some extent, but not to a great extent.
5. **Make Your Decisions Irreversible** When we can reverse a decision, we tend to be less satisfied with it. On the other hand, when we make a decision that is final, we resort to a variety of psychological processes that make us feel better about our choice relative to the alternatives foregone. When a decision is reversible, we don't benefit much from these psychological processes.

6. **Practice an "Attitude of Gratitude**" How we evaluate choices is profoundly influenced by what we compare them with including the alternatives that exist only in our imaginations. As Barry Schwartz put it: "The same experience can have both delightful and disappointing aspects. Which of these we focus on may determine whether we judge the experience to be satisfactory or not. When we imagine better alternatives, the one we chose can seem worse. When we imagine worse alternatives, the one we chose can seem better."

   If we consciously strive to be grateful more often about what is good about a choice or experience and to be disheartened less by what is bad about a choice or experience, we can significantly enhance our subjective experience.

   Since gratitude does not often come to us naturally, we have to practice an "attitude of gratitude" consciously. As Barry Schwartz put it, "When life is not good, we think a lot about how it could be better. When life is going well, we tend not to think much about how it could be worse. But with practice, we can learn to reflect on how much better things are than they might be, which will in turn make the good things in life feel even better."

7. **Regret Less** Regret, actual or potential, characterizes many decisions. While regret is normal and serves a useful function, excessive regret can be dysfunctional and even preclude decisions. So an effort has to be made to minimize regret.

   Barry Schwartz says we can mitigate regret by:

   "1. Adopting the standards of a satisficer rather than a maximizer.

   2.Reducing the number of options we consider before making a decisions.

   3.Practicing gratitude for what is good in a decision rather than focusing on our disappointments with what is bad."

8. **Anticipate Adaptation** We adapt to almost everything that we experience regularly . As Barry Schwartz put it, "When life is hard, adaptation enables us to avoid the full brunt of the hardship. But when life is good, adaptation puts us on a 'hedonic treadmill,' robbing us of the full measure of satisfaction we expect from each positive experience."

   While we can't prevent adaptation we can develop realistic expectations about how experiences tend to change over time. To diminish disappointment from adaptation be a satisficer and spend less time and energy agonizing over decisions.

Be ware of the 'hedonic treadmill' (we tend to adapt to a given experience so that it feels less good over time) as well as the 'satisfaction treadmill' (we tend to adapt to a given level of feeling good so that it stops feeling good enough). To deal with the phenomena of 'hedonic treadmill' and 'satisfaction treadmill.' The habit of gratitude can be helpful. As Barry Shwartz says, "Imagining all the ways in which we could be feeling worse might prevent us from taking for granted (adapting to) how good we actually feel."

9. **Control Expectations** We evaluate an experience largely by how it compares with our expectations. So by controlling our expectations we can enhance our satisfaction with the outcome of decisions. This seems difficult in a world that encourages high expectations and offers a profusion of choices. However, expectations can be lowered by reducing the number of options that are considered, by being a 'satisficer' rather than a 'maximizer,' and by allowing for **serendipity.**
10. **Curtail Social Comparisons** We have a tendency to evaluate the quality of our experiences by comparing ourselves with others. While social comparison can provide useful information, it often diminishes our satisfaction. So we should do it less. As Barry Schwartz put it, "Because it is easier for a satisficer to avoid social comparison than for a maximizer, learning that 'good enough' is good enough may automatically reduce concern with how others are doing." It makes sense to focus on what makes us happy, and what gives meaning to our life.
11. **Learn to Love Constraints** Thanks to the multiplicity of choices we face, freedom of choice can become a tyranny of choice. Hence, we should welcome constraints on the possibilities we face, as they can be liberating not limiting. Rules, standards, and norms can impose such limits. As Barry Schwartz put it, "By deciding to follow a rule (for example, always wear a seat belt; never drink more than two glasses of wine in one evening), we avoid having to make a deliberate decision again and again." He added, "This kind of rule- following frees up time and attention that can be devoted to thinking about choices and decisions to which rules don't apply."

3. THE HIDING HAND AND THE REVEALING HAND

Dr. Prasanna Chandra

The combination of accounting scandals in the early 2000s, failure of large financial services company during the global financial crisis, and disasters like the oil spill at British Petroleum has triggered legislation and regulation for and increased role for enterprise risk management.

Some argue that the increased emphasis on risk management will inhibit innovation and entrepreneurial activities. Such concerns have been voiced earlier too. For example, the development economist Albert Hirschman wrote in the late 1960s. "Since we necessarily underestimate our creativity, it is desirable that we underestimate to a roughly similar extent the difficulties of the tasks we face so as to be tricked by these two offsetting underestimates into undertaking tasks that we can, but otherwise would not, dare tackle." He introduced a principle which he called "the Hiding Hand," that justified incomplete and inadequate risk assessment. In a similar vein, Daniel Goldin, chief administrator of NASA made this pronouncement in 1992: "Be bold – take risks. ［A］ project that's 20 for 20 isn't successful. It's proof that we're playing it too safe. If the gain is great, risk is warranted. Failure is OK, as long as it's on a project that's pushing the frontiers of technology."

Robert S. Kaplan and Annette Mikes*, however, believe that planning practices should be guided not by "the Hiding Hand," but by "the Revealing Hand" that enables identification of risks and then mitigation of risks in a cost- effective manner. As Rene Stulz put it, "In a well –functioning, truly enterprise- wide risk management system, all major risks would be identified, monitored, and managed on a continuous basis." The rationale for "the Revealing Hand" approach is that normally human beings tend to ignore risks. There are well- documented psychological and sociological biases within organisations that lead people to overlook important risks and to systematically underestimate and undermanage the risks that they identify.

Individuals, whether they face uncertainty alone or in large organisations, tend to extrapolate on the basis of recent experience. Hence they grossly underestimate the range of possible outcomes from risk situations. This happens because they rely, by default, on what Nobel Laureate Daniel Kahneman calls 'System 1 thinking,' which is rapid and effortless and is driven by emotion, instinct, and experience. What is required for effective risk management is 'System 2 thinking,' which is slow and deliberate and based on analysis and evidence. As Kaplan and Mikes put it, "Managers and employees, especially under budget and time pressure, become inured to gradually emerging risks and their System 1 thinking leads them to override existing controls and accept deviances and near misses as the new normal.'" They further added, "By treating red flags as false alarms rather than early warnings of imminent danger, they end up tolerating unknowingly an increase in vulnerability to risk events."

*Robert S. Kaplan and Anette Mikes, "Risk Management the Revealing Hand," *Journal of Applied Corporate Finance*, Winter 2016, pps 8-18.

In addition to individual biases there are organizational biases such as "groupthink.' Groups strive for consensus at the expense of a realistic evaluation of alternatives. Groupthink is a classic example of dysfunctional group dynamics. Groupthink happens because group members strongly support a proposal put on the table by the leader. This is because (a) people want to ingratiate themselves with the group leader, and (b) people inherently love harmony and want to avoid discord.

While most policymakers, regulators, and academics subscribe to the Revealing Hand approach there is less agreement on how to go about this assignment. Some risk management experts advocate a quantitative approach to risk management. The "quants" believe in expressing risks in the form of statistical distributions, including the correlations among them. They argue that corporate decision makers should compare the expected outcomes of risky alternatives, evaluate the effects of risky investments on the value and risk of the firm's entire "portfolio" of assets and businesses, and benchmark the firm's aggregate risk exposure against its risk appetite.

Naseem Taleb and others have been very critical of this quantitative approach to risk management, as almost all financial risk models failed during the global financial crisis. There is widespread skepticism about quantitative risk management. The skeptics argue that effective risk management must go beyond quantitative measurement and encompass qualitative approaches.

B.SNIPPETS

1. **Phishing for Phools: The Economics of Manipulation and Deception**

In their book, *Phishing for Phools: The Economics of Manipulation and Deception* (published by Princeton University in 2015), George A. Akerlof and Robert J. Shiller argue that markets harm as well as help, challenging Adam Smith's insight that markets are essentially benign and always create the greater good. To make profits, sellers systematically exploit our psychological weaknesses and ignorance through manipulation and deception. Markets are filled with tricks and traps that will "phish" us as "phools."

Markets give and take away. As they put it, "The financial system soars, then crashes. We are attracted, more than we know, by advertising. Our political system is distorted by money. We pay too much for gym memberships, cars, houses, and credit cards. Drug companies ingeniously market pharmaceuticals that do us little good."

The book explains a modern paradox. While we live in a time when we are better off than ever before we lead lives of quiet desperation. The book also shows how economic trickery can be contained through greater knowledge and sensible regulation.

2. Shift to the Hybrid Annuity Model

In 2011-12, more than two- thirds of infrastructure projects were under PPP model. For large road projects, the PPPs became the default option. But difficulties in land acquisition, environment clearances, and inadequate equity base of concessionaries caused delays and litigation, casting a shadow over the PPP model.

PPPs now seem to have gained their relevance again, at least in the roads sector, thanks to a change in the terms of business between the government and the concessionaire. From a BOT model, most road projects are now being executed under the hybrid annuity model (HAM).

The HAM is a hybrid of BOT annuity and EPC models. Its salient features are as follows:

- The government contributes 40 percent of the project cost in the first five years through annual payment. The remaining 60 per cent is paid as variable annuity amount after the completion of the project, based on the value of the asset created.
- The developer has to raise the balance 60 per cent of the project cost in the form of equity and loans.
- The developer does not have the toll right. The National Highways Authority of India (NHAI) has the responsibility for revenue collection.

Thus, under the HAM model, while the private partner bears the construction and maintenance risk as in the case of BOT (toll) model, the government shares a portion of financing risk.

3. The Traditional Investment Paradigm

The central tenets of the traditional investment paradigm are as follows: (1) Risk and return are positively related across all financial assets.Moreover ,the risk – return tradeoff is linear, with risk being best measured by equity "beta." (3)Excess returns are measured by "alpha," which reflects the average deviation of a portfolio's return from the capital asset pricing model (CAPM) benchmark. (4) A passive, long –only, highly diversified market- cap-weighted portfolio of equities (i.e., those containing only equity betas and no alphas) provides reasonably attractive investments returns. (5) The most important decision that an investor makes is the strategic asset allocation decision. This decision should reflect the long- run investment objective and risk tolerance of the investors. (6) Investors should hold stocks for the long run. Collectively, these six principles represent the foundation of the investment management industry.

4. Power Law in Economics

A physicist once asked Paul Samuelson for a law in economics that was both nontrivial and true. This is challenging because many (roughly) true results tend to be trivial (for example, demand curves are downward sloping) while many nontrivial results in economics assume too much sophistication and rationality on the part of agents to be true in practice. Samuelson replied, "the law of comparative advantage."

Perhaps a modern answer to that question will be "power laws." What is a power law? Called a scaling law, a power law is a relationship of the type $Y = aX^{\beta}$, where X and Y are variables of interest, β is the power law exponent, and a is ordinarily an unremarkable constant. Thus, if X is multiplied by a factor of 10, the Y is multiplied by 10^{β} this means that Y "scales" as X to the power β. `

PART C: WIT AND WIDSOM

1. HUMOUR

- Commenting on cost consciousness in the 2002 Annual Report of Berkshire Hathaway, Warren Buffett wrote, "We cherish cost consciousness at Berkshire. Our model is the widow who went to the local newspaper to place an obituary. When old there was a 25- cent- a –word charge, she requested 'Fred Brown died! She was informed there was a 7- word minimum. 'Okay' the bereaved woman replied "Make it Fred Brown died, golf clubs for sale.'"
- A husband is a person who is under the impression that he bosses the house. In reality, however, he only houses the boss.

2. WISE SAWS

- "Success consists of going from failure to failure without loss of enthusiasm."

  Sir Winston Churchill
- "The very first law in advertising is to avoid the concrete promise and cultivate the delightfully vague."

  Bill Cosby