Are IndiGo's security checks in place?

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There is no denying that governance levels at Indigo could be strengthened. Even so, there is no taking away from the fact that the promoters have delivered – to run a profitable airline in the current environment is no small feat. The battle between the two sets of promoters will do more damage to shareholder returns than the issues getting raised by this discord.

Richard Branson once said, "*If you want to be a millionaire, start with a billion dollars and launch a new airline.*" This comment turned out to be prophetic for several of the Indian airlines beginning with Air India and ending with the most recent debacle of Jet Airways. The airline industry, by its very nature, is vulnerable to the slightest of shocks, which makes it a volatile business. In that context, IndiGo's success is no small feat. It is one of the few low-cost carriers to have expanded in such a short period of time, and remained profitable for a large part of its existence. Most importantly, from a small set up, it now has about 50% market share in domestic travel – displacing well-entrenched players. So, as far as investors as concerned, the board has delivered.

For the company to remain focussed on its current path of growth, improvement in corporate governance standards is important. This will ensure that the business can function independent of the promoters and decision-making processes are more broad-based. This is not to say that promoters should be made redundant (in fact, investors like promoters that have their skin in the game) but the degree of dependence on them should reduce. Listed companies must be influenced and guided by their promoters, but should not be dependent upon them.

IndiGo's success has come despite a relatively small six-member board – Indian boards have a median size of 8 to 9 directors. Of this six-member board, three are promoters, one is a promoter nominee and the remaining two are independent directors. Under regulations, IndiGo is required to have one independent director who is a woman – the company is yet to comply with this requirement. With four mandatory board committees to be formed, the membership of these committees itself could be construed as cause for conflict of interest – both the audit and the nomination and remuneration committees included either executive directors or promoters as members. It is only after Mr. Damodaran was inducted to the board in January 2019, that committee compositions changed – now both these committees comprise two independent directors and one promoter nominee.

Board composition is not the only concern. The engagement of promoters at the board level is an equal concern. Board meeting attendance of promoters was low, averaging at less than 40% in FY16 and FY17. It is only in FY18, perhaps as the differences between the two factions began to simmer or following Kotak Committee's harsh reappointment criteria for absentee directors, that their board meeting attendance improved – to average at 63%. Although this was an improvement, it continues to remain well below acceptable levels. With all that has occurred recently, board meeting attendance in FY19 will likely be at its highest ever.

The lack of promoter attendance at board meetings and a relatively small board composition can be interpreted in two ways – that the company was professionally managed and that it did not need the promoters' intervention, or that the promoters controlled the business and its operations, and that the board had a limited role. Given the discourse from both sides, it seems more the latter than the former.

Related party transactions have always been a sensitive issue for discerning investors – corporate India's past has taught them to immediately think of financial leakages. The allegations around due process not being followed for related party transactions carries momentum given the construct of IndiGo's board and its board committees. Even so, there is other side of the argument: these were not material in the context of IndiGo's size, and the annual reports (FY16, FY17 and FY18) confirm that these were in the ordinary course of business and on arm's length basis. The FY17 and FY18 annual reports specifically mention that all related party transactions were reviewed and approved by the audit committee. And, the company's related party transaction policy specifically requires prior approval of the Audit Committee for such transactions. But these facts are getting lost in the conversation, as both sides lament on each other's role in building the business and the brand. Had the board been expanded, (to include more independent directors) and the board effectiveness improved, the allegations themselves would have been seen with more skepticism.

Broad basing the board would add another important element to today's discourse – it would allow the company to separate itself from the promoters' dispute. The board could have held its point of view, which would be in the interest of the company and its stakeholders, and not necessarily of the promoters; much like when Mindtree's Committee of Independent Directors that decided Larsen & Toubro Limited's offer price was fair for shareholders, despite Mindtree's promoters' initially hostile reaction to the acquisition bid. An expanded board with more independent directors would also provide the necessary checks and balances to the control rights that the promoters have embedded within the company's Articles of Association. Today, IndiGo's board is silent and its ability to protect the company from the promoters' battle is limited.

The issues being raised on related party transactions may not be material in the overall scheme of things – but the impact that this battle will have on the company will endure. The seeds of discord are sown, and these tend to take roots quickly. It will likely distract the management from running the company, polarize the leadership, and make the organization inward-focussed. Stakeholders will be wary giving IndiGo their money just yet – they will want to know who wins this battle before they increase their exposure. So, new aircraft purchases, or engine replacements, and any other material expansion may be delayed. Investors may not be as concerned with the related party transactions as they will be with the potential for delays in value creation.

A modified version of this report was published on www.moneycontrol.com, which can be accessed here: https://www.moneycontrol.com/news/business/companies/are-indigos-security-checks-in-place-4208381.html

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