Fostering Good Governance in Corporate India

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As recent events in corporate India, especially at storied companies like Tata Sons and Infosys Limited, have demonstrated the role of independent directors and institutional investors is increasingly becoming vital to foster good governance in corporate India.

Good corporate governance is required for sustainable value creation by the company and for vibrant capital markets. Independent directors, institutional investors and regulators have a responsibility to foster good corporate governance.

The first line of good governance is a good Board comprised of Independent Directors with an independent mind and who protect the interests of the company above any individual shareholder – controlling or minority. More importantly, pacifist independent directors, who are 'Yes Man' to the controlling shareholders, do not contribute to shareholder value and long term sustainability of companies. Independent directors will increasingly be called upon to:

(i) own up to their decisions, both positive and negative, made in the recent past,

(ii) fulfilling their fiduciary responsibilities by advising shareholders to support or reject the proposals made shareholders, and

(iii) take sides at the time of shareholder disputes

The second line of good governance is institutional investors. In February 2010, the SEBI set the ball in motion by making it mandatory for domestic mutual funds to disclose their voting policies and votes exercised in investee companies. In early 2017, IRDA, the insurance regulator, has instituted guidelines for stewardship by Indian insurance companies. The PFRDA, the pension fund regulator, is also seeking to impose stewardship for the pension funds managed by asset management companies. Thus, there is increasing regulatory push to make asset managers accountable for exercising their fiduciary duties and being responsible investors.

The starting point of being a responsible equity investor is to demand better governance of companies. This responsibility is exercised by:

(i) outlining a detailed voting policy that companies appreciate, and

(ii) then exercising the votes objectively as per the voting policy.

The heft of an institutional investor, and thus the stewardship role, is manifest only if companies, as issuers, take the voting and voting policy of asset owners seriously. The voting policy isn't just meant for the website of the institutional investor, it is meant to be used to engage with companies. To this extent, leading global institutional investors like CALPERS, Norges Bank Investment Management, etc write annual letters and policy statements to their investee companies on what behaviour they expect from companies. For example, on 14th April 2016, Norway's Government Pension Fund Global excluded 52 companies for their universe of companies to invest based on new product-based coal criteria in their guidelines. This list included Indian companies like Tata Power, Coal India, CESC, NTPC, Reliance Power, Reliance Infrastructure, etc.

Currently, in India, no company is aware of or takes the voting policy of any asset owner seriously. Not many proposals have been voted out by shareholders. Mutual funds, on average, have only voted against 1.5% of votes. Institutional investors haven't articulated their collective stand on any front. There is no common platform for them to come together and voice their concerns on any significant development. For example, the infrastructure sector has been moribund due to the inactions of the banks and banking regulators. Another example, is the purported hiding of non-performing assets by banks. Yet, institutional investors don't have any collective stand or demand on these issues from sectors that can absorb a lot of capital. The equity investments made by institutional investors in the infrastructure sector have taken a severe beating.

The recent trend of longer term domestic capital investing in equity markets is a silver lining for Indian capital markets. Mutual Fund SIPs, Insurance Companies and Pension Funds have a longer investment horizons and have a need to preserve capital. Hence, they cannot always vote with their feet by selling their investments, but, must call for better governance of companies and demand more from Boards and the independent directors. They should realise that even large companies, example - the Tata Group companies and Infosys, aren't immune to strife, and large sectors like infrastructure and real estate can quickly become inaccessible due to the wrong-doings of a few companies. Only this will enhance the depth and width of the Indian capital markets.

Institutional investors should be more sophisticated in their engagement with companies by:

(i) engaging with companies beyond the financial results

(ii) use of independent proxy advisory firms for enhancing their capabilities and capacity for prudent voting
(iii) create a common platform for bringing together institutional investors for airing common concerns in corporate India

Since 2010, companies have responded to increasing investor scrutiny and regulatory push by taking up the following actions:

(i) explanations to proposals for shareholder votes are now detailed and informative
(ii) reach out to investors for passing proposals
(iii) engage with proxy advisors to understand investors' concerns
(iv) hire consulting firms to diagnose their existing corporate governance practices and enhance corporate governance edifice
(v) avoid contentious proposals during shareholder votes

However, companies and Boards also need to be proactive and sophisticated in understanding newer dimensions of investor concerns including:

- Compensation
- Board Diversity
- Board Evaluation
- Capital Allocation
- Shareholder Proposals
- Climate Change
- Water Management
- Social Rights

The Companies Act 2013, and the constitution of the National Company Law Tribunals, have further empowered minority shareholders and enhanced their rights. It is a fond wish that institutional investors will increasingly become more activist, and be constructive activists or vocally activist. India sorely needs a class of investors – the activist investors – who will take companies to task for errant behaviour. Some more developments in the capital markets – short selling, borrowing of shares, etc – needs to be made easier. Additionally, speedy disposal of cases by the NCLT will embolden investors to take companies and directors to court. In future, the entire spectrum of activism would likely be observed, where institutional investors undertake one or more of:

(i) engage with companies
(ii) voice opinions and express outrage at management actions
(iii) demand change in directors, management, capitalization, ownership structure, operations
(iv) seek and get Board seats
(v) propose and get shareholder proposals passed
(vi) file court cases against the company, its directors and management
(vii) file class action suit in the NCLT
(viii) takeover company by mobilising other shareholders

As corporate India moves from promoter-owned to widely-held companies and as shareholder disputes increase, and as institutional investors become more sophisticated, corporate governance in India is going to undergo a sea change.