

Changing Standards of Corporate Governance in India: NSE's Role



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In recent times, there are two significant news items in the Indian corporate governance (CG) landscape, that are encouraging. One, India's ranking in the World Bank's "the ease of doing business" report has risen from 130 in 2016 to 100 in 2017—an enormous jump in one year—partly due to improvement in India's performance relating to 'protection of minority

investors', which is one of the core objectives (of corporate governance in India) pursued by SEBI and the stock exchanges. It is heartening that in this respect India's rank has risen to 4th in the world, well ahead of several developed nations. Two, further to the Kotak Committee report on corporate governance, SEBI has decided on a new, improved CG framework, which has already come a long way in the last two decades. The two developments, taken together, signify that improvement in CG standards is a continuous process and there is room for improvement.

Against this backdrop, this article seeks to provide an exchange perspective of corporate governance. NSE recognizes that if there is one single factor that enables markets to remain stable and efficient, it is the public trust in the market, and that high corporate governance standards have a significant role to play in enhancing public trust. In this article, we discuss (a) what role NSE as a stock exchange has played so far in influencing corporate governance standards of its listed companies; (b) the CG challenges facing Indian listed companies and (c) what NSE plans to do going forward.

I. NSE's role as a CG stakeholder

Stock exchanges play a key role in CG given their mandate to monitor listed companies' compliance with listing and disclosure requirements. Recognizing that higher governance standards improve the integrity of the market, NSE has always taken measures to raise the bar on corporate governance.

NSE has also pursued several initiatives to influence policy debates by involving regulators, practitioners and academics in recent years. The establishment of NSE Centre for Excellence in Corporate Governance (CECG), an independent expert advisory body and a research

collaboration with Indira Gandhi Institute of Development Research (IGIDR) are two significant steps in that direction. While the NSE CECG helps NSE in its advocacy role through Quarterly Briefings (short, well researched notes on a topical CG issue), which are disseminated widely among NSE's listed companies and policy authorities, NSE IGIDR research collaboration is perhaps the only major initiative in India that promotes serious research in the area of corporate governance. The objective of this initiative is to provide a platform for industry and academia to complement each other and provide research support for effective policy making; toward this end, annual conferences are held that are attended by academics, practitioners and policy makers. We are convinced that these initiatives have advanced the objectives they have been set out for and will continue to do so in future. In fact, we are continuously exploring opportunities to expand the scope for providing research support for policy making. More recently, we have become an institutional member of the European Corporate Governance Institute, an international non-profit association which provides a forum for debate and dialogue focusing on major corporate governance issues and thereby promoting best practices.

II. CG challenges facing Indian listed companies

Because of persistent efforts by the Government, SEBI and exchanges, the standards of CG have improved and the CG culture has begun to change. Yet, there are major challenges facing CG in India; particularly in the areas of:

- Concentrated ownership
- Related party transactions
- Effectiveness of independent directors, and
- Deficiency in audit function

Concentrated ownership

In India, there is high concentration of ownership of corporates, with the median ownership by promoters of all NSE listed companies at above 50 percent. This pattern of ownership is problematic, because it raises the probability of majority shareholders exploiting the minority shareholders. To address this situation, SEBI prescribed a minimum public shareholding norm (25%) to be attained by listed Indian companies within a stipulated period. More can be done to increase public ownership of listed companies.

Related Party Transactions (RPTs)

Concentration of ownership makes it easier for the promoters to use RPTs as a means for expropriating corporate value at the cost of minority shareholders, because of their large voting powers. It is widely

recognized that regulations historically have had only a limited impact in deterring companies from doing so. Prior to the Companies Act 2013, India's regulatory regime focused primarily on disclosure of RPTs; the Companies Act 2013 created a new regime that required independent approval for many RPTs bringing India on par with global standards. We can do more to ensure promoters have a fiduciary responsibility towards minority shareholders in respect of RPTs.

Effectiveness of Independent Directors

An additional problem resulting from concentrated shareholding relates to the promoters effectively controlling the nomination and election of all directors on the board, including independent directors (IDs). While part of the role of IDs is protection of minority shareholders, it is an irony that the promoter himself, because of his or her high voting power, effectively appoints IDs in many cases. Similarly, if IDs views on crucial matters go against the personal interest of the promoters, their position on the board may become untenable. Although regulations regarding IDs have been strengthened, a lot needs to change to ensure effectiveness of IDs on boards of companies.

Deficiency in Audit Function

It is widely acknowledged that the audit committee and statutory auditors are important to enforce high standards of governance. The audit mechanism needs to be designed to ensure that a company produces relevant,

adequate and credible information that investors as well as independent observers can use to assess company performance. In India, attempts have been made to strengthen this mechanism, but, we are still short of global standards.

III. Moving forward

NSE plans to strengthen its initiatives outlined in Section I, encouraged by the fact that the Companies Act, 2013 as well as the amendments to LODR following the Kotak Committee recommendations, have provided an impetus to improving CG standards. NSE is mindful of the fact that India is still short of adopting best in class CG standards. NSE also recognizes that persistent addition to regulations encourages ticking the box compliance and beyond a certain level, would entail diminishing returns. Emphasis, therefore, is now necessary to create incentives for the corporate sector to adopt better CG practices. Currently, NSE is engaged in creating such an incentive structure, where corporates would sign up for better governance and disclosure norms than those required by law in return for greater visibility, higher liquidity and better quality of investors. The aim is to address the weaknesses in the current system, including the challenges stated in Section II, through an incentive mechanism that does not seek to change the existing laws and regulations. Hopefully, this new approach to governance reforms would be an important milestone in the evolution of CG culture in India.