Corporate Governance in India – The Road Ahead

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We have come a long way in improving Governance Standards in Corporate India. Regulators have played a significant role in enforcing certain minimum standards. The pressure from stakeholders has been no less in importance. Larry Fink, Blackrock CEO, in his 2022 letter to CEO's, encapsulates this in his statement that *"In today's globally Interconnected World, a company must create value and be valued by its full range of stakeholders, in order to deliver long-term value for its shareholders."*

Let me focus on a few trends that I believe are going to shape this space in coming years.

ESG is here to stay

Unlike expectations of some, focus on Environment, Social and Governance Factor is gathering momentum. Investors will increasingly look at company's environmental oversight, reporting and performance. The impact of Covid has highlighted the S of ESG. The Board will be under pressure to oversee risk from a reputational, social and health perspective to ensure the well being of employees, customers and other stakeholders.

In the same letter referred to above, Larry Fink states," Most stakeholders – from shareholders, to employees, to customers, to communities and regulators – now expect companies to play a role in decarbonizing the global economy. Few things will impact capital allocation decisions-and thereby the long-term value of your company – more than how effectively you navigate the global energy transition in the years ahead……*We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients."*

Pushback on unreasonable Promoter compensation

We see several cases of obscenely high compensation being paid to Promoters in Executive capacity. Sometimes more than 10 times what a professional executive will get paid in the same company or a benchmark company. This is rightly receiving serious pushback from Proxy Advisory firms and Institutional Investors. The promoter's votes should not count in the resolution approving their compensation. As executive they must get what a professional executive would get. For their significant holding they are anyway getting huge Capital Gains and Dividends. To get a premium on their compensation as executive is unreasonable and must stop. In the same way the practice of several members of Promoter Family working as executives at steep compensation must be questioned. If the company can get same or better skill sets at a much lower cost from market, why is it good for the company to bear the burden of multiple promoter family members on its payroll?

In Trident in 21-22 Remuneration of Promoter Non-Executive Chairman is Rs. 57.66 Crores while that of Professional Managing Director Rs. 1.92 Cr. In JSW Steel Promoter CMD gets 134.80 Cr. compared to Rs. 6.28 Cr. for Professional JtMD.

ESOPs with deep discounts to market value and skewed allocation

In a listed company with good cash flows, giving ESOPs with significant discount to market value is illogical. It defeats the very purpose of aligning the interest of employees and shareholders in future growth of the company. If the purpose is to give immediate rewards, its best served through a bonus or ex gratia payment. In a start up with limited cash flows, one can still understand the logic of these discounts. Proxy Advisors and Institutional Investors are rightly opposing ESOPs which are not at market value.

Allocation of ESOPs is another issue which will get increasing attention. A few top executives get bulk of the ESOPs and there is lack of fair distribution down the organisational hierarchy, significantly reducing the positive impact that ESOPs can have for the company.

Pandemic has permanently changed modes of stakeholder interaction

Pandemic left no alternative but for boards to meet virtually and so did the shareholders in General Body Meetings. On-line was the only way. Now, when physical meetings are possible, Boards and Company's are seeing many advantages of continuing with the virtual or at least hybrid mode of interaction, with significant implications.

If distance is no longer a hinderance, from both time and cost of travel perspective, the boards can interact more often and become much more diverse, specially across nationality. Many more shareholders participate in proceedings when meetings are virtual than physical. With fewer barriers to attendance, company's will have to enhance substantially their shareholder engagement programmes.

Related Party Transactions to get more attention

Full disclosure and transparency in related party transactions is a cornerstone of Good Governance. Taking open ended approvals – in value or in time – defeats the very purpose of these approvals. Significant issues like process to find the arm's length price and details of Related Party, especially comparison with benchmarks who could have been the counterparty in the transaction, are sometimes covered only sketchily in the memorandum to the Board and / or shareholders. I believe more questions are going to be asked as to why doing transaction with related party is better for the company and its stakeholders, than doing with others.

In its voting guidelines IIAS clarifies that “IIAS expects companies to disclose the ultimate ownership of the related party. In assessing these transactions, IIAS will question the underlying rationale for the transaction. This will include raising questions on the business structure. IIAS will generally not support arrangements where promoter-controlled business is running allied or adjacent businesses that are primarily dependent on the listed company: more so if such structures create business vulnerabilities and keep the listed company dependent upon promoter-controlled entities.”

Further emphasis on Equity, Diversity and Inclusive Culture

Diversity is one of the most significant and pervasive trends in the Developed World. Current focus has been on Gender Diversity, but diversity is much more and has to be across age, ethnicity, skill sets and nationality. The more diverse the board, the more likely that the advice will be well rounded and balanced. We have taken some positive steps towards gender diversity, but much more needs to be done.

Professional Independent Directors with deep expertise in Corporate Governance

A new breed of professional Non-Executive Directors would emerge. Their strength will be a deep understanding of Corporate Governance, diverse Board level experience in a number of companies and a proven track record of improving Governance standards in the companies they worked in. Their command over regulatory framework for Corporate Governance, integrity to oppose decisions they believe are not in the interest of the company, personal financial strength to be not dependent on director’s-fees and ability to manage stakeholder expectations much beyond the minimum standards prescribed by regulations, would make them a key asset for the board and other stakeholders.

Governance of Start-ups coming to Public Market

We will see many unicorns and valuable start-ups getting listed in public markets. The larger-than-life Founder-CEO, who till now managed relationship with a few large private equity investors, will have to manage expectations of much larger set of stakeholders. The degree of disclosures and scrutiny of transactions, specially RPTs will go up manyfold. The Board’ which till the company was private, had a large representation of nominee directors from its investors would have to become much more diverse to manage the company with very different dynamics and expectations.

Governance of Companies with No Clear Controlling Shareholders

Emergence of a large number of big corporates with no promoter or controlling shareholder will present its own challenges. In the absence of a check and balance from promoter, one of the biggest issues would be to make the Management and Boards work for all the stakeholders, and not just enrich themselves at the cost of shareholders. The Institutional Investors and Proxy Advisory firms will have to play an important role here and be prepared to take some tough decisions at times.

We have just started our journey towards Good Corporate Governance. There is a long way to go.