

Proxy firms in India punch much above their weight



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Proxy advisory in India is a 5 year old industry. That right – it's an industry now that there are three players and they are all registered with SEBI. Institutional Investor Advisory Services India Limited (IIAS) was formed in June 2010, followed a few months later by Ingovern (in September 2010) and Shareholder Empowerment Services (June 2012). Unlike international markets where proxy

firms often case proxy statement votes on behalf of institutional investors, the Indian firms provide voting advisory recommendations. This is a fundamental difference between the clout that international agencies hold in markets, vis-à-vis a more influencing role played by Indian proxy firms.

Proxy firms in India have had some visible success, but the important changes have been more subtle: proxy firms have changed the way companies and investors interact with each other.

The visible successes are well-documented (- as well as these can be for a business that is just five years old. Crompton Greaves changed its restructuring proposal as it faced immediate criticism from the proxy firms when it first announced its plans. Shareholders succeeded in defeating United Spirits' related party transactions – several of these transactions favoured Dr. Vijay Mallya at the expense of minority shareholders. Maruti was taken aback with the reaction to its announcement on the Gujarat plant: following a spate of explanations, road shows and changes to the terms of the contract with Suzuki, it is yet to bring the transactions to shareholders for a vote. IIAS worked with institutional shareholders in Akzo Nobel to compel the company to give something back to minority shareholders, when upon merging with the unlisted fellow subsidiaries, the parent's stake increased and other shareholders got diluted.

The lasting impact, however, has been in the more subtle changes. Their very existence has made companies think. Shareholder resolutions, that were more often ignored, are now sliced and diced by the proxy advisory firms. There is a discerning voice that questions – and which can be hard to ignore for long. That investors are listening to proxy firms prompts companies to think harder. Resolutions, which were being mechanically

brought to shareholders for a vote, are now being discussed and carefully worded. Within companies, secretarial teams are now consulting with their investor relations teams before putting out resolutions, which a sharp shift in how the power of the investor is being perceived.

The new shareholder is also far more empowered, which is reflected in several resolutions being actually defeated. Independent of whether one agrees with the investors' decision, defeats in resolutions brought by well-known companies like Tata Motors, Siemens and United Spirits Limited have not only cautioned companies of all sizes, but also excited the investor. For the most part, resolutions do not get defeated – but for those that do, and for those that proxy firms recommend voting against, a media mention causes enough embarrassment for companies. And so, for now, companies have become mindful of how investors think, and their investor lobbies have begun a renewed effort in engaging with investors.

While proxy firms have been instrumental in changing the discourse of corporate governance in India, they have been aided by a climate change of a different kind. Regulations have become investor focused, especially changes made by the two main governing bodies for Indian Companies – SEBI, and the Ministry of Corporate Affairs (MCA).

When it revised the Companies Act (from the 1956 to the 2013 Act), the MCA included several provisions that strengthened the governance oversight within companies. The Companies Act 2013 set some ground rules for the board: it defined a board composition that balanced the promoters with independent directors. It created greater accountability and responsibilities for directors as well as auditors. It provided for a majority of minority vote in related party transactions and has courageously included the possibility of class-action suits (although sections related to class-action suits are yet to be notified). These requirements resulted in companies having to undergo some fundamental structural changes. What also required companies to improve their internal standards was the greater disclosure requirements enforced by the Companies Act 2013. Companies are now required to disclose granular details regarding background of board members, board remuneration, and the nature and quantum of related party transactions. Several of these requirements, and some in more stringent form, were brought in by SEBI through amendments to Clause 49 of its Listing Agreement. While there has been some pushback for SEBI to remove the additional stringency of requirements with regard to listed companies, SEBI seems to be holding firm and standing up for the cause of investor protection.

Beyond the adoption of the new provisions of Companies Act 2013, SEBI has also played an active role in strengthening the corporate governance environment. SEBI has mandated e-voting for all resolutions – thereby changing the way votes are counted (from the show of hands to being weighed by the number of votes held). SEBI also requires mutual funds to vote on shareholder resolutions as a function of their fiduciary responsibility, and disclose on their website how they have cast their votes along with a quick rationale for their decision. Propelling a large set of institutional investors to vote based on their weight of holding has added to companies' caution.

Voting advisory firms are becoming critical for the market micro-system and have become the voice of the minority investor. Unlike in the west, where company management is usually divorced from its ownership, over 70% of the BSE500 companies are owner managed. Consequently any engagement is seen as between two sets of shareholders - with shared interests. In instances where investors have disagreed with management strategy or have concerns regarding governance, they have preferred to exit companies rather than stay invested. This is because a shareholder holding say 1% of the equity is unlikely to meet success when taking on the controlling shareholder with say 45% holding. The opinions – often in public domain, of the voting advisory firms allow the investors to group together, to collectively raise issues with company owners and managements.

Finally, the firms are engaged in advocacy. Commenting on market trends and writing on regulations themselves, proxy firms and their research have become an important source for regulators, who often turn to these firms to better understand market actions and the impact regulations have on corporate behavior. And to a large extent both regulators and proxy firms have a similar agenda: to ensure corporates embrace good governance practices. Interestingly, while acknowledging the role of proxy advisory firms, the Securities and Exchange Board of India decided to regulate them, and as a first step has registered them as research entities.

There can be no doubt that the voting advisory firms have met with some success to ensure that governance remains on the agenda not just of regulator, but also of investors and corporates. But there is a long distance to traverse. While a large number of foreign investors vote as do mutual funds, two categories of institutional investors in India have yet to do so: insurance companies (- though Life Insurance Corporation remains active) and the pension funds. We are still seeing limited participation from retail investors although eVoting is a boon for them - unlike institutional investors most will neither have the time nor the money to attend shareholder meetings and vote. Quantity of votes aside, given that companies and investors have just started to engage on governance issues, their quality of the engagement is also just evolving.

Suffice to say, the journey has just begun.
