Corporate Governance in India – Evolved and Evolving

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Like in most emerging economies, accountability has been one of the biggest concerns with the Indian capital markets. When a company mobilises funds from the public, you would expect them to be answerable to the shareholders. But corporate governance in India has been a bit of hit & a miss. While it has made considerable progress but it is a far way to go. Before 2010, shareholder activism has not been much especially by mutual fund companies (who sometimes hold a sizeable stake in companies), who did not bother to vote on important matters. In 2009, a huge corporate scandal in a software services firm 'Satyam Computers Ltd', was a wake-up call to SEBI to put in certain policies & procedures in place. This led to the birth of Indian proxy advisory industry as SEBI came out with a regulation in July 2010 on "mutual funds" shareholding voting policy. This regulation demanded more transparency in the voting and disclosure of the norms to be followed to determine the voting rights of the shareholders. I call this a CIBIL moment for Equity shareholders. Just how lending became extremely smooth & scalable post introduction of credit score and many credit rating agencies giving credit score to borrowers, the propensity to be responsible borrower increased drastically. Today, credit has become far bigger than it was 2 decades ago with far lesser risk, on account of use of technology and more availability of data. This has paved the way for development of credit market which in turn has contributed significantly towards the stability of the banking system and growth of the economy.

Introduction of proxy firms is also in the same direction. Proxy firms over the last decade or so have been putting infrastructure and framework for making sure corporate governance is respected and minority shareholders are protected.

The importance of corporate governance cannot be overstated, as it plays a crucial role, in ensuring the long-term growth, ethical conduct & success of an enterprise. It encompasses the relationships between a company's management, board of directors, shareholders, & other stakeholders. Protection of stakeholders, enhancing transparency & accountability, improving access to capital, long term sustainability, attracting & retaining talent, reputation & brand value are few reasons why corporate governance is significant.

Also on the other hand, at the country level, improved corporate governance contributes significantly to overall development of robust capital market ensuring more capital flows to the economy, reducing risk premium and many more. There is no doubt that India has made significant progress on this front and hence have received confidence of investors ahead of many markets. Indian systems are falling in place and most corporates are beginning to realise value of corporate governance in over value creation.

In recent times, the influence of proxy advisory firms has grown in the corporate governance landscape in India. This is not new as it has been there in the western countries for long. They offer recommendations to shareholders on matters such as executive compensation, board composition & various other corporate resolutions. Proxy firms are independent organisations that provide research, analysis & recommendations to institutional investors, asset managers, & shareholders. The end goal is for shareholders to make informed decisions by evaluating proxy statements, voting guidelines & corporate policies. They play an important role in shaping corporate governance practices & fostering shareholder activism.

The objective of these firms is to help bridge the information gap between investors & companies, thus promoting transparency & accountability.

Few instances where proxy firms have exerted their power:

Large Indian conglomerate (2016):
One of India's largest conglomerates witnessed a high-profile leadership change when its chairman was ousted. Proxy advisory firms weighed in on the matter by advising institutional investors on how to vote in the extraordinary general meeting called to decide the chairman's removal. This event highlighted the growing influence of proxy firms in shaping corporate governance decisions in Indian companies.

Healthcare company (2018):
A leading healthcare provider in India, was involved in a series of controversies related to its corporate governance practices and financial irregularities. Two large investors had called for an EGM demanding for greater independence at the board level to support an objective sale of the company. Proxy advisory firms played a critical role in influencing shareholder voting on key resolutions, including the removal of certain directors and the appointment of new board members.

Large private sector bank (2020):
One of India's prominent private sector banks, faced significant financial challenges in 2019-2020, leading to regulatory intervention and management changes. Proxy advisory firms were active in recommending voting strategies for shareholders during the bank's restructuring and capital infusion process.

Large 2-wheeler company (2021):
A special resolution was rejected by the shareholders on the re-appointment of MD & increased salary package.

Shareholders questioned the company's rationale of increasing salary by 10% in FY21, even as the median employee salary had increased by only 1%. The proposal came amid the Covid-19 pandemic when revenues were low and profit margins had taken a hit.

Overall corporate governance has evolved over the years in India and as our economy grows and companies grow this will further evolve as more and more companies realise the benefits and importance, few of them stated below:

- *Enhancing Shareholder Activism*
  By providing shareholders with objective analysis and voting recommendations, proxy advisory firms empower investors to exercise their voting rights effectively. In India, where minority shareholders often face challenges in influencing corporate decisions, proxy advisory firms help level the playing field, giving all shareholders a voice.

- *Improved Corporate Governance Practices*
  Proxy advisory firms have been instrumental in improving corporate governance practices in India. Their research and recommendations influence various aspects of governance, such as board composition, executive compensation, related-party transactions, and appointment of auditors. Through their analysis, proxy advisory firms shed light on potential governance concerns and advocate for best practices, ultimately pushing companies towards greater transparency and accountability.

- *Ensuring Independent Boards and Audit Committees*
  They scrutinize board composition and highlight potential conflicts of interest to ensure a robust and diverse board structure. By challenging the status quo, proxy advisory firms encourage companies to enhance their governance frameworks and appoint directors with relevant expertise, thus minimizing the risk of undue influence and improving overall board effectiveness.

- *Influence on Executive Compensation*
  Executive compensation has been a subject of scrutiny in India, with concerns about excessive pay and lack of performance-based incentives. Proxy advisory firms assess compensation practices and provide recommendations on aligning executive remuneration with company performance. Their influence has resulted in increased disclosure and better linkages between pay and performance, promoting a culture of accountability and responsible compensation practices.

As a decadal trend I see concept of promoters getting diluted and many companies will be without promoters. Like recent examples of a leading consumer durable company where there is no dominant shareholder except, public markets. Management and owners are clearly distinguished. All these instances will call for more stress on governance and role of proxy firms. As markets develop, I see a key role for proxy firms for equities as credit score companies played in credit. India continues to remain one of the most promising markets globally and it has taken lead in development of capital markets ahead of many developed markets with bold regulations and use of technology. I see it taking lead in the matter of corporate governance also.