Indian Corporate Governance: A five-year progress report

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Each year for eight years now, we at Institutional Investor Advisory Services, have been scoring the BSE100 companies on their governance. We published the 'scores' based on data for FY23 earlier this month. Using this data, it is time to look back at corporate India's governance practices over 5-years.

First, is it possible to measure something as fuzzy as governance? The scorecard approach attempts to do just this, by first breaking down the various elements and then assigning it a score. For example, while looking at a firm's dividend distribution policy, you first look at whether the company has a policy or not. If so, you look at elements of the policy, for instance, disclosure of a dividend payout ratio or a range. And finally, you look at evidence of adherence to policy or explanations for non-compliance.

As these elements span across parameters like transparency, board composition, risk management etc., assigning a number can be challenging as there is an element of subjectivity involved. Using well established frameworks, helps minimize such subjectivity, but does not eliminate it altogether.

We use the G20-OECD Corporate Governance Principles and scored the BSE100 companies focussing on four of the six pillars. These are 1. Rights and equitable treatment of shareholders 2. Role of stakeholders 3. Disclosures and transparency and 4. Responsibilities of the board. The remaining two pillars Ensuring the basis of an effective corporate governance framework and developments relating to institutional investors, stock markets, and other intermediaries, are not in the company's control, so are not relevant to this analysis.

This scorecard was developed jointly with IFC and BSE. There was one revision to our methodology in 2022 and following the update to the G20-OECD Corporate Governance Principles in 2023, is due for another refresh.

The key findings are summarized below:

- **The overall scores have been moving up:** The highest, and median and lowest scores have all moved up incrementally. The incremental improvement heeds the adage that 'governance is a journey, not a destination.

Table 1: **Scores of the BSE100 Companies**

	2019	2020	2021	2022	2023
Highest	79	80	80	82	84
Median	58	61	62	61	63
Lowest	44	39	38	43	49

- **Overall Improvement:** The number of companies scoring well on the Indian Corporate Governance Scorecard ('Leadership' and 'Good', the top two buckets) has increased significantly (from 45 in 2019 to 64 in 2023), despite tighter marking criteria.
- **Transparency & Disclosure:** Disclosure standards have become more stringent, leading to greater transparency. This includes publishing sustainability reports, making policies accessible, and improving communication with stakeholders.
- **Investor Engagement:** Board meeting and AGM attendance by board members has improved as there is increased engagement between companies and investors.
- **Regulation & Enforcement:** Regulators like SEBI have played a crucial role in driving better governance through stricter disclosure requirements and enforcement measures.
- **Family-Owned Businesses:** The dominance of family in businesses can hinder true board independence and accountability. Having said so, family-owned businesses overall for the first time scored higher than MNC's and institutionally owned firms, with PSUs anchoring the scores.
- **Board Effectiveness:** The category of "Responsibilities of the Board" has shown the least improvement, with boards often remaining passive on governance issues.
- **Executive Remuneration:** Alignment of executive pay with company performance seems to be declining.
- **Investor Activism:** Investor activism remains limited, with most cases arising when promoters lose control.

As is to be expected progress is not unidirectional. Even as there has been improvement, there are areas where companies can do better.

Progress across select parameters is shown in Table 2.

Table 2: Progress across select parameters

	2019	2023
Companies with more than 50% board independence (with a tenure of less than 10 years)	25	30
Boards that have separated the roles of Chairperson and CEO	57	68
Companies with at least one Independent Woman Director	97	97
Board with a diversified and comprehensive set of skills	41	62
Companies where all board members have attended at least 75% of the board meetings held over the immediate past three years	60	90
Companies where all board members attended the previous AGM	13	64
Companies where executive pay was in line with revenues and profits over three years	48	38
Companies where CEO's variable pay was at least 50% of overall pay and less than 5% of profits	55	59
Companies that have a publicly disclosed conflict of interest policy for employees	49	69
Related party transaction policies that prohibit interested directors from participating in discussion and voting	44	56
Companies with whistle-blower policies that extend to all stakeholders, including employees, customers, and suppliers	34	43
Companies that are spending at least 2% of profits on CSR	75	74
Companies that are impact assessments of their CSR spends	32	54

Although there are challenges particularly regarding board effectiveness, executive compensation, and the role of independent directors in family-owned businesses, the overall governance of Indian listed corporates has improved. This is due to a combination of factors, including stricter regulations, increased investor attention to disclosures, and a growing recognition of the link between good governance and market performance.

The biggest change, no doubt, is that governance is now central to a board's conversations and firmly on its agenda. This alone will ensure continuous progress.

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