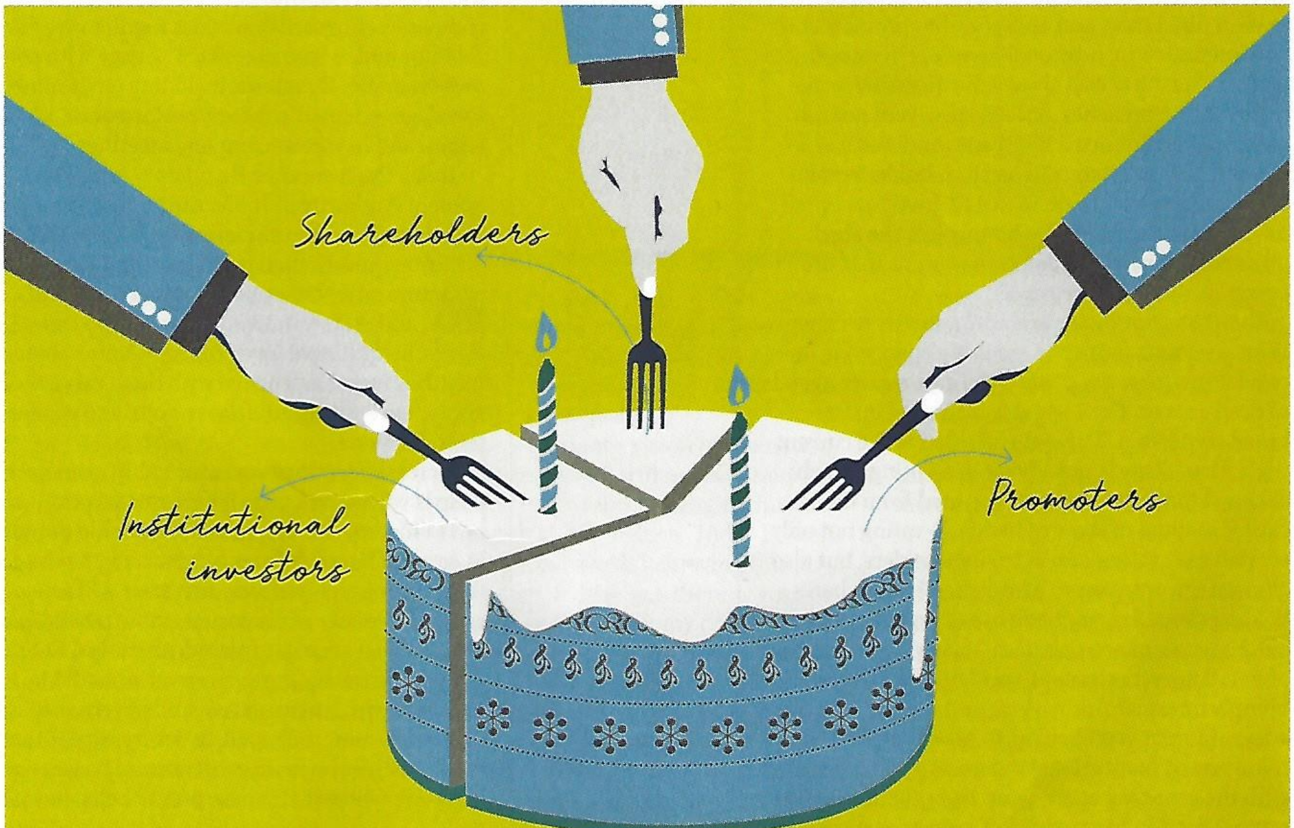
CORPORATE GOVERNANCE: INVESTORS GATHER HEFT

Institutional investors would generally abstain from voting on issues that could upset promoters, who would then force their way through at board meetings. With institutions now owning close to 35% of the market and promoter holding down to 54%, the power equation has changed. **By Amit Tandon**

THE ROLE OF INSTITUTIONAL investors in Indian corporate governance is evolving. Starting from being providers of capital, their role has extended. Today, as shareholders, they realise that they are more than purveyors of capital and that they, in turn, have a fiduciary responsibility to their investors to engage with their portfolio companies. Taking on this responsibility has helped outside shareholders declare, when needed, their displeasure with promoter control and management-proposed resolutions from which minority investors do not stand to gain. In India, this dynamic must continue to grow and evolve to create an appropriate balance in the corporate governance hierarchy.

In American and British companies, management and ownership generally tend to be separated. As a result, the dialogue between a company's shareholders and its management is through its board. The board is expected to hire the 'right' CEO and senior management, fire the wrong leader, ensure compensation is fair, and provide strategic direction to the company.



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In India, this dialogue is expected to take place between two sets of shareholders. Both promoters and outside stakeholders are owners looking for ways to make their business flourish. But their interests often pull them in different directions, mostly when dealing with related-party transactions—essentially, when the company transacts with the promoter group or companies controlled by promoters. Historically, this has been a cause of significant investor concern because of the risk of financial leakage involved in such deals. The other concern is simply differential treatment of one set of shareholders—for example, promoters hold majority equity and vote on their remuneration, which is seldom aligned with company performance. Controlling shareholders would often use their equity to force through certain decisions, sometimes ignoring the minority shareholders' voice.

Institutional investors, for their part, by abstaining from voting, allowed promoters to force their way through. There were several rationalisations for their apathy: Promoters are critical to the business and have controlling interest. Further, given the relative shareholding, voting will not make a difference, and antagonising promoters is detrimental to institutional investors' management access. The other was always the quantum argument—if the breaches, or leakages, were not too large, one could turn a blind eye. And one had to travel to the AGM to vote on shareholder resolutions (till e-voting came in 2014). Investors opted for the Wall Street Walk—simply exit the stock if the company undertook transactions that the investors did not approve of.

But that situation has recently started to change. What accounts for this? One is the change in regulations, that has pushed the governance agenda to centre stage. The second is increased institutional ownership. Three themes define the current regulations. One is the advent of e-voting, which changed the way votes were counted from the earlier method of show of hands. E-voting not only created easy voting access to shareholders, but also allowed the outcome to be weighed by the shareholding. Two, the emphatic use of regulation to enforce governance practices—using a combination of mandatory disclosures, regulatory diktats, and 'comply or explain' provisions and thereby empowering different stakeholders to assert their rights.

Increased institutional ownership coincided with the economy opening up from the 1990s. The mutual fund industry took off, private insurance companies entered the fray, and foreign institutional investors (FIIs) started investing, taking institutional holding from low double-digits to 24% by 2009. This was also the time when 'promoters' steadily increased their shareholding in companies. Promoter holdings in NSE-listed companies peaked at just over 64% in 2009. Since then, FIIs have continued to pour money into the market, mutual funds have spread, pension funds are now permitted to invest in equities, and there is a small but growing set of alternative investment funds (AIFs). Institutions now own close to 35% of the market. And promoter holding is down to 54%.

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This increased ownership itself has some consequences, one of which is that from holding three shares for each one held by institutional investors, the controlling shareholder now owns 1.5 shares. The power equation has altered. This increased institutional holding has coincided with one other regulatory development, namely the roll-out of stewardship codes by institutional investors. These are guidelines aimed primarily at institutional investors, who hold shares, and thus, voting rights in companies, to remind them that it is part of their fiduciary duty to behave as good owners of companies. Stewardship codes require investors to monitor and, where necessary, engage with companies on material matters, including environmental, social, governance, strategy, performance, and risk issues, and to vote at company meetings.

Today the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory and Development Authority, and the Securities and Exchange Board of India have asked insurance companies, pension funds, mutual funds, and AIFs to adopt a stewardship code. They expect institutional investors to monitor companies they invest in, engage with them on critical issues, have voting guidelines, vote, and disclose their decisions.

Increased institutional ownership also means boards will come under far greater scrutiny, with board members being held accountable not just in cases of board failures but for how they and their companies perform. Investors will soon drive appropriateness of disclosures, how related-party transactions are to be treated, aligning CEO salary with performance, how companies should approach environment, social, and governance issues and much more. All in all, in future expect that it will not just be managements and boards, but investors who will drive corporate behaviour. ■

Views are personal.