Corporate Governance in India
Three Drivers Of Change

ICGN, San Francisco
June 2016
### Did you know?

<table>
<thead>
<tr>
<th>22</th>
<th>% of investors in Infosys voted AGAINST the resolution on Employee Stock Option Scheme 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>61</td>
<td>% of institutional investors in Mindtree voted AGAINST the appointment and terms of remuneration of the Executive Chairman</td>
</tr>
<tr>
<td>Defeated</td>
<td>Shareholders of McLeod Russel India disapproved payment of minimum remuneration to the Managing Director</td>
</tr>
<tr>
<td>Defeated</td>
<td>Shareholders of Multi Commodity Exchange of India disapproved the amendments to the employee stock option plan 2008</td>
</tr>
<tr>
<td>Defeated</td>
<td>Shareholders of Siemens (India) disapproved slump sale of metal technologies business to its parent, Siemens AG. Siemens (India) increased the price before seeking a re-vote.</td>
</tr>
</tbody>
</table>
What has changed in Indian markets?

- Change in Indian regulations
- Increased institutional ownership of Indian companies
- Role of proxy firms (like IiAS) and the media in increasing the debate on corporate governance
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**Laws, Regulators, and Administrators in India**

<table>
<thead>
<tr>
<th>Laws</th>
<th>Administrators</th>
<th>Auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies Act 2013</td>
<td>Company Secretaries</td>
<td>Auditors</td>
</tr>
<tr>
<td>Banking Regulation Act 1949</td>
<td>Regulator: Ministry of Corporate Affairs (MCA)</td>
<td>Audit financial statements, report on the integrity of related party transactions</td>
</tr>
<tr>
<td>SEBI LODR 2015</td>
<td>Regulator: Reserve Bank of India</td>
<td></td>
</tr>
<tr>
<td>Corporate Governance Voluntary Guidelines, 2009</td>
<td>Regulator: Securities and Exchange Board of India (SEBI)</td>
<td></td>
</tr>
<tr>
<td>Company Secretaries</td>
<td>Regulator: Ministry of Corporate Affairs (MCA)</td>
<td></td>
</tr>
<tr>
<td>Auditors</td>
<td>Oversight: Institute of Company Secretaries of India</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Oversight: Institute of Chartered Accountants of India (ICAI)</td>
<td></td>
</tr>
</tbody>
</table>

**Regulators and Oversight Bodies**

- Applicable to listed and unlisted companies
- Applicable to all Scheduled Commercial Banks
- Applicable only to listed companies and banks
- Voluntary compliance; Applicable to all companies
- Responsible for ensuring regulatory compliance
- Audit financial statements, report on the integrity of related party transactions

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Changing regulatory landscape: alignment with OECD

**OECD principle**

**Ensuring the basis for an effective corporate governance framework**
- Mix of mandatory and non-mandatory provisions
- Autonomy to regulators
- Penal action for non-compliance
- More stringent norms for listed companies
- Delegation of compliance monitoring to Stock Exchanges

**Rights and equitable treatment of shareholders and key ownership functions**
- Right to approve amendment to charter documents
- Right to propose a resolution
- Right to call a general meeting
- Right to elect the board
- Right to file class action suit
- One vote per share (except DVR)
- Mandatory arms-length transfer pricing

**Institutional investors, stock markets and other intermediaries**
- Disclosures on voting policy
- Disclosures on voting patterns
- Prohibition of insider trading
- Proxy advisors and other advisors required to be registered with market regulator

**Role of stakeholders in corporate governance**
- Mandatory CSR contribution
- Mandatory Investor Grievance Committee
- Preparation of sustainability report
- Detailed Whistle-blower policy
- Mandatory Sexual Harassment Policy
- Woman director on board
- Auditor rotation

**Disclosure and transparency**
- Disclosures on
  - Ownership structure
  - Accounts and financial metrics
  - Key risks
  - Related party transactions
  - Board demographics
  - Remuneration
  - Analyst meetings
  - Board evaluation

**Responsibilities of the board**
- Training for directors
- Min. no. of independent directors
- Appointment of lead independent director
- Separate meeting of independent directors
- Policies on tenure, age and maximum no of directorships
- Quorum requirement for board meetings and decisions
# Stakeholder empowerment through regulation

<table>
<thead>
<tr>
<th>Area of regulation</th>
<th>What the regulations requires</th>
<th>Impact</th>
</tr>
</thead>
</table>
| E-voting           | All companies mandatorily need to allow e-voting | 1. Voting count changed towards one share one vote, against the earlier process of voting by show of hands.  
2. Improved accessibility for shareholders |
| Related Party Transactions (RPT) | RPTs above a certain threshold require shareholder approval, where related parties cannot vote | Increases the voting power of minority shareholders, which has also led to the defeat of a few resolutions. |
| Whistle Blower Policy | Mandatory for all companies | Improves the ability of stakeholders to address concerns |
| Class Action Suits | Minority shareholders can take collective action to protect their rights | Soon to be implement; shows the direction of regulation in empowering stakeholders |
# Disclosure as an enforcement tool

<table>
<thead>
<tr>
<th>Area</th>
<th>Disclosure requirement</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voting by mutual funds</td>
<td>Quarterly disclosure of how domestic mutual funds have voted and the rationale for their votes</td>
<td>Increased mutual fund participation in voting on shareholder resolutions.</td>
</tr>
<tr>
<td>Voting by pension funds</td>
<td>The pension fund regulator has asked the pension fund managers to decide and consistently vote on shareholder resolutions</td>
<td>Likely that the insurance regulator will also compel insurance companies to vote</td>
</tr>
<tr>
<td>Board evaluation</td>
<td>Evaluation process and criteria to be disclosed</td>
<td>Increased accountability of the board</td>
</tr>
<tr>
<td>CEO remuneration</td>
<td>Granular disclosures, including ESOPs granted</td>
<td>Increases the comparability of CEO remuneration and also compels boards to be more considered in their decisions</td>
</tr>
</tbody>
</table>
# India leads global norms in some aspects

<table>
<thead>
<tr>
<th>Requirements of Indian regulations</th>
<th>USA</th>
<th>UK</th>
<th>SG</th>
<th>AUS</th>
</tr>
</thead>
</table>
| **CSR**
  Indian companies need to spend at least 2% of 3-year average profits on CSR activities | ✗   | ✗  | ✗  | ✗   |
| **RPT**
  Majority of minority shareholder approval required for material transactions and those not at arms length or in the ordinary course of business | ✗   | ✗  | ✓  | ✓   |
| **Board Evaluation Criteria**
  Board evaluation process and evaluation criteria for Independent Directors need to be published in the annual report | ✗   | ✗  | ✓  | ✓   |
| **Auditor Rotation**
  Audit firms must be rotated every ten years. Regulations prohibit payment of any form of non-audit fees to the statutory auditor. | ✗   | ✓  | ✓  | ✓   |
| **Woman Director**
  Corporate boards must have at least one woman director | ✗   | ✗  | ✗  | ✗   |
| **Investor meeting**
  Schedule of one-on-one meetings to be filed with the stock exchanges | ✗   | ✗  | ✗  | ✗   |

1. UK auditor rotation is effective from June 2016
What has changed in Indian markets?

- Change in Indian regulations
- Increased institutional ownership of Indian companies
- Role of proxy firms (like IiAS) and the media in increasing the debate on corporate governance
Institutional ownership at ‘active engagement’ threshold

Ownership patterns

Promoter Holding

DII + FII Holding

An equal relationship

Shareholders have become more proactive in seeking redressal of their issues: supported by regulations
Siemens in India: Investors’ voice is getting louder

• Siemens wanted to sell its Metal Technologies (MT) business to a subsidiary of the promoter company, Siemens AG, Germany

• Resolution in August 2014 was defeated by shareholders with 49% institutional shareholders voting AGAINST the resolution – consideration of Rs.8.57 bn was lower than acquisition price of the business

• Siemens was compelled to increase the sale price to Rs.10.23 bn (equivalent to acquisition price) and put out a more detailed information on the business' performance for shareholders. The resolution was finally approved in December 2014

• Siemens radically changed the quality of its disclosures: it became far more transparent (first to disclose a complete valuation report in a subsequent transaction) and began a purposeful engagement with investors.
Suzuki in India: Investors unite to drive change

Maruti Suzuki (India) Ltd. (Maruti)

- In Jan 2014, Maruti announces a change in its strategy towards the proposed new plant in Gujarat – it would be owned and operated by a 100% subsidiary of Suzuki Motor Corp, the parent company, and not Maruti.
- Maruti will purchase the cars manufactured by Suzuki (at Gujarat) at cost and will sell them under Maruti’s product portfolio for an initial period of 15 years.

Maruti announces the Gujarat deal; seven mutual funds and some insurance companies voice displeasure over the transaction.

1 Jan/Feb 2014

Maruti says shareholder approval not required as new related party regulations yet to be notified; investors opine that Maruti may have timed announcement.

3 7 Feb 2014

Maruti Chairman says deal is win-win for stakeholders; IiAS of the view that parent has short-changed Maruti shareholders.

4 4 Feb 2014

After pushback, Maruti says it will seek shareholder approval.

5 Mar 2014

Mutual funds approach market regulator SEBI to voice concerns; Maruti says plant to be funded by Suzuki’s equity.
Suzuki in India: Investors unite to drive change

RPT regulations modified to allow >50% of minority votes; instead of >75% of minority votes; Maruti management conducts roadshow to convince shareholders

Maruti brings out notice for approval of Contract Manufacturing Agreement and Lease deed for Gujarat plant, they now require only >50% of minority votes

Resolution is passed as most FIIs vote ‘FOR’, however 18 out of total 33 mutual funds vote ‘AGAINST’

LiIAS points out how royalty payments by Maruti to Suzuki have increased from 2% to 6% of net sales over 15 years

Maruti says upto Rs. 15 bn to be spent over next five years on land-acquisition for dealerships and affiliated facilities, Investors contend that it is unlikely to spend amount over 1-2 years; will generate incremental cash flows to be able to fund expansion.

Suzuki to raise debt of ~$1.8 bn to fund Gujarat plant; U-turn from earlier stated position that Suzuki would use excess cash for plant

Implications for India

- Manufacturing companies in emerging countries are turning into marketing extensions of their global parents
- Cummins India and SKF India are recent examples of the trend
Features of Proposed Scheme

- Ambuja Cements Limited and ACC Limited were Holcim’s two Indian subsidiaries.
- Ambuja Cements Limited to acquire 24% of Holcim’s stake in Holcim India for Rs. 35 bn
- Holcim India to merge with Ambuja; Ambuja to issue 584 mn shares to Holcim India
- Holcim’s shareholding in Ambuja to increase to 61.9% from 50.5%
Promises

Operational synergies of approximately Rs.9 bn per annum (US$ 150 mn)

Over 10 MTPA of aggregate capacity will be added in Ambuja and ACC; commitment to invest for the 4.5 MTPA plant in Marwar Mundwa in North-Central India

Shareholders should expect an uptick in dividend

Actual Performance

Rs. 9 bn of synergies still on paper, margins are flat

Peers Ultratech and Shree Cements have both added more capacity than Ambuja and ACC combined (~2.1 MTPA)

Dividend payout ratio for CY15 has only increased by 14.5% over CY13

Ambuja stock has underperformed peers after announcement
Diageo in India: Drunken stupor?

### Diageo Plc and United Spirits Ltd

- Over 2012 – 2014, Diageo Plc acquires 54.8% in United Spirits Ltd (USL) to become largest shareholder
- The transaction is carried out even as market is awash with rumours of USL extending loans to other companies held by erstwhile management; amongst other improprieties

### Diageo Plc chooses to look the other way

- USL’s FY2014 accounts were delayed three times as audit committee sought clarifications
- PA Murali, USL’s CFO and Joint President until 2013; was rewarded with a Rs 50mn bonus in FY2015 as Executive Director

- Vijay Mallya, erstwhile promoter of USL, accused of financial improprieties and named as ‘wilful defaulter’
- Diageo allowed Vijay Mallya’s re-election to board of USL in FY2015; Vijay Mallya cites ‘contractual agreement’ with Diageo

- Vijay Mallya announces he will step down as Chairman on the boards of USL and other group companies
- Diageo to pay $ 75mn to Dr. Mallya over five years towards the exit
Akzo Nobel: Different shades for Indian markets

Akzo Nobel India Ltd.

- Akzo Nobel India planned to merge three promoter controlled unlisted companies with itself
- Promoter group shareholding would go up from ~56.4% to ~67%
- Royalty payments from Akzo Nobel India to parent were also being increased from 1% to 3% of net sales

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct 2011</td>
<td>Akzo Nobel India announces the proposal for merger; also announces increases in royalty payments to parent</td>
</tr>
<tr>
<td>Jan/Feb 2012</td>
<td>Investors approach Independent Directors of Akzo Nobel India; IiAS writes a letter to CEO of Akzo Nobel NV, the parent, expressing concerns</td>
</tr>
<tr>
<td>Feb 2012</td>
<td>Proposal passes through narrowly, with 76.85% shareholders voting in favour (&gt;75% votes required)</td>
</tr>
<tr>
<td>Jan 2012</td>
<td>IiAS and other mutual funds believe that valuations for the unlisted companies are high</td>
</tr>
<tr>
<td>Feb 2012</td>
<td>Akzo Nobel India agrees to revisit royalty proposal; also agrees to a share buyback from minority shareholders to provide exit option</td>
</tr>
</tbody>
</table>
Resolutions are getting defeated

Higher MF participation

![Bar chart showing increasing participation in resolutions from 69% in 2014 to 81% in 2015.]

Resolutions defeated

<table>
<thead>
<tr>
<th>Resolution category</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Related party transactions</td>
<td>14</td>
</tr>
<tr>
<td>Director appointments</td>
<td>8</td>
</tr>
<tr>
<td>Remuneration and compensation</td>
<td>4</td>
</tr>
<tr>
<td>Borrowing</td>
<td>3</td>
</tr>
<tr>
<td>Alterations to Charter Documents</td>
<td>2</td>
</tr>
<tr>
<td>Inter-Corporate Transactions</td>
<td>1</td>
</tr>
<tr>
<td>Dividends</td>
<td>1</td>
</tr>
<tr>
<td>ESOPs</td>
<td>1</td>
</tr>
<tr>
<td>Mergers, acquisitions, and amalgamations</td>
<td>1</td>
</tr>
<tr>
<td><strong>Grand total</strong></td>
<td><strong>35</strong></td>
</tr>
</tbody>
</table>

Data for resolutions presented by companies under IiAS coverage

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of resolutions</td>
<td>2,738</td>
<td>1,999</td>
</tr>
<tr>
<td>No of votes cast</td>
<td>37,351</td>
<td>30,008</td>
</tr>
</tbody>
</table>
## Higher intensity of the institutional investor’s vote

### Promoters’ votes helped pass these resolutions

<table>
<thead>
<tr>
<th>Company</th>
<th>Resolution</th>
<th>% Institutional Votes FOR</th>
<th>% Institutional Votes AGAINST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edelweiss Financial Services</td>
<td>ESOP Plan 2009: Extend the exercise period to June 2030</td>
<td>41</td>
<td>59</td>
</tr>
<tr>
<td></td>
<td>ESOP Plan 2010: Extend the exercise period to June 2030</td>
<td>41</td>
<td>59</td>
</tr>
<tr>
<td></td>
<td>ESOP Plan 2011: Extend the exercise period to June 2030</td>
<td>41</td>
<td>59</td>
</tr>
<tr>
<td>Financial Technologies</td>
<td>ESOP Scheme 2009: Reprice options at a 25% discount to market price</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>ESOP Scheme 2010: Reprice options at a 25% discount to market price</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>Bharti Infratel</td>
<td>Revise definition of exercise period from ‘7 years from grant date’ to ‘7 years from vesting date’</td>
<td>41</td>
<td>59</td>
</tr>
</tbody>
</table>

Source: IiAS
Domestic Mutual Funds are becoming more considered in their voting decisions

- **Adoption of Accounts**: 78% FOR, 21% AGAINST, 1% ABSTAIN
- **Dividend**: 86% FOR, 14% AGAINST
- **Issue of Securities**: 83% FOR, 15% AGAINST, 2% ABSTAIN
- **ESOPs**: 78% FOR, 12% AGAINST, 10% ABSTAIN
- **Remuneration**: 83% FOR, 13% AGAINST, 4% ABSTAIN
- **Related Party Transactions**: 82% FOR, 13% AGAINST, 5% ABSTAIN

Data for resolutions presented by BSE 200 companies

Source: IiAS
Domestic Mutual Funds are becoming more considered in their voting decisions

**Auditors**
- FOR: 80%
- AGAINST: 6%
- ABSTAIN: 14%

**Director appointments**
- FOR: 82%
- AGAINST: 4%
- ABSTAIN: 14%

**Alteration to Charter Documents**
- FOR: 88%
- AGAINST: 1%
- ABSTAIN: 11%

**Capital Reduction**
- FOR: 95%
- AGAINST: 5%
- ABSTAIN: 0%

**Borrowings**
- FOR: 86%
- AGAINST: 3%
- ABSTAIN: 11%

**M&A, Slump Sale and Intercorporate transactions**
- FOR: 81%
- AGAINST: 5%
- ABSTAIN: 14%

Data for resolutions presented by BSE 200 companies

Source: IiAS
Board quality in India

**Board independence**

*For BSE 500 companies*

- 72% >=50% ID
- 28% <50% ID

**Board diversity**

*Proportion of women directors: Catching up with developed markets*

- Brazil 7
- Singapore 8
- HK 11
- India 12
- USA 19

**Attendance levels**

*For board meetings held in FY15 for 4654 directors*

- 84% <75%
- 16% >75%

- Bulk of companies have board size between six to 10
- Regulations mandate appointment of at least one women director; 269 (59%) companies have appointed women director in last one year
- Average number of outside directorship: 3.1 (S&P BSE 500) compared to 2.1 (S&P 500)
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- Role of proxy firms (like IiAS) and the media in increasing the debate on corporate governance
Increasing the debate on corporate governance
### IiAS partners with institutions to push for change

#### Governance Scorecard
- Assess corporate governance framework of companies
- Help companies improve governance standards

#### Succession Planning
- Identify succession planning practices adopted by top 200 listed companies in India
- Evaluate preparedness in ensuring continuity of leadership

#### Board Evaluation
- Identify current board evaluation practices
- Help companies embrace and adopt robust board evaluation processes

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**Governance Scorecard**

- **Assess corporate governance framework of companies**
- **Help companies improve governance standards**

**Succession Planning**

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**Board Evaluation**

- **Identify current board evaluation practices**
- **Help companies embrace and adopt robust board evaluation processes**
IiAS develops a database to check executive remuneration - ComPAYre

**FEATURES**

- Remuneration data for 500+ companies and 1400+ directors across five years
- Detailed data on each pay component, including basic pay, short term incentives and long term incentives
- Benchmark executive compensation to industry and peer-set
- Establish linkage between pay and performance

Cloud-based tool to search and analyse remuneration data
Media provides critical push-back to companies

Proxy advisory firms take on Infosys over board appointment

At least two proxy advisory firms have recommended investors vote against reappointment of Jeffrey Sean Lehman as independent director at Infosys.

Proxy firms lead change in governance framework

After 5 years of sustained work, and with some help from Sebi, minority investors have got a voice and companies find these entities can no longer be ignored or brushed away.

Mallya Issue: Should Hold Diageo Board Accountable, Says Proxy Advisory Firm

Proxy advisory firm wants shareholders to reject Siemens' pay hike proposal

Proxy advisory firms give a boost to shareholder activism

Proxy advisory firms give a boost to shareholder activism

Bhuma Shrivastava

Scope for increasing dividend payout, says proxy advisory firm IiAS

Maruti rebuts proxy advisory firm’s call to vote against Gujarat plant

The 11-page IiAS report had recommended the shareholders of the firm to “see through the razzle dazzle” of the carmaker’s resolution and to vote “against” it.
About IiAS – Who we are

Board of Directors

Amit Tandon, Founder & MD
Ex-MD, Fitch Ratings India and Sri Lanka

Anil Singhvi, Founder
Chairman, ICAN Investments

Renuka Ramnath
Founder, Multiples Alternate Asset Management Pvt Ltd

Deven Sharma
Ex-President, Standard & Poor’s

Management Team

Robert Pavrey
Practicing Company Secretary

Amit Tandon, MD
Ex-MD, Fitch Ratings India and Sri Lanka

Hetal Dalal, COO
• 13 years with CRISIL
• Last position held: Director, Business Development

Our Shareholders

AXIS BANK
Fitch Ratings
HDFC
ICICI PRUDENTIAL LIFE INSURANCE
Kotak Mahindra Bank
UTI Portfolio Management
YES BANK
Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it is the only thing that ever has.

- Margaret Mead