Ethical Governance

Wake up call for Corporate Governance Standards

"The new decade has brought with it a host of new challenges. One of our foremost challenges is to improve corporate governance standards. The key driver of good corporate governance is transparency and disclosures in corporate reporting. In this upcoming age of turbulence only those who are transparent will survive" says Dr Madhav Mehra, President, World Council for Corporate Governance, UK.

At the turn of the year, the Ministry of Corporate Affairs under the leadership of Mr Salman Khurshid released new voluntary corporate governance guidelines. Guidelines that recommend sweeping changes such as limiting the term of an Independent Director to 6 years, separating the role of Chairman and CEO, 'Impact Analysis on Minority Shareholders' of every board agenda item and the rotation of audit firms every 5 years. And though the guidelines are voluntary, the ministry expects that companies inform their shareholders if it hasn't met any of them.

Could this herald a new era of governance disclosures & transparency?

Earlier this year the Church of England, followed by other investors like the Joseph Rowntree Charitable Trust, Marlborough Ethical Fund and Millfield House Foundation disinvested millions of dollars worth shares in metals giant Vedanta, citing ethical concerns regarding the company's human rights record in Orissa. This comes two years after Norway's sovereign fund, the 2nd largest in the world, sold it's 13 million dollar stake in Vedanta on grounds of environmental and human rights violations.

Could this investor rejection force Indian companies to improve their governance standards?

This year the U-N Special Representative will work to finalise proposals that corporate law be changed to promote human rights. Some of the potential changes include a human rights impact assessment by the Board of Directors and disclosure regimes for environmental, social and human rights issues.

Will human rights and environment protection drive new governance standards?

And finally this week, SEBI has directed all mutual funds to make detailed public disclosures regarding their voting rights in investee companies. From policies and procedures for exercising voting rights to disclosures on the actual exercise of proxy votes...the new rules expect 'mutual funds should play a more active role in ensuring bettercorporate governance of listed companies'.

Could this herald an era of activist investors in India?

These issue were discussed in an exclusive interview by Menaka Doshi of CNBC – TV 18 with Koushik Chatterjee, CFO - Tata Steel, Shardul Shroff, Managing Partner - Amarchand Mangaldas, Rahul Matthan, Partner - Trilegal, Sunil Singhania, Executive VP (Equities) - Reliance Mutual Fund and Karina Litvack, Director - Head of Governance and Sustainable Investment at F&C Investments. Here is a verbatim transcript of the interview.

Q: You represent the new age investor, I am curious to know what role governance standards play when F&C is determining whether it wants to invest in a company or not?

Litvack: Governance standards play a very important role in determining how we assess the attractiveness of an investment. But we also take the view that as owners of companies, we have an important role to play in encouraging positive change. So it is not just a case of buying a stock, holding it and then selling if you don't like it. What we see that actually having a dialogue with companies, acknowledging that things change overnight, acknowledging that expectations of good practice evolve over time and therefore we have an important role to play in bringing that dialogue onto the table and getting companies to improve.

Q: You interact with Indian companies as well. What do you make of their responsiveness to issues regarding governance and not just governance when it comes to board transparency or independence directors but also issues like social responsibility, environment protection, human rights? What do you make of the controversy around Vedanta and what it will mean for other Indian companies?

Litvack: I think it is a bit of a mixed bag. There are some stellar companies out there, Infosys is one, Tata Consultancy Services (TCS) has done a very good job, some of the members of the Tata Group have done a good job and I am not saying this on purpose because a gentleman from Tata Steel is here, it is true. But we do have difficulties sometimes getting a dialogue going and I think what that reflects in large part is the inherent passivity of the Indian institutional investor community and you were citing the fourth measure that was introduced to compel Indian mutual funds to disclose their votes. I think that is a very important port of getting institutional investors to play a role in driving improvements in corporate governance. It cannot all come from the regulator. There is a limit to what the regulator cannot I and what the regulator can please and therefore we as investors have a very important role to play in driving improvements.

Q: Institutional investors in this country have always been accused of being mute on boards that they sit on or have representative sit on. They rarely vote is one part of the story though if you do talk to institutional investors individually. Many of them will tell you that they have attempted to object to some corporate action but with very little luck. Do you think this Sebi move is actually going to usher in a new era of governance of some sort?

Singhania: I think what you are saying is right to some extent. Individually we all have tried in all bits and pieces, in our investing companies to object to a few of the resolutions which the companies were basically intending to pass. However this move is very positive in the sense that it now forces you to do it. So sometimes you basically take a view that individually you will not be able to do anything because you won't see half a percent or one percent of the company's equity. But if collectively Sebi is forced the mutual fund industry and hopefully the other regulators will also follow suit, suddenly you will have a block on the institutional investors sort of getting together and ensuring that resolutions which are intending to be passed by the companies are passed in favour of the minority shareholders. So I think to that extent it is a very good move.

Q: Do you agree with that, do you think that this could potentially be a game changer when it comes to corporate governance standards in this country?

Shroff: It certainly would change the level of disclosures and the manner in which mutual fund expects to be making a difference at the corporate meeting. But the way I see it is that it is a post fact reporting and the slight difference I have with Mr Singhania is that there is no compulsion still to vote in support of the minority because you can always have a view where the interest of your unit holders maybe in conflict with the interest of a minority but still in a sense that if one votes out of line, there is no punitive consequence, there is no sanction of the law because you voted in a particular way.

Q: Why should there be punitive consequences? You can exercise your vote whichever way you want as an investor

Shroff: I agree but if this circular is treated like that direction to play an active role for better corporate governance, what constitutes better corporate governance is qualitative. You can look at qualitative governance from perspectives of different stakeholders, if you look at it from the perspective of what you are talking in terms of social responsibility or human rights, are they in consonance with what stakeholder rights are? A shareholder may not want a huge expenditure being incurred on impact assessment of human rights but yes it is a right thing to do.

Q: How much of this is going to be a game changer in terms of institutional investors actually having to disclose which way they vote and also comment on the fact that do we really have active investors in institutional investors today?

Chatterjee: I would say that the whole debate about governance standards and I would imagine this debate is oriented around the role of the board.

Q: That is the debate we have got stuck in the last ten years – we have not found any resolution. Are independent directors truly independent? If they are on board for 15 to 18 years can they be independent? For instance the voluntary guidelines that I brought up in the beginning of the show. They say that they should limit the term of an independent director to six years. The truth is most companies will bock if you ask them to do because they have got directors on board for 15 years, 18 years, 20 years in some case so can we move beyond that conversation of independence of board, transparency of broad and into some of the most evolved debates that are going on globally when it comes to human rights, community building and environment protection?

Chatterjee: The number of years in the board and therefore the independence getting lost it is somewhat like the cricket debate that if you have aged you do not have the experience to play or the ability to play. It is not necessary that if somebody is in the board for X number of years beyond five years or seven years that person losses his independence, that person can very well be very independent.

Q: Can we do beyond that - are we finally ready to talk about other aspects of governance or because we have not been able to resolve the independence of board we are going to get stuck there and therefore some of these measures of how mutual funds vote will become ineffective so to speak?

Chatterjee: The whole issue is if you tend to codify corporate governance. I heard Shardul talk about the qualitative subjected part, the codification of governance standards results in tick-box governance. The issue today is as institutional investors as large minority investors, small minority investors – are you reflecting your concerns to the board, in the AGM etc. Has the company taken the view of all your interest in deciding what it does? When I was hearing Shardul talking about expenditure on impact assessment and I was telling you that I find that we have seen in the past where we use to invest and we still invest more than Rs 100 a year on community services. The analyst and investors would question is wasteful expenditure. Today 5-7 years down the line the in thing. It is a big debate therefore there are no codified answers to it.

Meneka Doshi: So I get the point that it is difficult to codify some of these things because then it becomes tick box so some of these needs to come through an investor push, investors need to push companies to ensure that they are toeing the governance line.

Q: Are increasing number of international investors when they come to invest in India making certain aspects of governance a minimum mandatory requirement before they invest in a company – does this same apply to Indian investors or are Indian investors still behind the curve?

Matthan: I guess foreign investors always had a certain higher standard. They approach investments with a slightly different moral compasses it works with regard to whether or not they should invest in industries where there is – just take for example child labour or whether there are consensus and approvals that are required. Have those consensus and approvals been obtained. In the recent past I found that in my personal experience some clients actually demanding that not only the joint venture company into which it is investing but also any subcontractor or any subcontractor of a subcontractor abide by a code of conduct which include things like a prohibition against employing child labour or doing anything which is violative of any environmental regulation and things like that.

Litvack: India has some pretty good rules already. They are pretty comprehensive, they are pretty explicit. The problem is with the way in which they are applied. What we really need here is not think of further rules and introduce things that are so radical. Forcing people of board after six years is not necessarily a solution. We can really make a difference is opening up for board to much more discussion with foreign investors. That is something that is not happening on the scale that it could. When you have discussion with investors you have intelligent people across the table who have an opportunity to understand the business and have discussions like the one that you were just mentioning before. But what may seem to be a conflict of interest between for example employing good environmental management practices or saving money and rally looking at these in the context of long term benefit of the company. These types of discussions are starting to happen much more often. But if you have an approach that is tick-box it is just about complying with more perspective rules. You are not really going to have progress. We really going to have this people on both sides of the table have an intelligent discussion about the direction in which the business is going to go.

Q: What is your experience in India? Are we still stuck in the age old debate of are board independent, should our independent directors have fixed tenures and cannot serve endlessly- what is the debate going on else where in the world because an increasing number of lawyers that I talk to overseas are talking issues about human rights, are talking issues about environmental protection and we are absolutely not cognizant of any of those issues as yet in India in any big fashion?

Litvack: I think that is true. I think your depiction is true notwithstanding some of the comments that we have just heard about companies who are in line, who are being pushed because of joint venture relationships over customers who are imposing certain standard across the supply chain but our experience working with Indian companies is very much that it is difficult to get these discussions going partly because when we go into a country that is not our home country we try to call on a phone call investment institutions who have a better understanding of the local market than we do. So when we go into Brazil,, we even follow discussions with large or small Brazilian institutions investors who understand the market and who understand the practice. We are unable to achieve that kind of a partnership in India because we have been unable to find any institutions who are interested in having this kind of discussion. So I am hopeful that the Sebi change is going to spur that kind of thinking. Also it is important to bear in mind that it is not sufficient itself to effect that real change for two reasons.

One is that votes often do not actually count because they go through the basis of accounts. So we can send thousand and thousand of votes but they do not actually reach the destinations. The other is that the companies do not cover the results of the vote. So we can do all the good stuff. No one knows but results of the votes are is not going to change anything.

Q: As an investor do you question governance practices that companies that you invest and I am saying go beyond issues of how are you valuing your assets in this demerger or commercial transactions that may look a little doggy can you go beyond that as an investor and tell me whether you truly do question issues of what is your environmental production policy or do you have a human rights policy in place – any of those aspects?

Singhania: We have to remember one thing that India is an emerging country and a developing country.

Q: Are you saying human rights and environmental production is not important in emerging country?

Singhania: So what Shardul and Koushik were mentioning were of the soft ratios on the quality were different. I think what you are also discussing that India and Indian companies still have a long way to go even as far as the quantitative practices are concerned so whether it is merger, valuation or remuneration or acquisition of a global company or some other commercial transactions. This is a good step to alt least to ensure that the institutional owners or the institutional investors start to have a say on that. The soft ratios are definitely important. But we also have to remember that in an emerging country it is always going to be a little bit more difficult to address them immediately.

Q: Do you think the Vedanta episode has hit India Inc hard and many companies will wake up and take notice of the way – it has become a public embarrassment for a company to have key investors pull out even if there are small amounts to have them pull out?

Shroff: Let me address it from whatever facts I have gathered from the newspapers and from the net. They seem to have come forth with the position not unlike what Koushik mentioned that they have spend USD 22 million on R&R issues and they are looking at questions where setting up health facilities, setting up community facilities are all part of establishing a healthy environment around where they are doing their bauxite mining etc.

The question which therefore arises is that is the condition in the nature of a human rights issue is it a barrier to capital flows just taking up from where Sunil Singhania just mentioned – you have to evaluate the process of where your economy is. If you have a very strict standard then you are effectively going to stifle mining and is that something which a country like India at this phase of its growth or its developmental phase can afford to do because cost will constantly escalate.

Chatterjee: I think if you look at any company's vision and I can talk about mine that in our vision and in our strategy, safety is a very important aspect so what are the safety processes that you follow. We are talking about mining, a dangerous mining, we follow a principle of zero harm.

Q: Is it being implemented?

Chatterjee: When you meet an investor, when you go in for capital raising the first communication to do is that vision and where you are vis-a-vice that every month, every quarter.

Q: The Vendanta incident not getting into whether it is right or wrong has it served as an alarm bell for Indian companies to say that we will suffer public humiliation and embarrassment at the hands of our investors if we do not do a certain minimum governance line?

Chatterjee: I think it really depends on what the company wants to achieve. If it wants to be an international company, if it wants to have its governance standard in will have to do it. It will have to follow it. There is no doubt about it.

Q: Do you think that this will serve as a wake up call of sorts?

Matthan: It may or may not. The point is that if you are looking to get investors from a particular jurisdiction where they have a high level of compliance obligations and if your compliance obligations are lower than that level, there is a good chance that investors are going to move away if they find that you have been non-compliant regardless of whether are compliant within the letter and spirit of the law and the country in which you are in. The investors are likely to move out because they cannot afford to continue to remain invested in a company which does not follow these kinds of compliance guidelines.

The point has been made several times that different countries at different stages of their development and just because of different circumstances will have different regulations and different thresholds with regard to what is and is not acceptable.

Q: Different standards for different countries based on where you are in the economic cycle?

Litvack: It is important to be pragmatic and to recognize that things can change overnight, but it is also very important to appreciate that the world is changing. Companies that operate in emerging countries such as Vedanta can compete on a global scale. If you think about Vedanta, it competes with Xstrata, which happens to be Swiss, and any number of other emerging markets. It is confronted with exactly the same problems that Vedanta faces. Each country is different but the same types of problems arise in Indonesia, in the Democratic Republic of Congo.

It is not unique to India in any way and it is just not a matter of antagonizing a small slice of investors in Norway or Great Britain. It is about recognizing the failure to manage these issues properly, creates legacy problems that are going to impose cost on the company for 20 or 30 years to come. So, it may not seem like a problem today. But ten years from now you will be paying a very-very heavy price for not having to manage these issues properly. We have learned our lessons now with the Canadian, Australian, and American firms who consulted with us. These firms were poorly managed 10-20-30 years ago and are having to pick up the pieces now.

So, if you are doing something now in India it is better to learn from the mistakes that we have made and invest a little bit now to be in better position for the future and to be more profitable.

Q: Are investors ready to step up?

Singhania: It is a good start. At least on the quality front, I don't think either the investment community or the companies are right now ready to really go all out and say that we are doing the best possible as far as the environment is concerned.

Thermal power plants might be a pollutant but for India to go forward you will need to have these plants for the next 15-20 years.

Q: We should demand better standards of governance?

Singhania: Definitely. We should keep on improving.

Q: Every mutual fund, which I have spoken to in the last two days about these new rules that Sebi has introduced, has grumbled saying they have shifted the owners of governance on to us. 'Do we really want to publish our voting pattern? No, we do not really want to do this. How we will get out of this?'

Singhania: We would love to do it. We are all in for it and we will love to do it.

Q: Do you think this is going to be a game changing situation?

Shroff: It is a game changer, so it is definitely a game changer. It is a game changer undoubtedly.

Matthan: The fact that voting history is going to be a matter of public record will allow people who are investing in mutual funds to actually make some decision. These are not necessarily only NAV based but this is a kind of fund that I want to invest and this is a type of fund that invest in certain types of projects.

Q: What is your experience of investors that come to you? I am not talking about the small community of ethical investors whose goal is to ensure that they only invest in companies within certain parameters?

Chatterjee: The first thing that I was saying that it is our responsibility is to first talk about it before somebody ask you about it. So, you start off with our vision to say what you are doing on safety, what you are doing on environment, what are the projects, what are the difficulties.

Q: Are Indian investors interested in knowing any of these aspects or are they only interested in the numbers and bottomline?

Chatterjee: They certainly do not walk out when I talk about it. So, I assume they are interested. But today and tomorrow when we are looking at large projects, there is a world of equity investors and even multilateral agencies which do financial closure of large projects. They certainly look at the environmental standards, certainly look at what is the kind of safety standards in their diligence. I do not think if Indian companies are going to set up large projects. If you are going to access multilateral capital, this is a part of the diligence process that has to happen.