



Corporate Governance (Regulations and Proxy Advisory) – An Impact Analysis

ADVENT OF PROXY ADVISORY IN INDIA

Proxy Advisory (PA) services have been in existence in the USA for almost 40 years, however, India saw emergence of Proxy advisory Industry only in the early 2010s, almost 30 years after emergence of such firms in USA. Presumably because Corporate Governance (CG) was not perceived to be a value additive factor. Also, investors did not pay much attention, until the Financial crisis of 2008. Regulators realized importance of governance and recognized that good corporate governance is a risk reduction tool and would enhance risk monitoring while investing.

In 2010, SEBI vide a Circular called on mutual funds to play an active role in ensuring better corporate governance of listed companies. In response to the SEBI dictate, Mutual Funds adopted a framework to vote and publish their voting patterns annually.

Simultaneously, MCA rewrote archaic Companies Act of 1956 and replaced with Act of 2013, introducing for the first-time concepts like Audit Committee, Nominations & Remuneration Committee, Independent director, women director, CSR, auditor rotation and various governance measure. Soon, SEBI replaced the Listing Agreement with a modified version i.e. LODR.

IRDA & PFRDA also mandated various measures to improve governance. Therefore, a lot of emphasis has been given over the governance practice by different regulators during the past decade.

OBJECTIVE OF STUDY

This Report analyses behaviour of investors and corporates for last 5 years which *inter-alia* include:

- Shareholders' voting pattern, Participation of Institutional shareholders and retail shareholders;
- Impact of SES reports and Company engagement with SES;

Limitation:

The data used in this report is limited to in house information available with SES. Since, the data is unbiased data of 7 years, one can say it is a representative data.

SES VOTING RECOMMENDATIONS

Graph #1 presents the number of resolutions and PA Reports published by SES during the past 7 calendar years. SES published only 861 Reports during 2015, however, this number has gradually increased and has remained in excess of 1,000 Reports throughout the remaining 6 years.

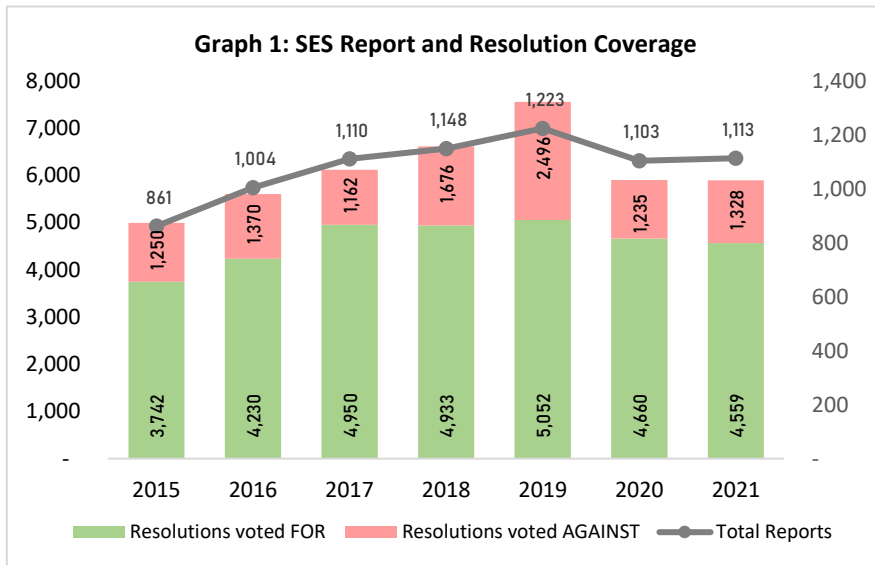


TABLE 1: SES recommendation		
Year	FOR	AGAINST
2015	74.96%	25.04%
2016	75.54%	24.46%
2017	80.99%	19.01%
2018	74.64%	25.36%
2019	66.93%	33.07%
2020	79.05%	20.95%
2021	77.44%	22.56%
Avg.	75.65%	24.35%

Highest number of resolutions and Reports were published during 2019. The outlier is mainly due to added resolutions relating compliance with laws relating to NEDs continuation beyond the age of 75 years and re-appointment of IDs and Auditors for second term after end of first block of 5 years tenure. On an average, SES has been publishing around 1,080 Reports on a yearly basis during the past 7 years.

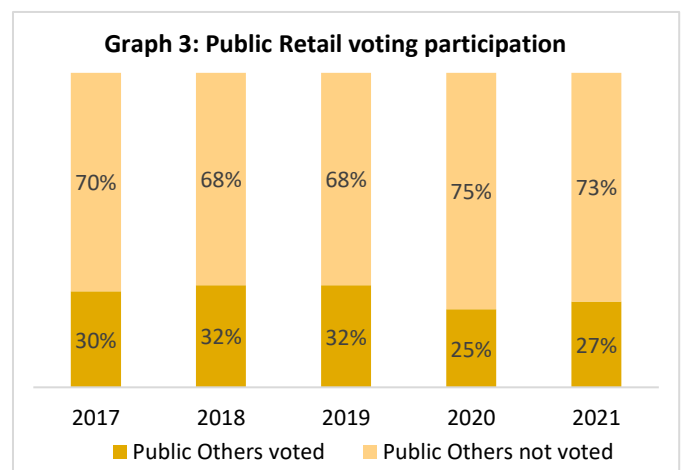
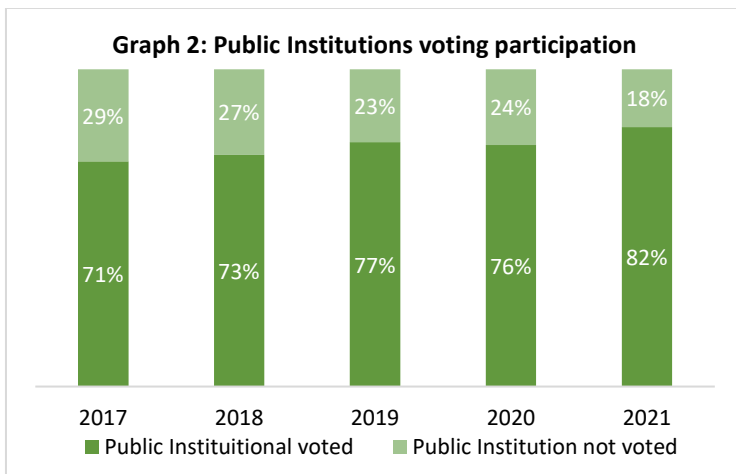
Further, Table #1 reveals the percentage of **FOR** and **AGAINST** recommendation by SES during the past 7 years.

SHAREHOLDERS' PARTICIPATION

Graph #2 clearly brings out that while institutional investors participation has increased from 70.95% in 2017 to 81.83% in 2021, on the contrary retail participation has decreased as can be seen in Graph #3. This could possibly be due to the fact that physical AGMs have not been convened during the past 2 years, as a result, regular retail shareholders who used to attend AGM in person have not attended.

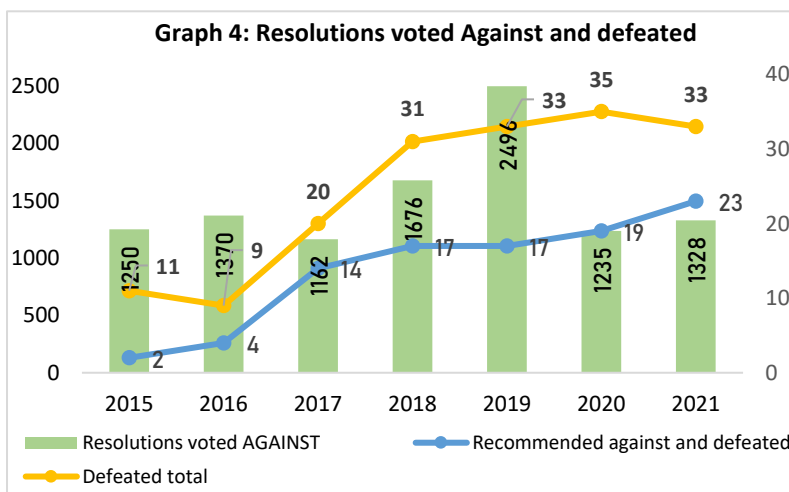
Having said that, even prior to the Covid 19 and travel restrictions, the retail participation had been quite low. Less than 1 out of 3 shares held by retail shareholders are voted upon.

This is a worry for regulator as, despite all efforts by SEBI, Retail investors participation remains subdued. Further, as many retail investors are participating through PMS routes and PMS are not voting, making retail participation further reduced. Voting by PMS is one area through which SEBI can increase retail participation by making voting mandatory for PMS holders.



RESOLUTIONS DEFEATED:

Graph #4 depicts number of resolutions that could not sail through, as the proposal was unable to garner requisite number of favour votes. One can clearly observe the increase in the proposals rejected during the past 7 years. 33 proposals have been rejected by shareholders during 2021, compared to only 11 in 2015. This is an increase of 3x during the past 7 years.



Further, the data is also matched with SES recommendation, while SES has recommended AGAINST for much larger number of proposals, however, those defeated remain only handful.

Further it is not a case that only those resolutions, where SES recommended AGAINST failed, on the contrary, few resolutions where SES had recommended FOR were also defeated.

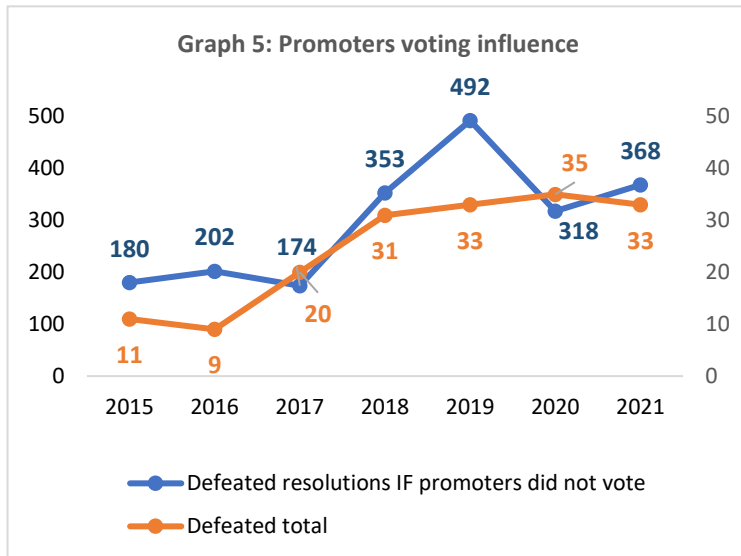
This clearly brings home the point, that investors are not blindly following recommendations of SES and rightly so, as SES or for that matter any proxy service provider is supposed to supplement the research activity and not supplant its research.

The objective of SES recommendation has never been to get resolutions defeated and cause turmoil, it is rather to bring to fore governance issues, enabling investors to take appropriate decisions and discharge their stewardship activity. Many governance issues can be solved by dialogue between investors and company, without going to extreme of defeating a resolution. Secondly, outcome of voting is resultant of actions of many investors including retail. Investors are primarily guided by their own research as also have objective to protect their investments. Disruptions may cause loss hence investors mostly take the negative opinion of service provider into account and engage with the company.

Does Low rejection indicate no governance issues?

Since, only handful of resolutions failed to sail through, which when compared in relative terms would not even constitute of 1% of total proposals put in front of the shareholders, can one conclude that there is no governance issue?

The answer is a definite 'No', despite low resistance from investors.



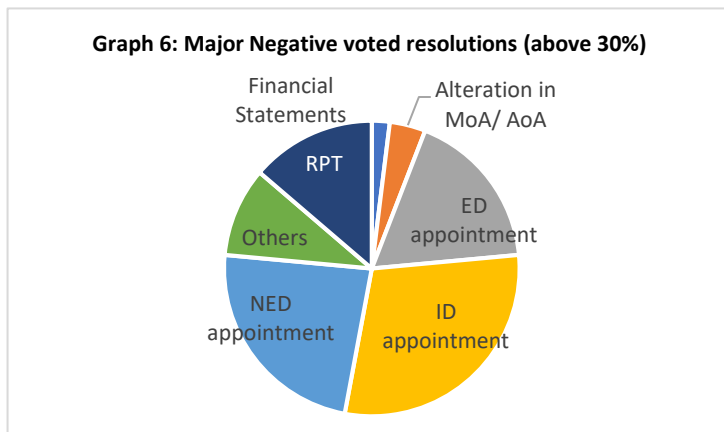
It's important to understand that Indian Companies are predominantly Promoter dominated who generally hold majority stake. Therefore, shareholding in most companies is such that promoters are able to influence outcome except in cases where they are prohibited under law to cast vote.

Another factor is extremely low retail participation in voting. SES carried out further analysis to extrapolate data to find out what if promoters were not allowed to vote?

As seen in Graph #5, the result of analysis reveals that collective power of public investors is blunted by promoter votes. Had promoters not been allowed to vote, defeated resolutions would be more than the ten times of the actual figures.

Negative voted resolutions during past year:

Graph #6 is self-explanatory, as it depicts the types of resolutions that received more than 30% of against votes.



Around 2/3rd of resolution which received more than 30% against votes relate to appointment or re-appointment of Directors, clearly indicating that a lot of importance is given to resolutions regarding individuals who forms the Board of the Company.

This is followed by resolutions relating to transactions with related parties.

Therefore, it is clear that public shareholders do not shy away from voting against the Company's proposal, yet they are not successful in their efforts.

IMPACT OF PROXY ADVISORS

In 2020, SEBI issued a circular for Proxy Advisors ([click here](#) to view the Circular) which stated that PA Reports must be sent to the Investor and Company at the same time. Also, if the Company has a difference of opinion, then the proxy advisors must issue an Addendum report after considering their view point and revise recommendation, if required. Has this regulation made any impact?

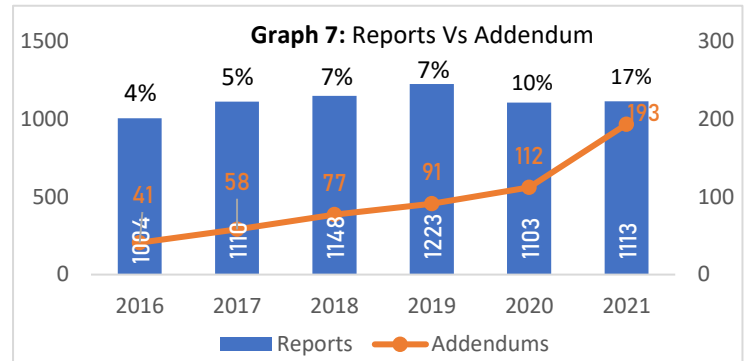
SES believes that data on number of addendums issued is best measure to assess the behavioural change of companies since proxy advisory industry in India came into existence.

Addendums issued by SES during the past 6 years

As a matter of responsible behaviour and transparency, SES had imbibed the practice of issuing addendums long before it was mandated by SEBI.

Graph #7 maps number of reports of SES vs addendum issued. Over the period the Addendum has increased significantly.

Year	Reports	Addendums	% of Addendums as to reports
2016	1,004	41	4.08%
2017	1,110	58	5.23%
2018	1,148	77	6.71%
2019	1,223	91	7.44%
2020	1,103	112	10.15%
2021	1,113	193	17.34%



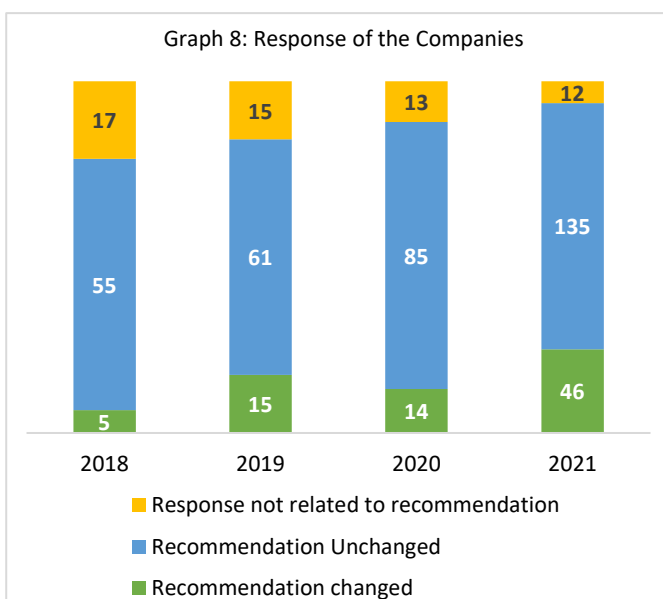
The response of the Company in 2016 as a percentage of the total PA reports released by SES was only around 4%, however, in 2021 the same percentage has increased to a significant 17%. Although number of companies covered by SES have remained relatively in the same range, however, addendums issued by SES have increased every year both in relative and absolute terms, indicating that the Companies have been sensitized about usage and importance of PA Reports by investors and are impacted by the recommendations made by the Proxy Advisors.

Such increase in number of addendums establishes that companies are taking observations made in the PA reports seriously and using the opportunity to express their view, unhappiness or put forth counter point.

Company's Response:

SES as a Policy does not share draft report with the Company since the same is not permitted under the SEBI Circular issued in August 2021. It may be noted that even prior to the SEBI Circular, SES never had a practice of circulating draft PA Reports to the Companies.

SES reports were always sent to the Company and SES clients simultaneously. The SES PA Report process is as follows:



Company's responses can be classified into the following baskets:

- i. Responses on resolution;
 - a. SES recommendation changed
 - b. SES recommendation not changed.
- ii. Responses not relating to resolution / recommendation.

During 2021, SES received response from 193 Companies which is 17% of total Companies covered by SES. This is a 70% increase from the previous year (2020).

94% of responses during 2021 were relating to the Company's proposal, while 6% of clarifications were additional information provided, that were not related to SES recommendation.

46 resolutions, around 24% responses, resulted in change in recommendation by SES. This is pre-dominantly due to additional information provided by the Company.

Majority of these resolutions are cases where the Company failed to place financials of subsidiaries on its website. However, post publishing of SES PA Report, the Company placed the same on its website and SES changed its stance due to the disclosure. Other cases where the Company had addressed SES concern, SES recommendation was subsequently changed.

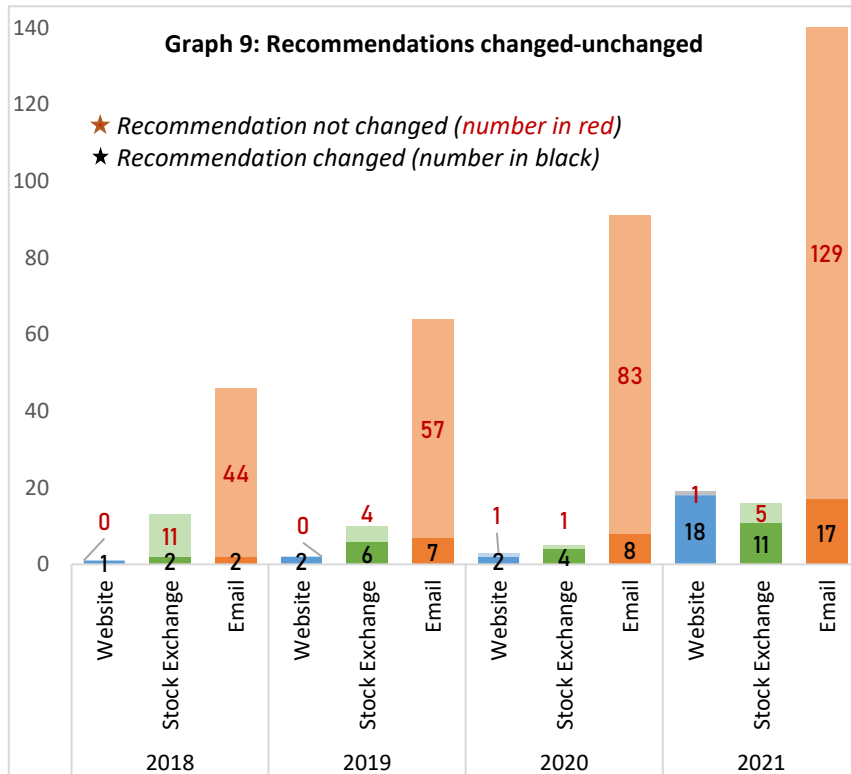
Viewpoint of the Company along with SES comments thereon, were circulated to all the SES clients, in the form of an Addendum.

COMMUNICATION IN RESPECT TO RECOMMENDATIONS

Clarifications provided by the Company can broadly be classified into the following 3 categories.

1. Clarification through email.
2. Additional disclosure made at Stock Exchange.
3. Additional disclosure made at Company's website.

Graph #9 below depicts the past trend regarding the manner of disclosure provided by various Companies.



181 out of 193 responses in 2021 (99 in 2020) from various Companies were regarding recommendations in PA Report.

Majority of these communications were through email only.

Companies in most cases reached out directly to SES, provided their dissenting opinion on observations made by SES and in certain cases provided additional information which was important for the shareholders along with the email. However, any additional information was ignored by SES unless the same was disseminated to shareholders uniformly, as SES cannot base its recommendations based on asymmetrical information.

Recommendations were changed by SES, when Companies response provided clarity on certain Resolutions such as RPT transaction/ Borrowings transaction/ ESOP scheme, limits on increase in investments, data provided regarding directorships/ full time positions of directors when data is different

than public data on MCA etc.

In some instances, SES made required changes in its report not necessarily change in recommendation, when Companies informed SES via email that certain important disclosures such as Annual Return, Remuneration of each directors, Articles of the Company, Key financial ratios which was not available earlier, were uploaded after the lack of disclosures was pointed out by SES in its report.

Disclosure made to the Stock Exchanges:

In instances, where certain material information was made available publicly through Stock Exchanges or Company's websites, change in recommendation was warranted and if the information was sufficient to alter SES opinion, SES recommendation was changed.

In 2021, post release of report by SES, there were 16 such instances in which additional disclosure was made by the Company on Stock Exchanges, where in more than 65% of such instances, SES changed its recommendation to a positive one.

In majority cases where recommendation was changed, material information such as disclosure of remuneration of auditors, profile of directors, meetings attended by directors, valuation report, exercise price of ESOPs, change of resolution type to Special from Ordinary were intimated on the Stock Exchanges.

Information on Website of the Company:

During 2021, in 18 instances additional information was uploaded by the Company on its website and almost 100% of these resolutions, resulted into change in recommendations. Mainly it related to disclosure of financials of subsidiary company or AoA proposed to be amended which were made available on the website of the Company, after SES had pointed out shortcomings.

CONCLUSION

As the shareholder activism surged in the last decade, it appears that the Corporate governance bug has also caught up with the Companies. Their increasing response to the Proxy Advisory Reports corroborates this proposition. Companies now appear to be engaged in better corporate governance practices now, and appear to be taking efforts to make transparent disclosures for benefit of shareholders.

Although not wishing to beat its own trumpet, SES is of the opinion that Proxy advisors have played their role in Shareholders engagement as well as sensitising corporates to good governance practices.

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REPORT RELEASE DATE: 3RD MARCH, 2022

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