In the context of Corporate Governance, an institutional investor should not conform to the strong and silent type. Strength must find expression in the form of effective engagement with managements that are prima facie problematic.

We present our take on the subject in the hope that activism that is assertive, but not antagonistic, will carry the day.

Editor

CORPORATE GOVERNANCE SAHI HAI?

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In a move that was as rare as it was strange, the heads of some large Mutual Funds in India, as a group, chose to call on the Chairman of a beleaguered private sector bank. While there is no clarity on the matters that came up for discussions, it has been speculated in news reports that the meeting was intended to get some kind of an assurance that the share price of the bank would not travel rapidly southwards in the event of a change of the Chief Executive Officer. There is not even a hint, going by the newspaper reports, that these influential persons sought any assurance that there were no governance issues involved.

This meeting took place at a time when the television viewer, across channels, is being bombarded with the assurance "Mutual Funds sahi hai." Did they ask the question – "Corporate Governance sahi hai?"

The incident in question raises the larger issue of the role of the institutional investors, especially in situations in which an investee company has come to adverse notice, not for its financials, but for practices and attitudes that, prima facie, do not seem to pass muster. In the case of financially weak entities, institutional investors, the world over, have been known to vote with their feet. On occasion, and especially in emerging markets, if a large institutional investor is in some sense a proxy for the government, an attempt has been to persuade the Board of Directors to take corrective measures rather than to exit the company and cut losses.

What sets apart institutional investors from retail investors is the leadership role, consequent on the size of the holdings, and the ability to influence good practices consistent with the highest standards of Corporate Governance. Institutions such as California Public Employees' Retirement System (CalPERS) and Harvard Asset Management, to name only two, have for a long time been in the forefront of the efforts to pressurise companies to adopt the right practices while delivering consistent results. While the standards set by them may, at this point of time, be aspirational for Indian entities, nothing prevents Indian institutional investors from publicly taking aggressive positions vis-à-vis managements which are unresponsive and seemingly indifferent to the concerns of an average stakeholder.

There is no shortage of institutional investors in India. Mutual Funds, insurance companies, both public and private, foreign institutional investors and Private Equity funds that invest in public markets have to reflect on the kind of stance that they need to adopt when questions are being raised regarding governance practices, especially conflicts of interests. Mutual Funds have an especially important role to play. As the link between the small saver and the users of capital, it is not enough for them to provide the former with the benefits of research and risk diversification. At least as important is the responsibility of the Mutual Funds to stand up for what is right so that the faceless investor finds his voice heard in corporate Boardrooms and in the larger financial arena. Will benign neglect on their part, force SEBI, in due course, to direct them to engage more effectively with managements, in public interest?

In this context, developments in recent times raise interesting questions. Many Mutual Funds continue to buy shares of the beleaguered private sector bank at every dip. Research houses continue to have a 'Buy' recommendation on the stock. Clearly, both of these approaches are consistent with the short-term interests of the funds and their investors. The question that needs to be addressed is whether in extending support, through such action, to the listed entity, a signal is being sent that short term interests are paramount and that Corporate Governance, which is a necessary condition for sustainable performance, can be given the go-by.

The role of other institutional investors on the Boards of companies in difficulty is equally disquieting. There has been deafening silence from a large institutional investor with around 12% of shareholding in the bank presently in focus. It would have been legitimate for the nominee of that institution to assume a leadership role in the Boardroom and to satisfy himself and his organisation that the allegations being bandied about were without basis. To make matters worse, the website of the bank shows the Nominee Director as an Independent Director, even though Section 149(6) of the Companies Act, 2013 clearly states "an Independent Director in relation to a company means a Director other than a Managing Director or a Whole-Time Director or a Nominee Director." One fervently hopes that being categorised, for definitional purposes, along with a Managing Director and a Whole-Time Director, does not compel the Nominee Director to act strictly in accordance with the interest of the former. Whatever happened to IRDAI's salutary provisions in the Stewardship Code relating to investee companies?

Institutional activism in India is not without precedent. The erstwhile undivided Unit Trust of India, even when battling its own problems, took principled stands on two occasions, once getting a proposal to be withdrawn, and on another occasion, forcing a vote which was narrowly lost. In recent times, promoters were pushed on the back-foot by institutional investors seeking clarity and probity.

If one may take liberties with an old saying, an occasional swallow does not make a Summer.

READERSPEAK – WHERE ANGELS MUST NOT FEAR TO TREAD

"General (Retd.) Ved Prakash Malik, Former Chief of Army Staff "
"Sound observation and advice, as always."

"Shankkar Aiyar, Author and Columnist"
"Angels must tread but where are the angels…"

"Bahram Vakil, Founding Partner, AZB & Partners"
"If I may say, very well written and spot on."

"G Mohan Gopal, Former Director, National Judicial Academy and National Law School of India University, Bangalore"
"I agree with your take about privatization of banks. Giving up on the mixed economy is a huge and very costly error."

"Sabyasachi Hajara, Former CMD, Shipping Corporation of India"
"Completely concur with your views. PSBs have served our economy with great distinction since independence and must continue to be allowed to play their vital roles going forward."

Do let us know of any specific issues you would like to see addressed in subsequent issues.