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Expert Expressions
Corporate Governance Demystified

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REGULATIONS MUST BE OWNERSHIP-NEUTRAL

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A regulatory regime that frowns on exceptions and exemptions, adds significantly to the credibility of the regulator and the regulated universe. This confidence-building measure should get continuing attention.

The announcement that the 15% residual shareholding of the Government of India in IDBI Bank, post the disinvestment, would be classified as public shareholding has evoked mixed feelings. On the positive side, every measure intended to make the proposal more attractive for potential investors, and thereby, to increase the earnings of the Government, needs to be supported. At the same time, concern ought to be expressed at the manner in which regulatory exemptions and carve-outs are being thought of from time to time for public sector undertakings (PSUs), making the playing field less level on a continuing basis.

The special treatment given to PSUs, in the matter of overcoming regulatory constraints, has been in evidence for a long time. The examples are too many to be detailed in a newsletter. The LIC-IDBI merger tells its own story, and sheds adequate light on how regulations have been given the go-by. Traditionally, and in accordance with legal provisions, the Insurance Regulatory and Development Authority of India (IRDA) had not permitted LIC to invest in more than 15% of the shareholding of any company. This hurdle was overcome by the Government advising the IRDAI that the 15% investment cap will not apply in the case of LIC's acquisition of shares in IDBI Bank, as this was to be an exceptional acquisition. Complying with the Government's stated wishes, the IRDAI on 29th June 2018 allowed LIC to buy up to 51% in IDBI Bank. On 21st January 2019, IDBI Bank became a subsidiary of LIC. On 19th December, 2020, it was reclassified as an Associate company, since it reduced its shareholding to 49.24%, consequent on the issue of additional equity shares under Qualified Institutional Placement (QIP). It is relevant to mention that while allowing LIC to buy up to 51%, the IRDAI had imposed a condition that the stake should be reduced to 15% over a period of 5-7 years. Reading all these developments together, it becomes abundantly clear that LIC was merely to hold the baby till a suitable private investor came calling.

SEBI Regulations stipulate that a mandatory open offer shall be made when the shareholding reaches a prescribed limit. This condition was not insisted upon. Stated briefly, regulations and legal provisions, which were found inconvenient, were merely swatted away to pave the way for a smooth transaction at every stage.

There was a time when regulatory organisations did not exist. The regulatory and supervisory functions resided in the administrative Ministries and Departments of the Government. Thereafter, with several sectors being opened up for public participation, it was felt that the responsibility for regulation must be shifted from the Government to an entity tasked to discharge these functions in an objective and transparent manner, without factoring in the nature of ownership. It was recognised that so long as the Government chose to be a direct participant in some sectors of economic activity, there would be co-existence of, and resultant competition between, the PSUs and private sector units. This mixed economy approach (sometimes referred to as a mixed up economy approach) has served the needs of a heterogenous population over the decades.

As regulatory organisations began to get established, there was the legitimate expectation that acting in a functionally autonomous fashion, such organisations would lay down the common framework applicable to PSUs and private sector units. This did not happen overnight. Ministries and Departments, long used to exercising these powers, were reluctant to cede ground, and there was often a standoff between the concerned administrative Ministry and the regulatory organisation, when it came to even-handed implementation of regulations. It was almost as if the fear of letting go was premised on the fear of becoming irrelevant, forgetting that the domain of policy continued to remain with the concerned Ministry. At the same time, there were critics and commentators that spoke of “independent” regulatory organisations, giving the impression that these organisations existed independent of everyone else, even though they had no territory of their own, and did not fly a flag of their own. The legitimate expectation that these were to be functionally autonomous regulators, and not much more, was lost sight of, with the focus on the imaginary independence of such regulators.

One of the first task of regulators is to put in place a set of prescriptions, to ensure that the regulated entities, public or private, functioned in the manner that was expected of them. One of the expectations was that all stakeholders would be treated equally, and that there would be checks and balances, and structural arrangements put in place, to ensure that there was no disproportionate benefit to any segment of stakeholders.

Notwithstanding these intentions, the Government, through various measures, ensured that PSUs were required to comply with a lesser set of prescriptive arrangements, which were less rigorous. To cite one example, public sector banks (PSBs) were exempted from some of the requirements that as listed entities they would have had to comply with, in the absence of such exemptions. There were occasional carve outs from regulations to provide a different, and an easier, playfield for PSUs.

In the matter of reducing Government shareholding in PSUs, and also in cases of divestment, a number of exemptions were sought from the regulators, and were given with admirable alacrity. There was not even the pretence of digging in, to establish that regulations should apply equally to all entities in a regulated universe, notwithstanding the pattern of ownership. When it came to offers for sale, special dispensations were made available easily. In the context of minimum public shareholding in listed entities, Government undertakings benefitted by the existence of differential treatment. There were very rare cases in which ownership was not allowed to be made the basis for special treatment. In one such instance, when Clause 49 of the Listing Agreement was given effect to, it was noticed that PSUs did not bring on board, the prescribed number of Independent Directors (IDs). They sought extension of time for complying with this requirement. Failing that, they wanted exemption, on the basis that they were majority owned by the Government of India. When both these requests were turned down, they continued to cock a snook at the regulator. Only a later change of mind in the regulatory organisation led to their getting away with non-compliance. Later when the Companies Act, 2013 and SEBI LODR Regulations, 2015 provided that there should be at least 1 woman Director on the Board, the PSUs were found to be non-compliant for long periods, with no action being taken against them for such regulatory non-compliance. This continued when the stipulation was that every listed entity should have at least 1 woman ID. What is worse was that after the Coal India imbroglio, the IDs, for fear of being proceeded against by an institutional investor, opposed the management’s decision on pricing. They were then collectively shown the door, and similar treatment was extended to IDs on the Boards of several other PSUs. This resulted in completely non-compliant Boards, with only management representatives on the Board, thereby negating even the basic requirement of Corporate Governance.

There is no doubt that going forward there will be instances in which with the maximisation of revenue as a major objective, and for making the offering more attractive to investors, some regulatory requirements would be ignored. It is not necessary to produce evidence that such an approach would undermine the concept of functionally autonomous regulators creating a level playing field for all participants. Since these are undertakings that compete among themselves, it is inconceivable why the same set of rules cannot apply equally to all the participants. You

should not have a game in which a PSU competes against a private sector unit, with different rules applicable to them in the playfield.

There are some who believe that the Government has no business to be in business. In this situation, there would be no need for carve outs, and the concept of a level playing field would come into being without much effort. However, there are those that believe that in an economy with multiple challenges, and with segments of the population being on opposite sides of different divides, there would be a need for a strong healthy vibrant public sector to continue to exist. The latest statement emanating from the highest level of the Government of India is very encouraging, since it urges the public sector and the private sector to work together in furtherance of national goals and objectives. What would have further strengthened this view would have been the expression of a hope that regulators will function autonomously in an even-handed manner, dispensing no favours based on ownership.

Tailpiece –
After the Government had reduced its shareholding in some banks, an Executive Director of a PSB was asked why the number plate on his car had the words “a Government of India Undertaking”. He replied that it made access to parking easier in crowded areas. What he did not foresee was that with PSBs reducing in number, he too could be “parked” in due course.