The Ethical Corporation
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Lecture - 20
Concluding Session on Corporate Governance

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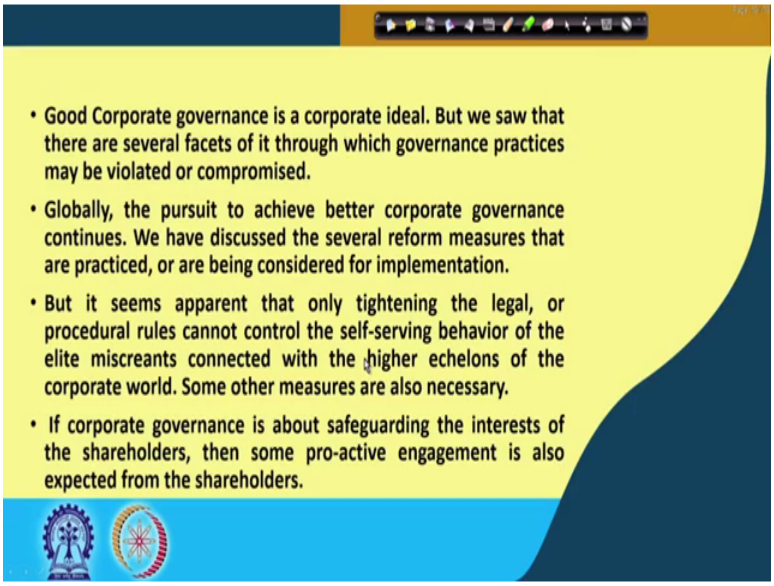

We are back and this is our last session on this topic of Corporate Governance. I have already showed you that corporate governance has many facets, where problematic ethically problematic issues can emerge. So, good corporate governance is certainly an idea and we try to achieve that and globally, this is a pursuit that is happening. We have talked about several reform measures that are practiced that are suggested from the legal side, from the ethical side, what people are trying and so on.

But you know it probably is evident now that only tightening the laws or the procedural matters is not going to control, the self serving behavior of the people who are at the higher echelons of the big corporations. Because that is where corporate governance can start. There has to be self discipline, there has to be self restraint and what we call an ethical awakening in the people.

That is there, but is there no other option. So, tightening of the rules, then ethical awareness is a no other option. Well, the other side is that if corporate governance is about protecting the interest of the shareholders, then perhaps there is some responsibility that the shareholders have to now shoulder. There must be some engagement from the shareholders some proactiveness from them which is expected and we are going to talk about that today.

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So, I am going to introduce the concept of shareholder democracy. Just like in a political system, we have the concept of democracy, similarly shareholder democracy. You need to understand that a corporation is an economic institution of course, but it is also a political institution in the sense, there are people in there who have power based relationships.

One of those power verticals is what we have talked about namely the shareholders and the management and their relationship. This is what we said is the agency problem, one kind of agency problem. From here if we want to go towards shareholder democracy; then, first thing to note is that the thing that really made the change and the concept that grew out of this is when shareholders got something called the voting rights.

You see earlier there used to be rules by kings and the wealthy in our society and from there, the modern ideal is democracy which means ruled by the people, for the people and of people and one of the strong foundation of a democracy is the voting rights or suffrage that people enjoy. Similarly, in the shareholder democracy the voting rights of the shareholders becomes a cornerstone. So, the empowerment of the shareholders, they have a say and how can they are let the corporation know that they ever say by exercising the voting rights.

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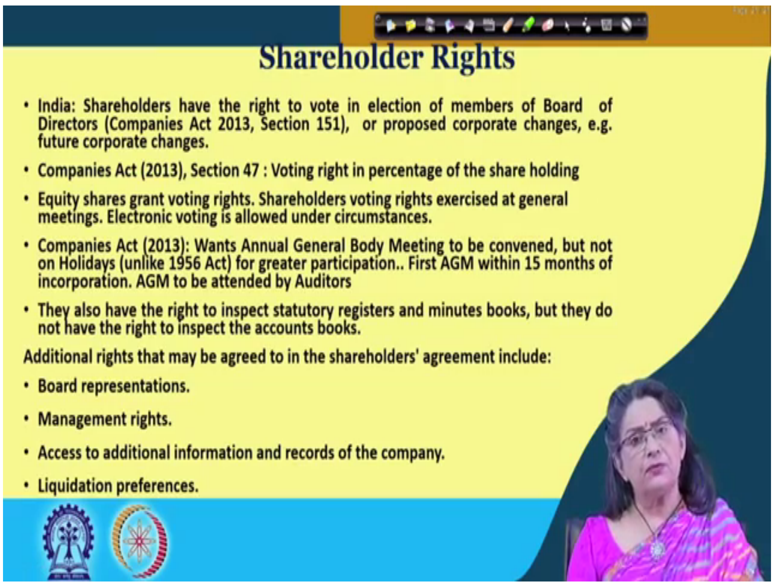

If you look at the rights of the shareholder, then voting rights is just one of them. There are many others, but we are talking about the voting rights. So, in our country at least Companies Act fully supports the voting rights of the shareholders, where in the election of the members of the board of directors. You know the appointment, the selection as well as removal through voting rights by the shareholders.

And the shareholders get the voting rights when they hold equity shares of a company, where do they exercise it? At the general meetings and in order to give the shareholder more power Companies Act, even allowed the electronic voting because it is not possible for all the voters to all the shareholders to attend each and every general meeting physically. So, electronic voting is also allowed. The voting right is in our country in percentage of the shareholding. So, however, much share you hold in the company that many voting rights you have.

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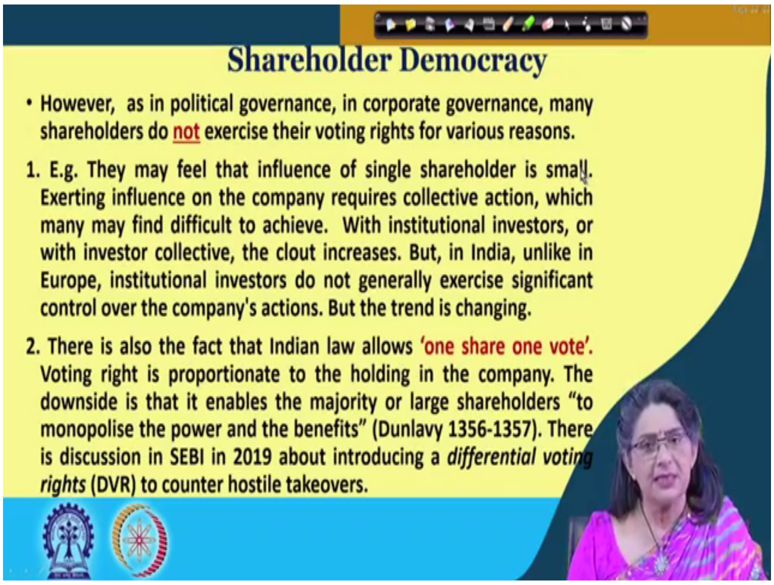

But the story just as in the case of the election time or any voting time that we have, the story remains the same that though people have rights to vote shareholders. They do not always exercise the voting rights. Why? There are at least two major reasons; one is that many shareholders are there only to invest some money and to get value for their investment. If the return is good therapy, if not they will go to the another company. They do not want to bothered; even if they have voting rights, they do not.

There is another class of shareholders who think that they are too small. How can my you know I hold a small amount of shares in a company you know how can my voice even make any difference; what it requires in order to exert some influence in the corporate decision is something called collective action by many shareholders which is not easy to achieve.

And there are large investors of course, specifically the institutional investors, but their collective action we see a lot in Europe for example. But in India that is also very low, but that trend is changing. The other reason is that the law allows 'one sharer one vote'. So, it is according to the percentage of shares that you hold in a company that much voting rights.

So, one of the implication of that is that it enables the majority or the large shareholders to walk away with a decision and the minority obviously, will not have much of a say. It is counting the votes. So, there is that problem. Therefore, the minority shareholders often do not feel like even casting their votes. Recently, there is talk from SEBI about introducing a differential voting rights, specifically to counter hostile takeovers. These are special voting rights for the promoter shareholders.

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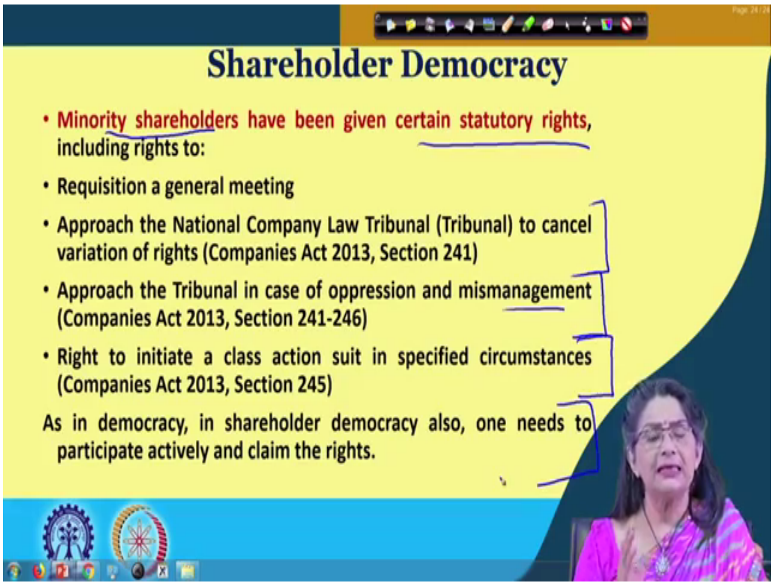

Shareholder democracy is a concept which allows certain rights to the investors have said that already, but as you know we have just touched upon the problem of minority shareholders and their specific rights. So, if there has to be empowerment, then minority shareholders need additional empower. So, that is why they have been given certain statutory rights. For example, you know they can approach national company law tribunal, if there are some issues or if they feel that they are oppressed by the majority shareholders or there is mismanagement has happening.

Then, Companies Act allows them to approach the tribunal. In fact, there is also provision for initiating a class action suit in very specific circumstances. So, this; so, there are rights. Minority shareholders as well as ordinary shareholders, large shareholders, they have voting rights.

They have a way to voice their opinions, but as is the case always; you know only having a right is not enough you have to claim the right, you have to exercise the right. Just saying that you know I have this right and people will automatically you know leave your path that is not how the world works.

If you have a right, you have to make a case for it, you have to claim it. So, this means that the shareholders need to participate actively and claim their rights.

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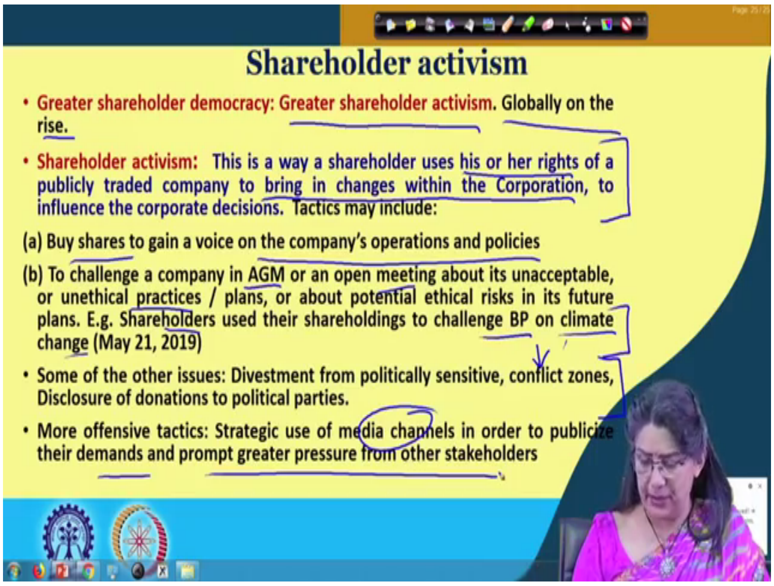

We are talking about shareholder democracy and participation, active engagement in the process. So, greater participation in shareholder democracy leads to something called shareholder activism. Passive enjoyment of rights is one actively going forward and claiming your rights is another. Shareholder activism is about you know greater participation by the shareholders exercising their rights.

Globally, this phenomena is on the rise and I will show you some examples. So, what is your holder activism? This is when a shareholder uses his or her rights of a public traded company to bring in changes within the corporation to influence the corporate decisions.

So, you are using your voting rights to let the company know about your opinion not only that you are trying to influence the corporate decisions where you want it to go. Tactics there are many manoeuvres that take place and some of these are that people activists may buy shares in order to gain a voice on the company's operations and policies.

You may not like a corporation, but you buy shares in that corporation so that you can make a point to them this is one kind of activism. The other kind is you know to go in the AGM or in an open meeting and challenge the company on its objectionable practices unethical practices and plans.

So, this is only last month in May 2019 in an open meeting shareholders challenged BP British Petroleum on climate change act related activities. So, this is shareholder activism, they are might be various kind of social issues that the shareholders may feel strongly about. For example, you know if there is any investment in of the company in conflict zones which directly support some regimes, some oppressive regimes or military regimes; the shareholders may not like it and they would like the company to withdraw from there.

More offensive sort of a tactic in your face type of a tactic is to call up the media channels and hold a conference with them publicly letting them know about the demands and so that other stakeholders are informed and they can also join. This is shareholder activism.

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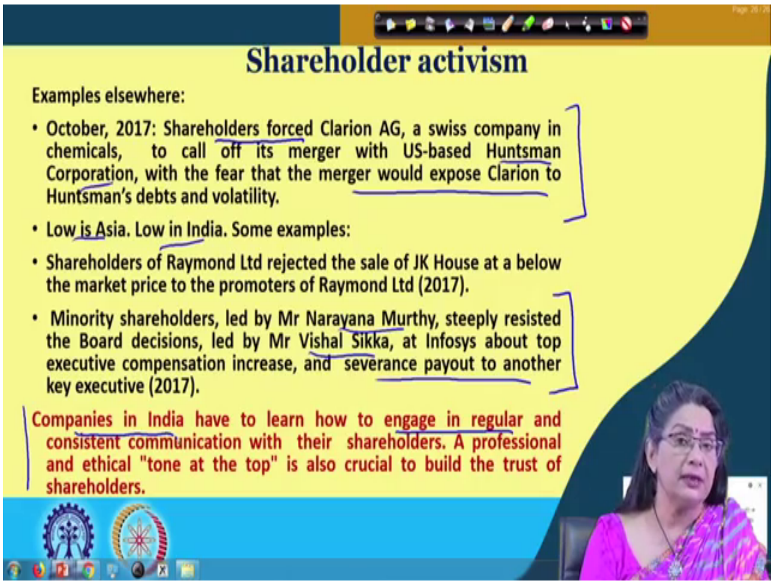

I told you it, I will give you example. So, here is one example from recent time. This is October 2017 when clarion AG, a Swiss company in chemicals was trying to get into a merger with the American Huntsman Company, Huntsman Corporation. The shareholders came in the way. The board wanted to merge, but shareholders did not want them. They forced that there should be no merger. Why not? Because they were scared, the merger would expose clarion to the dates and the liabilities of the American company which is not good for the shareholders.

So, this is forcing the company to listen to the shareholders. This is low not as much seen in Asia as for example, in other countries and specifically low in India, but there are have been some examples of clear shareholder activism. I have already told you about the Infosys case and it was group of shareholders, promoter shareholders they were minority which was led by Mister Narayana Murthy and they went against the board decision to question Mister Sikkas compensation package as well as I mean exorbitant compensation package and also about the civilians payout to another key executive.

The board was led by Vishal Sikka and the shareholders stood their ground to resist the board decision the question and finally, they won. So, this is a phenomenon that we need to be aware about. This is sending a message to the corporations, regarding their corporate governance practices, regarding their other activities as well. So, the companies nowadays in elsewhere in the world, they have already started. Companies nowadays, they understand that it is important to engage in regular and consistent communication with your investors.

Companies in India, need to learn that there is a way to communicate and it has to be regular and consistent and not only that, there has to be a trust building exercise. So, the professional and ethical tone from the top is what going to build finally, that bridge between the investors and the companies.

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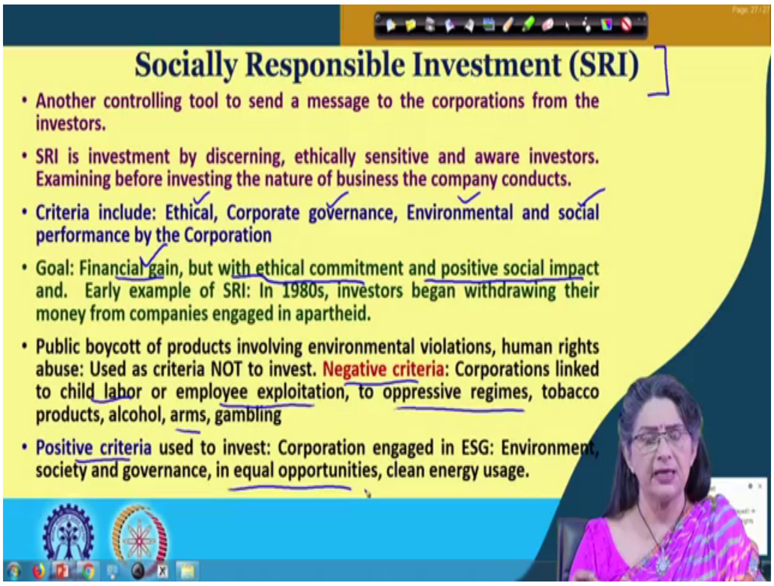

The other thing that I want to talk to you about is another controlling tool, another way for the investors to let the corporations know what the investors want. This is called socially responsible investment.

This is investment you have disposable money, you want to invest which is good, but this is not just about financial gain. It is about financial gain, but without compromising your own ethical values and looking for positive social change. So, this is investment by consensus investor's, socially aware investor's, ethically sensitive investors. So, they are going to look for ethical corporations. You know they will look for the activities of the corporations closely instead of only looking at the share prices. Because they are going to look into the ethical activity, the corporate governance practices, the environmental practices and also the social performance by the corporation.

So, this comes clearly into the ambit of the ethical corporation, the one that we are talking about in class. The socially responsible investment, they use two sets of criteria; one is the negative criteria, where you do not want to invest and this could be you know corporations which are linked with dubious practices such as you know engaging in child labour or treating the employee, absolutely in humanely or you know having some links with some oppressive regimes. If you do not like such regimes, then this is not where you want to take money or companies which manufacture or sell socially dangerous products such as weapons such as arms and so on.

The positive criteria, the other set of criteria is where you want to invest and this would be as I said in the ethical corporations and there are some telltale marks. For example, you might look for a corporation which not only speaks about equal opportunities, but actually practices it. There are tangible signs that they are practicing equal opportunities or corporations we choose to use clean energy instead of fossil fuels.

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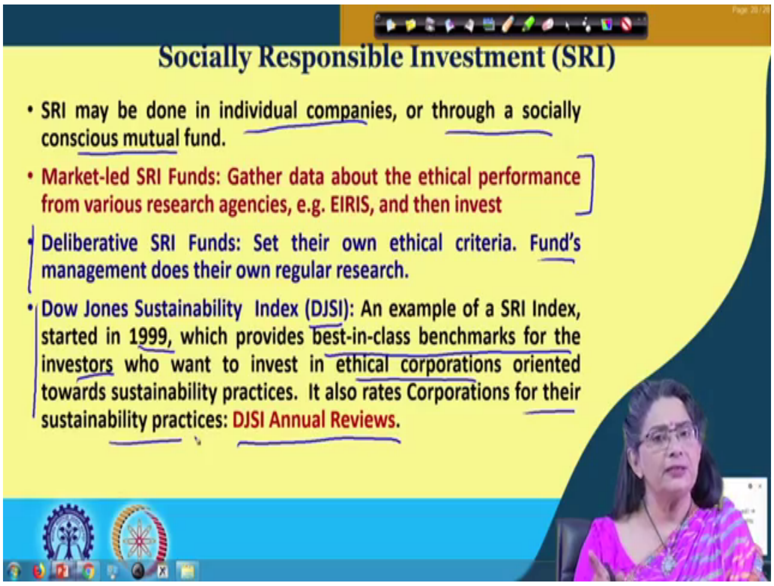

You might now think that where are we going to know about such companies; how do we know about the ethical corporation and their activities? There are more than one way to answer that question. One is that you know there are market laid is a right funds, where the data are you can individually invest in companies, in particular company or it can be through socially conscious mutual funds.

In case of market laid its arrived funds, the research is done by some professional agencies and from that data; then, the investors on investors behave behalf the fund's manager put the money in those companies. The other choice is deliberative SRI funds which have their own ethical criteria, they do their own research and the funds management; then, decide where to put the money.

In terms of a performance of these ethical corporations, where can we look or where can we know about the performance, I would suggest try this Dow Jones Sustainability Index in short, DJSI. This is an example of socially responsible investment index. It started in 1999. What it does is that it provides best in the class benchmarks for investors, who want to invested; who want to integrate their ethical considerations sustainability considerations in the portfolio. So, they are looking for ethical corporations, oriented towards sustainability practices.

Every year the DJSI publishes the DJSI annual review, where they are ranked the corporations rate the corporations for their sustainability practices. The ratings do not remain the same some companies do feature regularly, but some are eliminated from the list. Because every year, they look into the data the practices and if there are questionable practices and their own mind even deleting some of the leading corporations. Financially, maybe they are doing exceptionally well, but they do not get to show up in the DJ SI in the Dow Jones Sustainability Index.

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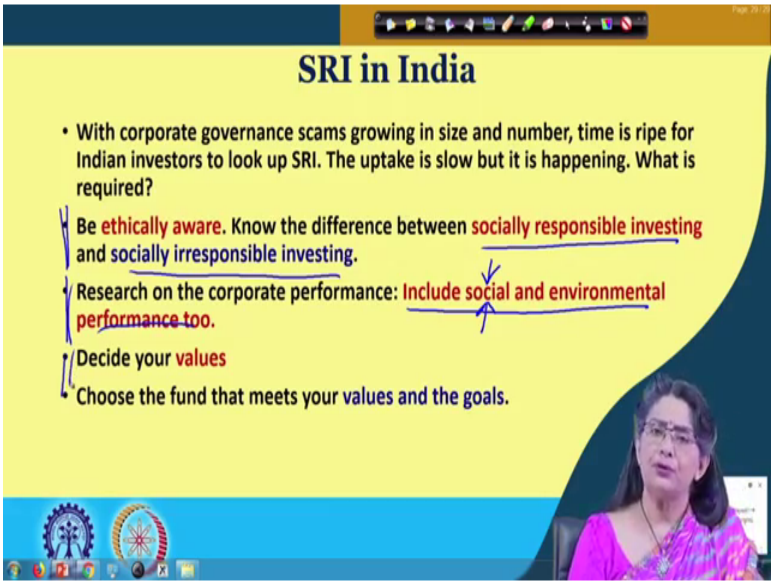

In India, the SRI uptake is low but it is time that Indian investors try this out because after so many every day, every time you open the newspaper, you probably come to know about it yet another corporate scams, yet another corporate fraud. So, when the scams are growing in number and you want to put your money in the market as investment, it is better that you do a little bit more research and become one socially responsible investor. What would it take? One is that you need to be yourself ethically aware; meaning you need to understand the difference between socially responsible investment and socially irresponsible investing.

Socially responsible investing is sending your money knowing fully well that it would not bring society any good. It may give you some private gain, but it is not going to change much in the society. In fact, your money might be used to undo some of the goods of the society. So, this is about your values, your discretion and your ethical sensitivity. Second when doing research for investment, you have some disabled money and most of us try to do a little bit of research before you invest your money. Instead of looking only at the financial performance of a company include the company's social and environmental performance also.

For example, try to find out how does the company treat its employees? What do the employees of that company say about that corporation? Or you might try to find out whether it is actually helping the communities around it and in what way, what are its contribution at all in terms of the society in terms of the community? Third is know your own values; you know the end goals, the priorities in your life and then, choose the fund that meets the values as well as your goals.

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So, here are some these are my suggestions, but the overall thing is that we want to encourage that people become a little bit more ethically aware even in the money matters. I will now finish this discussion on corporate governance, but not before I mention some of the earlier effort in reform.

You know this effort on trying to better the corporate governance practices in the country has been a long standing battle and but one particular effort stands out and I am going to talk about that is the Kumara Mangalam Birla Committee Report, it was set up by SEBI in 1999 to promote and raise the standards of corporate governance in India. In that report, there are many recommendations and some were mandatory, some were non mandatory; but one of the remarkable mandatory firms that was proposed is all the Clause 49, where for the first time in our country.

There was talk about the composition of the board the board members behavior, the structure of the audit committees, the meetings of the board; what would be the frequency of those meetings; how many committees you can be member of if you are a board member; the remuneration of the directors and the board procedures and also the disclosure are the reporting practices of corporations. Many of the recommendations of Clause 49 have been incorporated in our Companies Act 2013 and that talks about the success of that or the far reaching sight of that committees report.

There have been as I said many other efforts and I have mentioned some of the prominent ones, but together what they wanted is a reform, it is a reform. But what I have tried to present to you that reform does not come only from the law; it does not come only from the shareholders, their activism. It does not come only from the company if they try, but the system is such, the society is such that they are not ready for better corporate governance. So, what I am trying to say is that it has to be a concerted effort.

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It has to be an effort that must be put together by all the important stakeholders in it. With that know I am going to stop my lecture here.

Thank you very much.