Focus

First Reaction
Governance Spotlight
✓ **Regulatory Overview**
Thematic Research
Event Based Research
✓ **General**

Governance norms: Direction or diktat?

Highlights from the IGCN Annual Conference, held in San Francisco this year. The discussion about US experience with gender diversity on boards at the ICGN event, contrasts with the Indian experience. This shows that companies tend to wait for regulations to change, before implement change. Given such an attitude, regulators need to do a balancing act: regulate the basic requirements of good governance while remaining directional about others.

The International Corporate Governance Network (ICGN) annual event is one of the few must attend events for Corporate Governance buffs. The theme this year was "Promoting long-term thinking and behavior for sustainable capital markets," so ESG, Sustainability and Integrated reporting, Non-GAAP disclosures, engagement in Asia, Stewardship codes etc. all were on the agenda. But like in all such events, a few topics dominated the conversation. In this event there were two: 'one share one vote' and 'gender diversity on boards.'

A few days before the conference Peter Clapmann and Richard Koppes, both of whom had served on the board of ICGN wrote an op-ed for the Wall Street Journal urging investors to rethink one share one vote. In this piece (http://www.wsj.com/articles/time-to-rethink-one-share-one-vote-1466722733) they argue that the corporate landscape to is very different from the 80's. Today 90% of the directors are elected by majority vote and shareholders increasingly propose directors on the board and only 3% have poison pills in place. They go on to argue that "we see aggressive pushes for stock buybacks and calls to spin off or break up businesses and cut costs, including spending on research and development. Activists increasingly demand board representation to implement their agenda, often meaning that short-term investors take and quickly relinquish boards' seats. Boards frequently settle with activists out of fear of losing a proxy battle—or worse, winning a pyrrhic victory." They then argue for change including tenure voting i.e shareholders with long holding periods have greater voting rights.

Given the immediacy of announcement by Facebook introducing a third class of shares (http://www.business-standard.com/article/opinion/amit-tandon-prepare-to-unfriend-promoters-116050901325_1.html), to say nothing of the fact that the conference was being held in San Francisco a city that favors innovative thinking across all domains - including governance structures, this was clearly a hot button issue. But investors, including long term investors, overwhelmingly weighed in for one share one vote. While

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Write to us
Institutional Investor Advisory Services India Limited
DGP House, Ground Floor,
88-C, Old Prabha Devi Road,
Mumbai 400 025
Email: solutions@iias.in
Website: www.iias.in

companies, lawyers and academics will continue to press for change, do not expect this to change anytime soon.

Another issue that cropped up in session after session was the absence of women directors on (American) boards. Delivering her key note address – through video as the BREXIT vote required her to stay back in Washington, Mary Jo White, the Chairman of the Securities and Exchange Commission (SEC), remarked that "In 2009, women held only 15.2% of board seats at Fortune 500 companies and that number has only risen to 19.9% in the past six years; 73% of new directorships in 2015 at S&P 500 companies went to men. At this rate, the US Government Accountability Office has estimated that it could take more than 40 years for women's representation on boards to be on par with men's. The low level of board diversity in the United States is unacceptable."

In the absence of any authority to mandate board diversity has, the SEC has focused on disclosures. The SEC ruled – way back in 2009, that companies need to disclose if they have a policy on diversity – including how they define it. It then required the nominating committee to comment on its effectiveness.

What has been the impact of this rule? Mary Jo White says "Companies' disclosures on board diversity in reporting under our current requirements have generally been vague and have changed little since the rule was adopted. Very few companies have disclosed a formal diversity policy and, as a result, there is very little disclosure on how companies are assessing the effectiveness of their policies. Companies' definitions of diversity differ greatly, bringing in life and work experience, living abroad, relevant expertise and sometimes race, gender, ethnicity, and sexual orientation. But these more specific disclosures are rare." Clearly the SEC is not satisfied.

Gender diversity clearly is an area where Indian boards have rapidly moved ahead. The Companies Act 2013 legislated that all listed companies and companies above a threshold needed to have a women director on their boards. And Indian firms with some nudging and cajoling have embraced this change.

Figures from the PRIME database showed 1268 out of 1,457 relevant firms listed on the National Stock Exchange of India had appointed women by 1 April. It would have been ideal if all of them were also independent (even though there is no such regulatory requirement), but contrary to the popular misconception, a study my firm carried out last December found that only one-fifth of the women directors belong to promoter families.

This difference in outcomes is in a sense reflects on 'regulating through disclosures.' While it is understood that different stakeholders will have different objectives, it is now increasingly clear that investors too are a varied bunch, with different objectives and goals: the short term investors perspective is very different from that of a long-term investor, while others may focus on environment and sustainability. Regulators have the difficult task of balancing these demands, while ensuring they do not burden companies with additional disclosures that quickly become meaningless.

Using disclosures as an enforcement tool is a signal – a strong one no doubt, but it is not a diktat. Companies that are forward-looking will hear the message and comply. But both in India and elsewhere it is clear companies prefer to wait for regulations to compel change. Given such corporate behavior, regulators need to do a balancing act here as well: mandate the basic requirements of good governance (for example, enforcing diversity), yet remain directional about others.

A modified version of this article written by Amit Tandon was published in Business Standard on 21 July 2016. Read the article by clicking this link or typing the following on your browser:
http://www.business-standard.com/article/opinion/amit-tandon-governance-norms-direction-or-diktat-116072001317_1.html

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Office
Institutional Investor Advisory Services
DGP House, Ground Floor
88-C, Old Prabha Devi Road,
Mumbai 400 025
India

Contact
solutions@iias.in
T: +91 22 2421 6493/2432 0240
F: +91 22 22721574