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IndiGo flies into turbulence

With two of the largest airlines in doldrums, IndiGo's addition to the pack is worrisome. The battle between the two sets of promoters may not have affected operations just yet. But, we have yet to see an instance where governance issues don't eventually work their way into balance sheet challenges.

The [recent allegations of the Gangwal faction](#) (RG group) against the Bhatia faction (IGE group), both promoters of Interglobe Aviation Limited (IndiGo) with almost equal shareholding, revolved around three broad issues: (a) the Articles of Association (AoA) give the IGE group superordinate powers, (b) related party transactions between IndiGo and the IGE group were not conducted in a transparent manner, (c) the board decided not to convene an extraordinary general meeting (EGM) at the behest of RG group, even though they have the legal right to it. The mere suggestions of these – independent of which faction is correct – raises concerns over corporate governance standards at the board level.

Corporate governance at IndiGo can be strengthened. At a very basic level, the size of the board at six directors allows greater board control to the IGE group by virtue of their board nomination and executive director appointment rights (Exhibit 1). The median size of boards in India is between 9 to 10 members, and therefore board expansion will create room for more independent directors. Rakesh Gangwal, who was appointed to the board in June 2015, was not a member of any of the board committees – which effectively means that the same set of 5 people formed every board committee. The engagement of IndiGo's directors post-IPO, reflected in poor attendance levels, was another element of concern: promoters together had attended less than 50% of the board meetings (Exhibit 2). It is only in FY18 that attendance levels increased – perhaps as the Kotak Committee proposed harsh re-election criteria for absentee directors or that the differences had started to simmer. The root allegation made by the RG group is that of managing conflict of interest. This is reflected in IndiGo's audit committee composition, which included an executive director since its listing – Aditya Ghosh while he was still around, and then Rahul Bhatia once he took over as interim CEO – until recently (Exhibit 3). We believe having executive directors as members of the audit committee creates a conflict of interest that could best be avoided – more so, seeing that the main issues being raised are those of related party transactions.

Investors must question the need for related party transactions in the first instance. Why should allied services required by the airline be owned and provided by promoter-controlled entities? It is essentially the same question that Sun Pharma's investors are asking of Aditya Medisales. Such

operating structures add a layer of opacity and create investor mistrust at the first inkling of wrong-doing. While the IGE group can continue to assert that the related party transactions are a non-issue, such structures have often been the cause of financial leakages in other companies in the past.

IndiGo, in a sense, is the test case for what a differential voting rights (DVR) environment will look like. One of the concerns over differential voting rights is that it could result in management entrenchment. In IndiGo's case, the disproportionate voting rights (because the RG group must vote with the IGE group) provides enabling conditions for board capture – which is perhaps reflected in the board decision to not acquiesce to hosting an EGM. The RG group will now have to use its privileges under regulation and host the EGM on its own (Exhibit 4).

Investors recognize the difference between leadership (having someone at the helm who is accountable) and management / promoter entrenchment. But holding disproportionate power can be detrimental to stakeholders. It is in this context that SEBI needs to think long and hard once again about its decision to allow differential voting rights. Independent of SEBI's decision on this, stock exchanges, too, must not allow companies to list on their platforms under these circumstances.

With two of the largest airlines in doldrums, IndiGo's addition to the pack is worrisome. The battle between the two sets of promoters may not have affected operations just yet. But, we have yet to see an instance where governance issues don't eventually work their way into balance sheet challenges. It may be a while before lenders and investors trust them enough to give them access to capital. Most will ask them to sort out their internal battle first. Essentially, this means that if the airline wants to buy or lease more aircrafts to take advantage of the open slots, it will find it that much more difficult. Existing lines with banks may see some contraction if lenders believe the governance issues will impact credit quality. Some of these risks are now at the horizon. Investors must fasten their seat belt; this has the makings of a bumpy ride.

A modified version of this article was published in the Financial Express. The article can be accessed here: <https://www.financialexpress.com/opinion/indigo-flies-into-turbulence-investors-must-brace-for-a-bumpy-ride/1639958/>

Exhibit 1 – Rights afforded to the IGE group and the RG group in IndiGo’s AoA

- Where either of the groups wishes to transfer their shares to a third party, the other group (non-transferring party) will have the right of first refusal (shares can be purchased by the group or any person nominated by it) or a tag along right.
- Prior consent of the other (non-transferring) party will be required in case IGE or the RG group wants to transfer their shares to a competitor or to any person in a manner that will trigger an open offer.
- The right of refusal and tag along right will not apply to shares acquired by the groups after the IPO.
- None of the groups can acquire shares in a manner that will trigger an open offer.
- If the minimum public shareholding limit increases, the groups will be obliged to sell their respective stakes proportionately.
- IGE has the right to appoint 3 non-independent directors, 1 among these shall not be liable to retire by rotation. IGE also has the right to appoint the Chairman of the Board. (Clause 17.1)
- RG Group has the right to appoint 1 non-executive director not liable to retire by rotation. (Clause 17.1)
- IGE has the right to appoint the MD/CEO/President of the company (Clause 17.4)
- Presence of 1 director each nominated by IGE and RG group is necessary to constitute quorum for board meetings (Clause 20.2) - the groups can waive this requirement

Source: IndiGo’s AoA; IiAS research

Exhibit 2 – IndiGo’s directors’ board meeting attendance

Director	FY16	FY17	FY18
Rahul Bhatia (Promoter)	30% (3/10)	38% (3/8)	50% (4/8)
Rohini Bhatia (Promoter)	50% (5/10)	25% (2/8)	75% (6/8)
Rakesh Gangwal (Promoter)	14% (1/7)	50% (4/8)	63% (5/8)
Average attendance of promoters	33%	38%	63%
Devadas Mallya	100% (10/10)	88% (7/8)	100% (8/8)
Aditya Ghosh	90% (9/10)	100% (8/8)	100% (8/8)
Anupam Khanna	80% (8/10)	63% (5/8)	100% (8/8)
Average attendance of the entire board	63%	60%	81%

Note: Rakesh Gangwal was appointed to the board on 25 June 2015

Source: Annual Reports

Exhibit 3: Composition of IndiGo’s Audit Committee

Director	Category	31-Mar-16	31-Mar-17	31-Mar-18	30-Sep-18	31-Mar-19
M Damodaran	Independent Director	-	-	-	-	Chairperson
Devadas Mallya	Independent Director	Chairperson	Chairperson	Chairperson	Chairperson	-
Aditya Ghosh	Executive Director	Member	Member	Member	-	-
Rahul Bhatia	Interim CEO / Executive Director	-	-	-	Member	-
Anupam Khanna	Independent Director	Member	Member	Member	Member	Member
Anil Parashar	Non-Executive Non-Independent Director	-	-	-	-	Member

Note: M Damodaran joined the board in January 2019 and Anil Parashar joined the board in October 2018

Source: Corporate Governance filings on BSE

Exhibit 4: Procedure for calling an EGM (Section 100 (2) of Companies Act 2013)

- The Board shall call an EGM on the requisition made by shareholders -
 - In the case of a company having a share capital - holding not less than 10% of the paid-up capital of the company on the date of receipt of the requisition.
 - in the case of a company not having a share capital - holding 10% of the total voting power of the company on the date of receipt of the requisition
- The members should provide the requisition to call an EGM in writing or through electronic mode at least 21 days prior to the proposed date of the EGM.
- The notice should specify the place, date, day and hour of the meeting and contain the business to be transacted at the meeting. It is not mandatory to provide an explanatory statement for the proposed resolutions. Further, the requisitionists may disclose the reasons for proposing the resolutions. The meeting should be convened at the registered office or in the same city or town where registered office is situated on working day.
- The notice shall be signed by all the requisitionists or by a requisitionist duly authorised in writing by all other requisitionists and delivered at the registered office of the company.
- If the Board does not, within 21 days from the date of receipt of such requisition, proceed to call an EGM on a day not later than 45 days from the date of receipt of such requisition, the EGM can be called and held by the requisitionists themselves within a period of 3 months from the date of the requisition and reimburse any reasonable expenses from the directors in default for holding the meeting.
- The EGM shall be called and held in the same manner as any other meeting held by the Board.

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