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Infosys is no longer the bellwether of corporate governance in India

Infosys continues to maintain high corporate governance standards – but it is no longer a cut above the rest of corporate India. This diminution in its stature began well before Vishal Sikka's appointment.

Infosys signified corporate governance in India for the longest time. Its founder has been instrumental in developing and strengthening the corporate governance framework in India[1]. And while India was still trying to figure out what imbibing good corporate governance practices entailed, Infosys had steamed ahead by benchmarking itself to global players. Corporate India has changed radically since then, and one may argue that it has caught up with Infosys.

Infosys' governance standards have deteriorated by its own measure. Take Infosys' Corporate Governance Philosophy, (see Box 1) for example. The first two of its tenets say that the company will satisfy the spirit of the law and not just follow the letter of the law, and that it will go beyond the law in upholding corporate governance standards. Yet, the company's earlier auditors, BSR & Co LLP were its auditors for over 15 years. It is only in January 2017 that Infosys has rotated its auditors and appointed Deloitte Haskins & Sells LLP. Regulations require auditor rotation once every 10 years, but provided companies a three-year window period to make the switch. If Infosys indeed wanted to follow the spirit of the law – and mandatory auditor rotation being on the anvil was known as early as 2012, when the Companies' Bill came out – it should have considered rotating auditors much sooner.

Box 1: Infosys' Corporate Governance Philosophy

Our corporate governance philosophy is based on the following principles:
- Satisfying the spirit of the law and not just the letter of the law
- Going beyond the law in upholding corporate governance standards
- Maintaining transparency and a high degree of disclosure levels
- Making a clear distinction between personal convenience and corporate resources
- Communicating externally in a truthful manner about how the company is run internally
- Complying with the laws in all the countries in which the company operates
- Having a simple and transparent corporate structure driven solely by business needs
- Embracing a trusteeship model in which the management is the trustee of the shareholders' capital and not the owner
- Driving the business on the basis of the belief, 'when in doubt, disclose'

Source: Company website

Another case in point is the March 2016 reappointment of Professor Jeffrey Lehman as an Independent Director for a period of two years. Professor Lehman had completed his tenure of 10 years, and while regulations allowed him to stay on, the spirit of the regulation demands rotation. In response to IiAS' recommendation to vote AGAINST Professor Lehman's reappointment, Infosys cited that it was legally complaint. While that was indeed so, Infosys was in violation of its own Corporate Governance Philosophy. That investors too did not

[1] *Narayan Murthy Committee Report 2003 on Corporate Governance*

like this stance is evidenced in the voting pattern – 15% of the shareholders voted against the resolution, which is unusually high for Infosys.

The recent controversy over severance pay being paid to senior officials is not one for which the chairperson needs to resign. But, it needs to be explained – especially given the simmering discontent with a few investors. The nature and terms of the severance pay of its last CFO, Rajiv Bansal, should have been disclosed in the company's 2016 annual report. Infosys should have articulated the number and nature of roles that are eligible to have severance pay embedded in their contracts. Its remuneration policy should articulate which segment of employees will be eligible for severance pay. In not 'maintaining transparency and a high degree of disclosure levels' expected from it, Infosys has fed more controversy to the market than was necessary.

The other controversy is about Vishal Sikka's remuneration. Vishal Sikka is one of the highest paid CEOs in India, but a large proportion of his remuneration is variable in nature and linked to performance. His proposed remuneration on appointment in 2014 estimated at $7.08 mn annually was about 24% higher than what he was paid in SAP AG – but 60% of this is variable. The 2016 revision in his remuneration was also focussed more on equity compensation and less on the cash compensation and resulted in over 70% of his compensation being performance-linked, a strategy that directly aligns his pay with shareholder returns.

But, the lines were blurred when Narayan Murthy was reappointed to Infosys' board in 2013. The sequence of events and press releases from Infosys seems to suggest that Narayan Murthy's appointment was shoehorned into the AGM, with the required paperwork conveniently falling in place (See Box 2). Moreover, his appointment violated Infosys' retirement age restrictions – the 60-year retirement was summarily dispensed for Narayan Murthy.

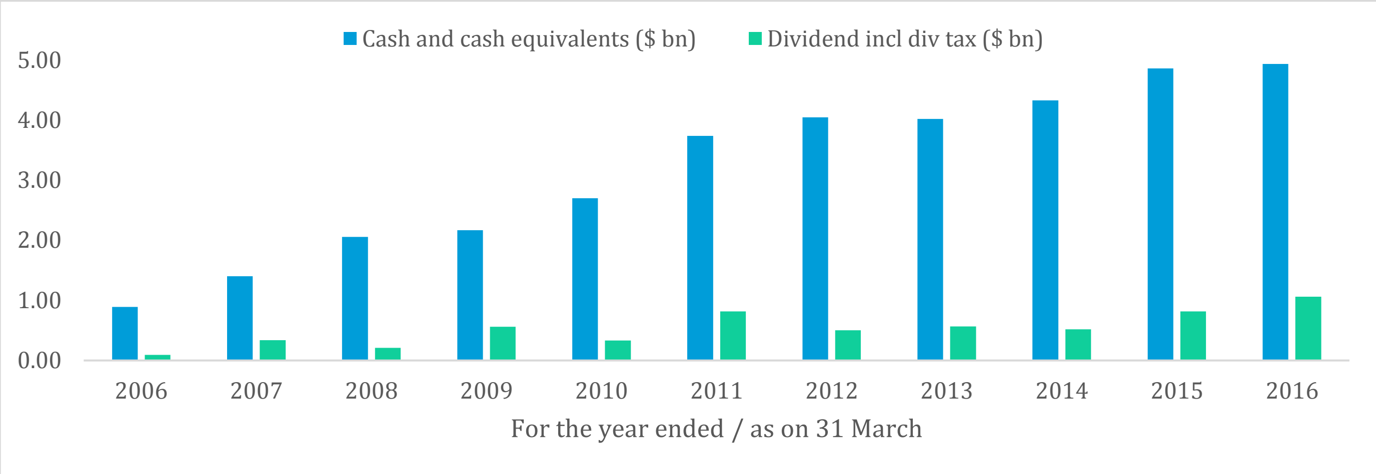
And even before Narayan Murthy's reappointment to the board, the decision to let each of the founders have a go at the CEO role is the antithesis to the meritocracy that Infosys had established as its corporate culture. While Infosys founders repeatedly maintained that their family members would not join the company, Rohan Murthy's appointment – even if it was co-terminus with that of Narayan Murthy and at a nominal pay – was a violation of their own principles.

Box 2: Narayan Murthy's reappointment to Infosys' board

In a June 1, 2013 release, Infosys announced the board had appointed Narayan Murthy as an Additional Director and that it would organize an EGM to appoint him as an Executive Director. On June 6, 2013, Infosys' released another statement saying that on May 31, 2013, it had received a notice from a shareholder proposing Narayan Murthy's candidature for the election to the office of a Director at the ensuing AGM, which was to be held on June 15, 2013. The shareholder's notice seemed to be conveniently timed just so that Narayan Murthy's reappointment could be placed before shareholders at the AGM: with appointment proposal dated May 31, 2013, shareholders were given a 15-day prior notice to vote him in at the AGM. Coincidence?

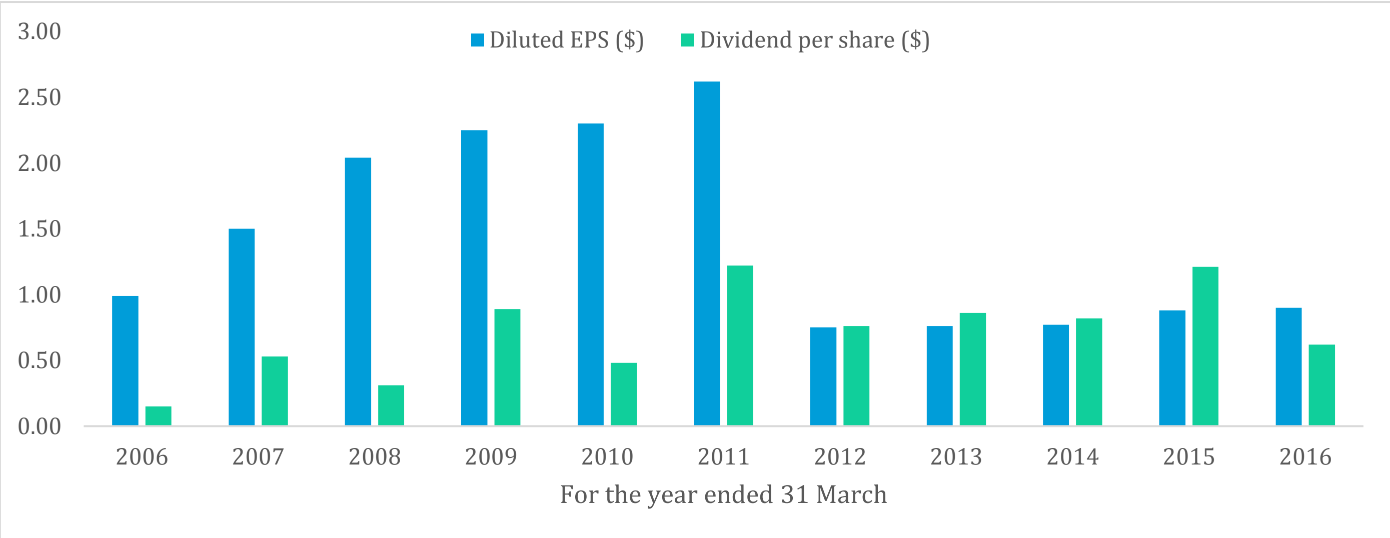
The promoters' concern that Infosys is hoarding cash and must consider a buyback is valid (See Chart 1) - on December 31, 2016, Infosys' cash and cash equivalents stood at $3.8 bn (Rs.261.13 bn) – despite its stated dividend policy (See Chart 2). But, Infosys has been hoarding cash for several years, well before Vishal Sikka or the current board took over the company's oversight. That some of the promoters wrote to Infosys board in 2014 – just before Vishal Sikka's joining – asking it to consider a buyback, is a testimony of this.

Chart 1: Infosys' cash hoarding (Consolidated)



Source: Infosys' 20-F filings; based on IFRS accounting *Note: Dividend includes special dividends declared in FY11 and FY15*

Chart 2: Infosys' dividend payouts



Source: Infosys' 20-F filings; based on IFRS accounting *Notes: Dividend and EPS have been adjusted for bonus shares*

Despite the slippages from its Corporate Governance Philosophy, Infosys remains one of the more transparent companies in India. Its disclosures, the structure and nature of its policies, and its ability to be ahead of the market on some governance practices remains undisputed. For example, Infosys is one of the few companies that has an articulated dividend policy with a target payout ratio (though we may disagree with this and believe the company must pay out more to shareholders) well before regulations required it to do so. It publishes consolidated financial statements (including the balance sheet) on a quarterly basis, which is more than required by regulations. Its investor discussions are easily accessible and the webcast of its AGM is available on the company's website. Infosys also has one of the best disclosures on non-financial information – especially on segmental performance and risk disclosures.

Infosys' board composition is also stronger than required by Indian regulations – six[2] of its 9-member board comprise independent directors. Infosys ranks in the

[2] *IiAS considers Prof Lehman as non-independent on account of his tenure – he has been a director on Infosys' board for over 10 years.*

top 5% for gender diversity on boards – only 21 of the S&P BSE 500 companies had three or more women board members on 31 December 2016[3].

These are just some areas that set Infosys' governance practices apart from the rest of corporate India. But what has changed is that while ten years ago, Infosys stood tall as a beacon of good governance, a few others have caught-up and in some aspects, have even moved ahead. This should irk. And while the management and board might be focused on reinventing the business model, its stock will not perform if they take their eyes off the governance agenda.

A modified version of this Institutional EYE was published in the Business Standard on 13 February 2017

[3] *Source: Prime Database, IiAS Research*

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