

**Session 5**

**Corporate governance and capital market regulation**

**Presentation by Session Chairman:**

**Mr. Mohan Das Pai, Whole Time Director and Chief Financial Controller,  
Infosys Technologies**

**Presentation by Mr. Luca Enriques  
( not to be done - as requested )**

**Presentation:**

**Mr. Ravi Narain, Managing Director & CEO, National Stock Exchange**

This is not the first conference on Corporate Governance that I have attended and participated and I am fairly sure, it won't be the last, so virtually one common thing, I have heard and mentioned in all Corporate Governance conferences is that Corporate Governance is about an attitude, is about culture, is about ethics, is about way of running the business. Well, if there is a clear consensus and if we all agree on that, then we ought to do nothing, whether we have had tremendous Corporate Governance but the fact of the matter is that this is one of the most elusive concepts to see in practice. The fact of the matter is and I completely agree with many of the statistics sighted whether from the McKinsey report and otherwise that good Corporate Governance does provide a clear premia in the stock markets for stock valuations.

Again, if that premia was so powerful and so compelling, in terms of a company going back to raise capital and conversely if poor Corporate Governance was such a debating factor, hampering and completely obstructing the ability of the corporate to raise capital, then all that we had to ensure was that the market should somehow provide for all capital needs by that simple token, I think, we would have a very powerful instrumentality of ensuring good Corporate Governance. The fact of the matter is that good Corporate Governance is only one of the elements which go into showing up in stock market performance and very often, there are so many other factors at work that when you look at it holistically, it is very hard for some of the market participants to figure out what is the Corporate Governance element. Do I truly vote for my feet for a company with poor Corporate Governance and of conversely and so on and so forth. So the dilemma therefore is this, if it is about a sector, it is about a movement, if it is about corporate ethics and that's long term, that's not going to happen overnight. It is like a society evolving, it is going to perhaps take a generation or two for good Corporate Governance to truly become a movement of sorts, which is really, I think, what all of us in this room are talking about.

Now, if that statement is given as taken and two, if capital markets are so important for an economy like ours, India cannot afford to show up a low rate of growth because of corporate scandals or because poor examples of Corporate Governance which severely hamper the ability of savers and corporate users of capital to come together, then some sort of intervention approach, obviously becomes inescapable and I think, really that is at the heart of this debate. Is there too much regulation, is there too little regulation. What we are really saying is that, is there too much paper work.

Forget for a minute, all of this detail. I think, what we are saying is, we recognize, it's a movement, we recognize its about value and ethics, we recognize, its not going to happen overnight, its going to take quiet a while, as I possibly sad, a generation and we don't have the luxury of that time because we need to build our markets, we need to build our corporate sector, we need growth, we need capital to flow to the most efficient areas, we must use the

market to be most efficient allocator of resources. Therefore, some intervention is required.

Now, Clause 49 fits right into that. We heard about Europe, we know, in our markets, it is Clause 49. What I will say is there are couple of principles enshrined in this approach. The principles are that management can have weaknesses. We were described that these weaknesses are because of pressure of quarterly results, the pressure of stock options, the pressure of analysts chasing for information, it is not practically to reverse any of that, I am not even convinced that we need to reverse it, we need good disclosure, we need timely disclosures, we need frequent disclosures. If that paradigm is not going to change in a hurry, then we obviously need to do something.

Now, the principles enshrined in the Clause 49 are this that if management are not going to have an over arching incentivisation paradigm to ensure that good Corporate Governance happens by itself, then what are the couple of knots that we can tweak to help the process along. My sense is, it is not about policing, my sense is, it is not about somebody sitting on somebody's head with a hammer to hit them hard when they make a mistake. It's about helping things along. What could help? The principle that is enshrined there is, if you have good and a larger number of independent directors who, it is believed, will be more neutral in their outlook to all those principles and pressures of quarterly results and e-stocks and management compensation structures and so on, some good will prevail, some progress will be made in this area. If audit committees are given some key conflict areas to look at, third transaction is an obvious one and so on and so forth. Then again, some good will happen, they will ask some intelligent questions, they will ask a few more piercing questions and therefore act as a voice of conscious on the corporate, it is really as simple as that.

Now, obviously in practical terms, in implementation, things can sometimes go a little awry. Why is that? Simple because, as a market society, as we are trying to find the right balance, we will go a little bit this way and that way, I don't think, frankly, that we should get too worked about it, yes it hurts, it pains us, because in the process, there is a little bit of paper work involved, there is a bit of bureaucracy involved at times but ultimately and I am sure that Infosys will agree with me that if the logic of a corporate is that it wants to practice the best Corporate Governance, I don't think, for them, it's a paper work issue at all. It would be very hard to persuade myself that, that is the case. Infact, we find for example and I remember today in our system, it is for the company to confirm that it is in compliance with Clause 49. Now, if a company in any case is striving to follow the best standards of Corporate Governance, they should frankly find it quiet easy to confirm that they are in compliance with Clause 49. What happens is at the margin? We have seen some companies and they are few and far in-between. We have seen some companies, we will say, we are in compliance but then in a footnote, there will be reasons why they are actually not in compliance. Now, again I am saying, leave that aside for a minute, this is all a question of over time, the system of finding the right balance and coming out to a point where all it is seeking to do is to nudge and push corporates to find their inner voice, to find their inner conscious, whey

they find that actually, over a period of time, good practices pay, good practices reward.

At NSE, we have tried to do one more interesting thing and that's called NFCM. NFCM stands for a NSE certifications of financial markets. We do that for all kinds of people in all kinds of areas, we do it for trading members, for brokerage areas, we do it for mutual funds, we do it for insurance companies, we do it for bank employees. We have recently launched a Corporate Governance module, which is typically for the practicing Company Secretary, about 150 practicing company secretaries have already taken that and there is a 75% pass rate on that. It is something worth thinking about. Again, there is no magic bullet here. There is really marvelous thing happening but again, it is to sensitize about where the problem lies. With the corporate sector, it is about us working with the key people in the company who are part and parcel of that compliance regime, the company secretary to make these things happen. Again, the rating agencies have come out with a Corporate Governance rating. Well, we can all sit and question that and there are obviously lot of negatives or worries or concerns about what a Corporate Governance rating can do but again it gives clues, it gives suggestions, it sort of nudges people into the past, so again it is a question of how does it happen.

So, just to summarize, if we believe, it's a movement, it's a value system, it is not happening by itself, if it is not happening by itself, the market-based economy is too important to leave alone, some intervention approach is required. If this approach feels a little heavy handed at times, its really a process, it will correct itself, very very quickly but in the process, it is important to not loose sight of one or two key principles, that if we have somebody important on the Board, who is neutral and remember, it can be the Chairman, it can be an independent director, it just takes one important director on a Board to make a difference. This search for one-third or 50% independent directors is not about the arithmetic of independence directors, it's really about the search of that one person who will act as the inner voice of conscience for that corporate and push it in the right direction.

**Presentation:****Mr. Ajeet Prasad, Managing Director & CEO, ASREC (India) Ltd:**

I think all points have been covered, so there is hardly anything to say. But still a few thoughts as an investor and also in the current environment where the Corporate Governance is being talked and seminars are being held and this is a good thing. But I just want to say in a very clear-cut manner that if we look at the Corporates, at the end of day, if it is a promoter-managed company or if it is a professionally-managed company, because you have to and if it is a public-sector, we presume it is a professionally-managed company. If the management has the belief and faith that they would like to profess, Corporate Governance as it is, again just to repeat something, numbers, rules, laws would not make any difference but if the management does not believe, when I say management, I mean working management, executive management, if they don't believe, then whatever may be the numbers, whatever be the law, it will merely be like a policing and new laws will keep emerging and emerging and nothing will happen. At the end of the day, we will have to deregulate everything, that's one significant point, I would want to make from my assessment.

Obviously, it is important that you have to have a platform for that, you have to create an environment and environment, when I say, as an investor, I would say, one has to bring those inputs in terms of openness in terms of expressing the view, in terms of giving the proper and right information of the company and I am restricting myself to the company right now and also ensure that there is no fear psychosis, there is no dictatorial management and professional management and let me also make a very candid point. If anybody says that professional management is not dictatorial and it is only the promoter-led management, I just dis-agree with that totally, having seen number of employees but vice-versa is also true.

Second point is that at the end of the day, the players have to be conscious and also there is a greed. For example, we are talking about the premium on a good corporate company which professes good Corporate Governance but if you look at it, when the market booms, majority of those 'fly by night operator' companies are the ones who are in the prominence. Also without getting qualitative, without making the qualitative comment but if you look at the IPOs, which are coming today, anybody can make it out that what is the situation, so what is the driving force.

The driving force actually is the greed because there is another facet of the entire thing. We keep talking about the corporate, stock exchange, regulators, auditors, other intermediaries but generally speaking, it is felt that it is investor who is gullible. Actually the investor is gullible at some point of time but he is also very greedy, so therefore, while it is important to have all these constituents of the capital market or financial market in the proper place and bring out the guidance, I would say, guidelines rather than rules and regulations, but it is equally important that the investor needs to understand that if he is greedy, which he is, then he cannot afford to always see the profits or good things. What we are trying to discuss here and invariably, it has happened, if you can take various events which have taken place at xyz

point of time, since eighties or so, it is the greed of the investor, which has caused this kind of situations. Now we have made enough rules and regulations. We need to now stop at it and actually make the movement and it is the market again, apart from the fundamental needs, fundamental strength of the company, market is a big leveler, market will not allow anybody to go in a long-term and again, its an issue of the short-term, mid-term and long-term and ultimately it is a long-term player or long-term investor who is going to make the best of the profits and also, I think, India has risen on a scale of 1:10, in my assessment, at least, six to seven. It has got good practices, which if you compare with pre-1992, there is a change of a huge dimension and it compares not only equally but much more than any of the so called modern countries. Infact, I would strongly recommend that you should read the latest Economist where they have talked about Germany. Germany, we know, used to be a very close-door economy, like a club of few people and all those kind of step and even the regulator, whatever little knowledge I have, used to consist of ten - fifteen people at some point of time because there was no governance etc. But the winds of change, which India has already been benefited has actually brought an openness and today the competitiveness of German economy is much more than what US does, so time is a great leveler and environment is a great leveler and I think, that's the way, one should be looking at it. Less of rules and more of practice and environment.

## **Question & Answers**

### **Question:**

My name is Louis Bouchez from the OECD. I think, it was a very interesting session till now and we will continue on this way. I just have one observation, which many of the speakers have underlined, the role of institutional investors, investors in general, whether they be greedy or not, indeed they play a crucial role in facilitating good Corporate Governance. If we look at India now, as far as I know, there is no such system in place which facilitates the exercise of voting rights by investors in a sort of way which OECD promotes, I mean, proxy voting. In Europe, as Professor Luca mentioned, currently a debate is going on, on proxy voting. This indeed may be a mechanism, which may be useful in India to give investors indeed a tool to exercise their votes .

India had a proxy voting system from 1956. There is a proxy voting system and proxies are sent by institutional investors to companies and these proxy votes are kept in a register, open to everybody, people read them out and companies appoint an officer of the company to act on behalf of the proxy holder, to stand up in the shareholders meeting and oppose the resolution

In India, we do not have that kind of a proxy agency but today the proxy voting in India, actually it is like this, if I give my proxy to Mohan and if he votes as per my requirement but obviously, it is more done in a very routine manner, that's the way but it has both the sides because if I give my proxy voting to agency then the agency must have that kind of an information ability, intelligence and accountability to perform my desire.

In addition to the proxy concept available since the very first day of Company's Act, we have now the concept of postal ballots also, which is picking up and which is on the same lines so that an ordinary shareholder can express his view on whatever he wants to say, if he doesn't want to attend the meeting etc.

### **Question:**

In addition to this observation on the previous question, I have a specific question to ask Mr. Luca. I think, if I have heard him correctly, my name is Ghiani. I am the Group Vice President of a Group called PSL. It is part of the Punj Group. I think, when he was mentioning about the various initiatives to modernize the EU corporate laws, one step he was mentioning was that the over ambitious project on the dual class shares and programmes. I have not understood dual class shares and pyramids. I have not understood this exactly, what you are saying. If you are referring to the dual class as the class of shareholders as equity and preferential, then you is it going to indeed help, if it is going to indeed help. In India at least, our experience is that this dual class has not worked very well in practice, so I don't know, whether you have got my question right.

### **Response:**

We have not worked well in practice. Well in Europe, there are many countries where separation between ownership and control is done by either issuing non voting shares for outsider investors or by issuing voting shares for



the promoters, the founding families. In other countries, pyramids are used, by which you have a chain of companies, each of them is listed so that the family at the top of the business group controls a big conglomerate with a very tiny investment. There is a discussion amongst economists on the merits of these forms of separation between ownership and control, which of course allow dominant families to retain control of companies having a very low percentage of the cash flow rights to dividends for those companies and the European Commission is taking the view that, this is bad because there is very bad conflict of interest between dominant shareholders and the outside investors, however, you will agree with me, there is a rationale for having these sorts of ownership structures, that is basically, if control of a listed company is very valuable to the controlling family. When the controlling family will never accept the idea of selling control to the market, divesting from its block of shares and let anyone buy control of the company with a takeover bid, simply because control would be up for grabs and it would be difficult to get what is worth when you divest it on the market so that the only way for young companies, countries where control is highly valuable for growth, the only way, by which they can grow and engage in more investment opportunities and so on is by issuing non voting shares because otherwise the founding family will simply decide, not to let the company grow in order to retain control so it is lesser evil between having companies not growing, not exploiting investment opportunities and having the family retaining control because they would then be able to sell at the full price, if they had to sell it to the market.

Do you folks that differential voting rights makes for good governance?

While there is, officially you have non-voting shares available so I think, that actually answers that question, what is known as, basically a golden share. If you view it in terms of the voting right caps, of course, right now, it is into the FDI arena but domestically it is not. In that case, the issue of investment into having non voting right shares will depend actually on the investors. What Prof. Luca is saying that whether you would like to have a control or you are going to look at only the return on investment, so that's basically the issue and that's what the model base of principle difference between, you see a widely based company and the closely held company.

Recently, we saw Google come to the market place and the founders of Google gave a prospectus to say, we shall do no evil but there are no differential voting rights.

I think, there are serious issues on this subject, which need debate. I don't think, I have an answer in two minutes. Its really a very complex subject and I think, there are issues, which need a lot more discussion on that. Before, I stop, can I sneak in one quick question for Professor Enrique here.

You said that in EU, the Board is collectively responsible for annual accounts. Now, if there is a mis-statement of accounts and the EU decides that some action has to be taken so when the Board is collectively responsible, what happens.

First of all, at the EC level, for now, there is only a proposal for a directive, which will soon be adopted and then it will have to be implemented by the member States, however, it is already the case in at least some of the member States that, Board, all of their directors are already responsible for their annual accounts. That is for the fact that they are drawn in accordance with the relevant accounting principles and regulations, which means that, it will depend on national sanction for false accounting, what the consequences will be. In many countries, there are criminal sanctions for directors in case of false accounting and in most of them, there are rules on civil liability, that is, as an investor, investing in a company who has issued the false accounts, you can go to Court and ask for damages, if you can claim that you received the damage from relying on those false accounts.

I don't think, that is the question before us. This panel said, good governance ought to reduce the cost of capital, this is a big American belief that the practice of good governance is to reduce the cost of capital. If that is granted, so that is one objective. The purpose of having differential voting rights is only to increase the number of instruments available in the capital market for companies to be able to access capital. Also with the same purpose of reducing the cost of capital, they both achieve the same objective but though both of them achieve the same objective, they are not inter-dependant so the purpose of having differential voting rights is not to have good or bad governance, not at all. It is to reduce the cost of capital, which is also the purpose of good governance, if I understood the panel.

**Question:**

Mr. Ravi Narain said that corporate governance evaluates over time and we have to have patience but my question is that for the regulator, are there 'no tolerance' zones in this, which you will not simply accept and they have to enforce it very vigorously.

**Response:**

When you go for a rule-based regime and any non-compliance, actually leads to 'zero tolerance'. In any case because if you have a rule, you can't say that, I have a rule but I will allow you to break it. This does not happen. When you jump a traffic signal, you are not supposed to cross the signal at red. The police will catch you and fine you or you will do an underhand dealing, I would say that when you talk of rule-based regime, everything needs to be complied with and no additional emphasis needs to be laid that this is a 'zero tolerance' zone.

I think, the point about patience was not about non-complying with rules and laws of the land. I was just saying that if its truly a cultural thing, we all know, how hard it is to change culture. It takes time and in the interim, some interventist approach is inescapable.

Prof. Luca made a very interesting point and the point is, what is good for a dominant shareholder, good for the rest of the shareholders. We see voices in India in this direction where a leading figure has come and said publicly, what is good for the promoter who is a dominant shareholder is good for

everybody and you don't like me, go and sell the stock. How does it impact the shareholders who buy the stock and how does it play in the market place. How does the market react to all this. I think, in India, the stock went up, in the short run but in the long run, well, this is another point, which we need to debate because EU very clearly talks about forcing, allowing, incentivising family dominant companies to sell stock and to grow and the focus there, I think, has to do with culture because the EU is married to the question of a social compact, stakeholder interest. We have seen the President of France say that, we are not shareholders, we are stakeholders, we have a voice and we seen, our Commerce Minister said, it is the shareholders who decide, not stakeholders. Governance is getting extended to stakeholders and people who don't have a financial interest in the Corporation are now getting a voice. We saw employees get a voice in Europe, so I think, the European model is very broad based, it is not a free market model like the United States. In India, I don't know, which way it is moving.

**Question:**

My name is Suresh from Kesoram Industries, Kolkata. My humble submission is that, since yesterday morning we have been listening over the form and materiality concept. My point here is only that the regulator should also give some thought to these perspectives because ultimately, it is substance which matters than the form. I think, this is the objective

There is a point. In the United States, for example, the SSC catches up companies for some violation and some difference of opinion in accounting where they say, it is their opinion and bash them up.

**Question:**

With respect to proxy reform in the US, we have just recently lost a big battle where shareholders would have direct access to the Board, where they could actually challenge the Board so shareholder participation would have some merit. In England, we know that Board essentially can be taken out by shareholder challenge through the Charter, which means that, infact Europe is much more concentrated with respect to changing the Board than the US. Infact the US is much further behind. So the question I have for you with respect to your presentation, which I thought was excellent was with respect to cross border shareholder rights, which is now thought to be the most important issue for Europe to facilitate a level playing field, to make the market for proper control more robust. Why is it that Europe, if it is going to raise this logic hasn't taken on board the very idea of proposals that challenge the shareholders by essentially direct questioning their control and effectively going much more toward shareholder activism of the US variety which we stepped back from paradoxically.

**Response:**

The proposal on shareholder voting does contain some provisions of this kind. It will require member states to empower shareholders with the right to the items on the agenda and to table draft resolutions, which is what you are talking about basically. So we are going into this direction, of course, the bait was big and there were many voices in the US who had finally the upper hand, according to which, it is not such a wise policy to let shareholders

always decide on everything because shareholders also have conflict of interest, some of them at least. When there are important shareholders, they might have their own agenda, which may be conflicting and second shareholders are often un-informed, they don't know much, they often cannot get enough information in order to decide what is best for the corporation, of course, this is the managerial view.

**Question:**

My question is addressed to Mr. Luca. As you mentioned that 10% and more disclosure requirements for only the small shareholders, if I correctly read it, not for the block shareholders. My question is, the objective behind this is what. Ultimately it is the block shareholders, who are going to have much more influence on the decisions of the corporates than the small shareholders.

Any shareholding more than 10% is required to be disclosed in the event of small shareholders not block shareholders so what objective it attains to?

**Response:**

If you are talking about prompt disclosure of trading by dominant shareholders, I think it was an implicit decision, it was not even discussed at the EC level that only directors and managers have to disclose trading on company shares and the fact that this was not even discussed is quiet telling of the force of dominant shareholders in European Company Law making and Policy making but there is no rationale for this choice, dominant shareholders usually have access to inside information whether legally or not so there is really no justification other than timidity on the part of European Policy makers.

**Question:**

My name is M. K. Chouhan from Asian Centre for Corporate Governance. My point relates to some remarks of Mr. Ajeet Prasad. It is an observation. In the context of India and Asia, we refer dominant shareholders as promoter shareholders. The point is not that whether the family scions, who are the sons and daughters of the promoters are in certain important management positions. The point is whether they are professionally qualified to discharge their duties, for which they are appointed and there is an interesting trend taking place, which I want to share with this august audience. In Asia, the scions of these families are getting more and more qualified in Harvard's, Wartons and Kelloggs of the world and therefore they are definitely bringing in the professionalism in managing these companies and if you see from the international examples, at least two very distinct examples you have where the family scions have come back in managing the companies, take the case of Ford Motors. Ford was absent from the Board as well as management for a very very long time, they have come back to manage the company. Take the case of Bata, which is more than hundred years old company. Bata family, only two survivors, one son, one daughter. Mr. Bata has come back after hundred years to be a part of the management so the point is, whether it is a family member or a promoter's son or daughter, we should not look at them with tainted eyes. We should look at them whether they are professionally qualified to discharge the duties for which they are appointed.

I think, that is debatable because it is the duty of the Board to choose the CEO and the best person they can get should be the CEO and naturally, if you have a dominant shareholder and if the family of the dominant shareholder puts forward his candidature, it is a question that the Board has to question and debate

**Question:**

This is only to supplement on differential shareholding. I think, this concept has become very very useful in situations in these emerging economies where joint ventures are getting formed and they are not listed companies but to differentiate the shareholding between the joint venture partners, this concept is very well written. This is my supplemental information.

**Question:**

Sir, my name is Asit Ahmed. I am from Business & Economy magazine. Sir, when we talk about mergers and acquisitions, there are two types of barriers. One is transactional barrier, which makes the deal itself very difficult. Other is efficiency barrier, that is, it restricts the company from extracting maximum synergies.

Sir, my question is regarding the ongoing consolidation in the European, banking sector specially. There have been lots of talks about efficiency barriers in European region, be it the Bank of Italy, 30% stake or the recent BNP Paribas and the BNL which is also the leading bank in Italy. Do you think, isn't it the case of excessive regulation or does it have any tangible benefits. Your comments.

**Response:**

Well, it is an embarrassing question you ask to an Italian. However, as I work as a consultant to a company who was the legal advisor to the ABN Amro last year in the take over battle for the Belgium bank which was finally taken over by the Dutch bank so I was on the right side at least, in this embarrassing situation but of course, there was an excess of regulation in the banking sector with regard to ownership structure, which is still there because the European directives haven't changed yet and the European directives did nothing to make it easier for bank to take over another bank from another member state. To the contrary, they made it somewhat more difficult because the procedures were more complicated, if the take over was a cross border one.

However, scandals always have a positive component in that this is not done any more and I have a doubt whether other countries would act in the same way after what happened in Italy. There are some attempts in Poland to do something similar with an Italian bank having taken over Polish bank but the European Commission is very tough on this. However, as you perhaps think, there are not only regulatory obstacles to cross border consolidation of the banking sector in the Europe, there are also market obstacles. The banking markets are still quiet unintegrated and its quiet hard to find synergies between banks from different countries and therefore, there are limits to banking integration in Europe which derive from the structures of the market

which not necessarily reflect regulatory progress but also structural problems. These are natural markets and we have to integrate them as a market matter, not just as a regulatory matter.