Investors’ signal that regulators must enforce board composition norms for PSEs

Having endured the failure of PSEs to meet board composition regulations over several years, in the 2020 AGM season, several institutional investors voted against board (re)appointments. But, because the Government owns majority equity in PSEs, and regulations that allow the Government extraordinary control powers over listed PSEs, investors’ ability to effect change is limited. In this context, regulators need to step in and enforce compliance for board composition norms at PSE. Better governance leads to better valuations which will help achieve our disinvestment goals.[1]

The Niti Aayog’s Strategy for ‘New India @ 75’ published in November 2018, recommended that the government should exit central public sector enterprises (CPSEs) that are not strategic in nature. It argued that inefficient CPSEs surviving on government support distort entire sectors as they operate without any real budget constraints. For larger CPSEs, it was suggested that the goal should be to create

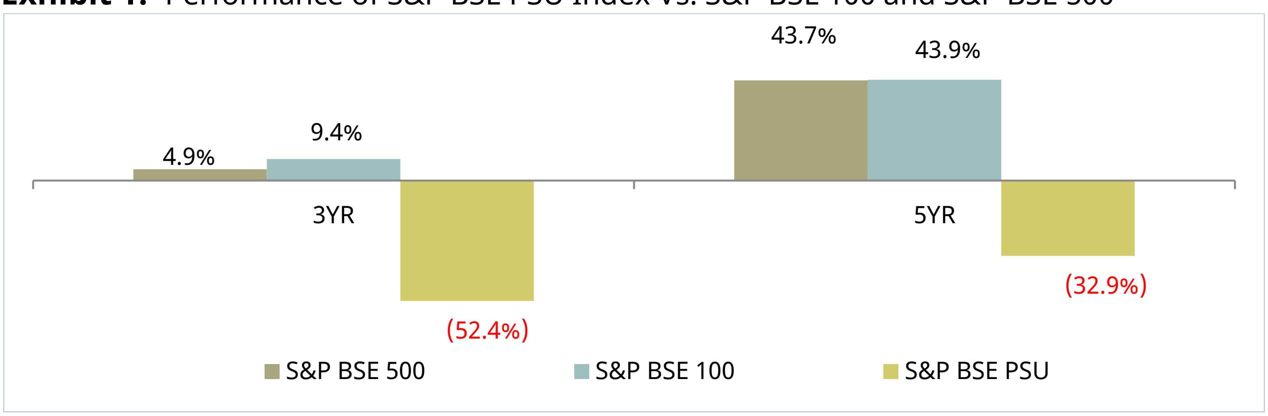
[1] Note the original blog has been edited with a clarification regarding the ‘category’ of directors being voted against. The insertion has been made to the last para on Pg 3.

widely held companies by offloading stake to the public to create entities where no single promoter has control. Niti Aayog felt that this will both improve management efficiency and allow government to monetize its holdings with substantial contribution to public finances.

The Government has made inroads on the divestment agenda, mainly triggered by tepid GST collections. We believe that the agenda of improving efficiency and productivity of PSEs and realizing the right price from the sale of whole or part of the business will be incomplete without having an independent, robust, and empowered board.

Over the years the administrative ministries should have streamlined the process of appointing directors to the boards of various PSEs under their administrative charge. Their repeated failure to even meet the regulatory requirements, reflects their indifference and their lack of understanding the financial cost of such unconcern. Although there may be a number of reasons for PSEs underperforming in the market, the apathy shown by the administrative ministry in appointing directors, is an important factor leading to sizable underperformance in the market (Exhibit 1). The net result is a loss for the exchequer.

Exhibit 1: Performance of S&P BSE PSU Index Vs. S&P BSE 100 and S&P BSE 500*



Source: IiAS Research, BSE data
* About 70% market capitalization of PSU Index comprises of public sector enterprises (residue 30% is public sector banks), which reflects the conclusions of our analysis

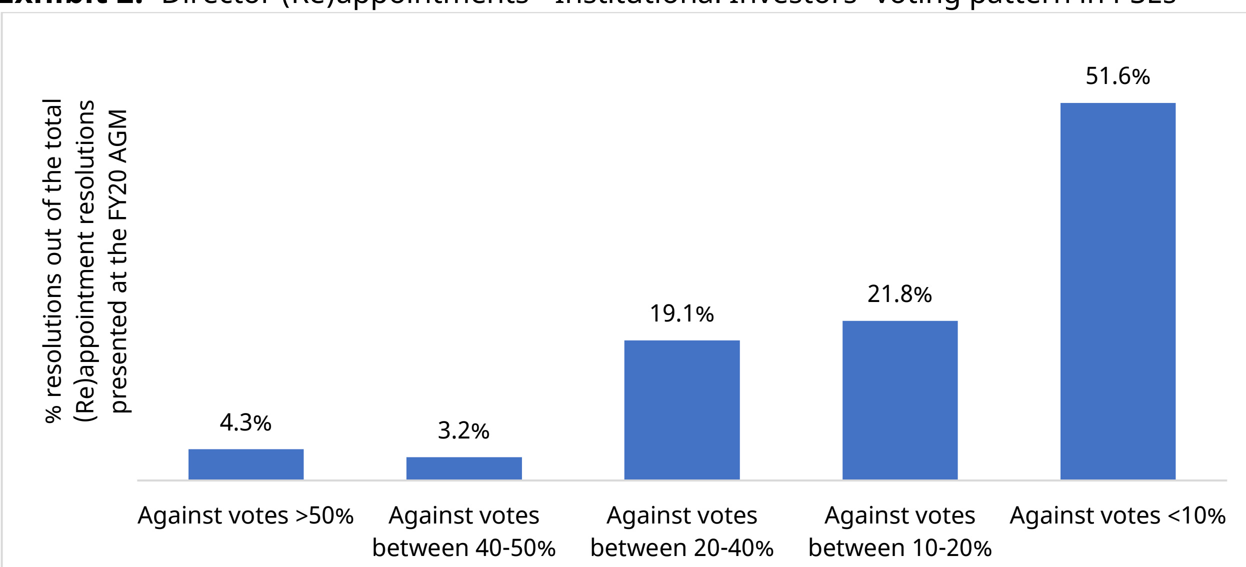
Regulation 17(1) of the SEBI Listing Obligations and Disclosure Requirements (LODR), states that for a company with an Executive Chairperson, at least 50% of the board should comprise independent directors. Given, PSEs appoint Executive Chairperson, 50% of the board should comprise of independent directors. Of the 45 PSEs (excluding government owned banks) for which IiAS sent out voting recommendations this year, 30 companies (or 2/3rd of the pool) were not compliant with the Regulation 17(1) of the SEBI LODR. Five of these 30 companies did not have even one independent director (see annexure).

Performance on the diversity agenda is equally poor. About 45% or 20 companies do not have an independent woman director, two years after SEBI made it mandatory in April 2019.

As the Government is a controlling shareholder in PSEs, the board appointments are completely directed by them. All director appointments are made by the Administrative Ministry of the Government, and these are seldom timely. Providing autonomy on board appointments may help the companies, not only to comply with the regulatory requirements but also mark the first step in decentralizing the decision-making process. This can help the companies to accelerate on the Government's strategy to improve efficiency or divest a particular PSE.

Institutional investors no longer have the patience for the lack of compliance by PSEs on board composition. In the 2020 voting season, investors have pushed back on board appointments/reappointments: 26.6% of the 188 resolutions for director re-appointment proposed by these 45 PSE's had more than a 20% institutional investors voting against, of which 3.2% had between 40-50% and 4.3% more than 50% against.

Exhibit 2: Director (Re)appointments - Institutional Investors' voting pattern in PSEs



Source: IiAS Research, BSE data

We observe that investors have voted against director appointment/reappointment (other than CMD and independent directors) resolutions in PSEs, where the board does not meet the independence norms, does not have an independent woman director or executive directors that have been appointed on the Audit Committee or the Nomination and Remuneration Committee.

While investors have voted their frustration, their ability to effect material change is limited. The Government has dominant shareholding in PSEs and the regulatory environment allows the Government extraordinary control rights despite these being listed companies. Further, listed PSEs continue to straddle twin agendas - increasing returns for shareholders and executing the national policy agenda - which could sometimes be at odds with each other. In this context, minority investors in PSEs are left with little rights and almost no recourse.

Governance begins when compliance ends. But PSEs are still struggling with hygiene level issues: with compliance breaches continuing for several years, addressing the corporate governance agenda is moot. But it is worth keeping in mind that better governance leads to better valuations, which will help achieve our disinvestment goals.

The regulators have stepped in time and again – either through a direct intervention or through policy creation – to protect minority shareholder, more so if these are small, retail shareholders. However, the regulators have let things slide with PSEs. Nudging these companies into better compliance has not worked – it is time for regulators crack the whip.

Related Research:

- For want of a nail; September 2018
- Listed PSUs: Explaining the governance gap; March 2016
- PSU’s must lead the governance agenda, not trail behind: August 2015
- Coal India must expand its board; August 2015

ANNEXURE: List of PSEs under IiAS coverage

#	Company	Independent Directors as a % of total board	Independent woman Director	Institutional Shareholders Against Votes on (Re)appointment resolutions					
				>50%	40-50%	20-40%	10-20%	0-10%	Total resolutions Presented at the 2020 AGM
1	REC Ltd.	0%	No	-	-	1	-	-	1
2	NHPC Ltd.	0%	No	-	-	-	3	1	4
3	National Aluminium Company Ltd.	0%	No	-	-	4	-	1	5
4	Housing and Urban Development Corporation Ltd.	0%	No	1	-	-	-	-	1
5	Cochin Shipyard Ltd.	0%	No	-	-	-	-	5	5
6	Bharat Electronics Ltd.	10%	No	-	-	-	4	-	4
7	ONGC Ltd.	10%	No	-	-	1	4	-	5
8	Engineers India Ltd.	11%	No	-	-	-	5	-	5
9	IRCON International Ltd.	14%	No	-	-	3	-	-	3
10	Bharat Petroleum Corp. Ltd.	17%	No	-	-	2	-	-	2
11	Coal India Ltd.	22%	No	-	-	-	4	1	5
12	Bharat Heavy Electricals Ltd.	27%	No	-	-	-	7	-	7
13	NLC India Ltd.	27%	No	-	-	-	-	5	5
14	Chennai Petroleum Corp. Ltd.	29%	Yes	-	-	3	-	2	5
15	Hindustan Petroleum Corp Ltd.	30%	No	-	-	4	-	-	4
16	Oil India Ltd.	30%	No	-	-	-	-	7	7
17	RITES Ltd.	33%	Yes	-	-	-	-	5	5
18	GAIL India Ltd.	33%	Yes	-	1	2	-	-	3
19	MOIL Ltd.	33%	No	-	-	-	2	1	3
20	Mishra Dhatu Nigam Ltd.	33%	No	-	-	1	-	-	1
21	Power Finance Corporation Ltd.	33%	Yes	-	-	1	1	-	2
22	Petronet LNG Ltd.	38%	Yes	4	2	-	-	-	6
23	Mangalore Refinery & Petrochemical Ltd.	38%	Yes	-	-	5	-	-	5
24	Power Grid Corp of India Ltd.	40%	Yes	-	-	3	-	-	3

#	Company	Independent Directors as a % of total board	Independent woman Director	Institutional Shareholders Against Votes on (Re)appointment resolutions					
				>50%	40-50%	20-40%	10-20%	0-10%	Total resolutions Presented at the 2020 AGM
25	Bharat Dynamics Ltd.	42%	Yes	-	-	-	-	3	3
26	Hindustan Aeronautics Ltd.	42%	No	-	-	-	-	3	3
27	Container Corporation of India Ltd.	43%	No	1	2	-	-	-	3
28	BEML Ltd.	45%	Yes	-	-	-	-	6	6
29	Indian Oil Corp. Ltd.	47%	Yes	-	-	2	1	1	4
30	NTPC Ltd.	47%	No	-	-	1	5	-	6
31	Garden Reach Shipbuilders & Engineers Ltd.	50%	Yes	-	-	-	-	3	3
32	PTC India Ltd.	50%	Yes	-	-	-	-	7	7
33	PTC India Financial Services Ltd.	50%	Yes	-	-	-	-	5	5
34	Mahanagar Gas Ltd.	50%	Yes	1	-	-	1	2	4
35	Gujarat Gas Ltd.	50%	Yes	1	-	-	1	3	5
36	Gujarat Alkalies and Chemicals Ltd.	50%	Yes	-	-	-	1	4	5
37	SBI Cards and Payment Services Ltd.	50%	Yes	-	-	-	-	2	2
38	LIC Housing Finance Ltd.	50%	Yes	-	-	-	1	4	5
39	Indraprastha Gas Ltd.	50%	Yes	-	1	-	-	4	5
40	Gujarat Narmada Valley Fertilizers & Chemicals Ltd.	50%	Yes	-	-	1	-	3	4
41	Gujarat State Petronet Ltd.	55%	Yes	-	-	1	-	5	6
42	Repco Home Finance Ltd.	56%	Yes	-	-	-	-	1	1
43	Gujarat State Fertilizers & Chemicals Ltd.	57%	Yes	-	-	-	1	5	6
44	Tamil Nadu Newsprint & Papers Ltd.	60%	Yes	-	-	-	-	5	5
45	SBI Life Insurance Co. Ltd.	60%	Yes	-	-	1	-	3	4
	Total			**8**	**6**	**36**	**41**	**97**	**188**

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