"ROLE OF PROXY ADVISERS IN CORPORATE GOVERNANCE"

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ABSTRACT

Foreign institutional investment inflows also are increasing all over the globe in general and India in particular. Corporate governance is essentially concerned with the process by which companies are governed and managed. It is more-or-less a country-specific system. Corporate governance mechanisms are the methods employed to solve governance problems at the firm level. The concept of proxy advisors is an age-old one around the globe. The institutional investors are playing a dominant role in the governance of the companies and vote with millions of shares at general body meetings or postal ballots, e-voting etc. with the support of proxy advisors as they may not have expertise to ensure proper corporate governance. SEBI (Research Analysts) Regulations 2014, issued regulations for proxy advisors. **The present article focuses on the role of proxy advisors in corporate governance. P**roxy advisors are supposed to be unbiased. Otherwise they may have an adverse affect on resolutions/ decisions of the company. The general body meetings are no more formal meetings for compliance under Laws and controlled by few, but directors have to tune themselves in the meetings as per the expectations of proxy advisors who are behind the institutional investors.

Key words: Corporate Governance, Institutional investors, Proxy advisors, Shareholders' participation and General Body meetings.

Introduction: Corporate governance is essentially concerned with the process by which companies are governed and managed. It is a set of standards which aims to improve the Company's image, efficiency, effectiveness, and social responsibility. It is a specially designed framework of legal, institutional, and cultural factors shaping the patterns of influence that shareholders (or stakeholders) exert on managerial thinking and decision-making process. The concept primarily hinges on complete transparency, integrity, and accountability of the management with an increasingly greater focus on stakeholders protection. A key element of good governance is transparency projected through a code of good governance which incorporates a system of checks and balances between all stakeholders. It is more-or-less a country-specific system. Corporate governance mechanisms are the methods employed to solve governance problems at the firm level.
The concept of proxy advisors is an age-old one around the globe. However, it may be relatively new in India. The role of proxy advisors seems to be critical and brought a significant change in the governance of corporate. The investors may affect the shareholder's value and the quality of corporate governance. The institutional investors may hold large number of company's shares collectively in various industries all over the world. The institutional investors are playing a dominant role in the governance of the companies and vote with millions of shares at general body meetings or postal ballots, e-voting etc. with the support of proxy advisors as they may not have expertise to ensure proper corporate governance.

Review of literature:

Corporate Governance in India - A Historical Perspective : At the time of Independence, India had a functioning stock market, an active manufacturing sector, a fairly developed banking sector and also a comparatively well developed British-derived convention of corporate practices. From 1947 to 1991, the Government pursued markedly socialist policies. The state nationalized most banks and became the principal provider of both debt and equity capital (Pande and Kaushik, 2012). Firms were evaluated on the basis of capital invested rather than their return on investment. Competition, especially foreign competition, was suppressed. Private providers of debt and equity capital faced serious obstacles in exercising oversight over entrepreneurs due to red-tapism, long delays in judicial proceedings and difficulty in enforcing claims relating to bankruptcy. Public equity offerings could only be made after ratification by the Controller of Capital Issues, Government of India. Public enterprises were only required to comply with limited governance and disclosure standards as enumerated in the erstwhile Companies Act (1956).

Faced with a fiscal crisis, the Government of India initiated major economic reforms in 1991. Accordingly, a new Industrial Policy was adopted. The office of the Controller of Capital Issues was abolished. Firms were encouraged to access capital markets for their financing needs. Since then, remarkable developments in capital issue volumes, trading volumes and resultant increase in gross domestic product (GDP) growth have taken place. There was a substantial growth in the year-on-year in-bound and out-bound Foreign Direct Investment (FDI) flows. Foreign institutional investment inflows also increased as India was viewed as an attractive emerging market destination. This necessitated improvements in corporate reporting systems for the benefit of investors. Corporate governance reforms and major corporate governance initiatives began in the mid 1990s, as the process of globalization of the economy gained momentum. Corporate disclosures had to be 'adequate, fair and full' (Sareen and Chander, 2009).
The Companies Act (2013) contemplated a shift by introducing legislative provisions on corporate governance rather than leaving it in the domain of the listing agreement. This led
to corporate governance being regulated by the Ministry of Corporate Affairs (MCA), Government of India, as well as SEBI. In addition, Central Public Sector Enterprises (CPSEs) are required to follow

corporate governance guidelines issued by the Department of Public Enterprises (DPE) from time to time (2007, 2010, and 2011 respectively).

Definition of Corporate Governance: According to the Institute of Company Secretaries of India (ICSI, 2009), corporate governance is "the application of best management practices, compliance of law in true letter and spirit, adherence to ethical standards for the effective management, and distribution of wealth, discharge of social responsibility for sustainable development of all stakeholders".

DPE Guidelines (2010) stated that corporate governance is the acceptance by management of the in-alienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about business conduct and about making a distinction between personal and corporate funds in the management of the company. Blair (2011) stated that corporate governance is "about the whole set of legal, cultural and institutional arrangements that determine what public corporations can do, who controls them, how that control is exercised and how the risks and return from the activities they undertake are allocated."

The Organization for Economic Cooperation and Development (OECD) provided a functional definition of corporate governance as "the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as Board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance." (Desai, 2011).

Therefore corporate governance referred to was as to how a company was managed, in terms of the institutional systems and protocols meant to ensure accountability and sound ethics. It encompasses a variety of issues, such as disclosure of information to shareholders and Board members, remuneration of senior executives, potential conflicts of interest among managers and directors, supervisory structures (David F et al 2010). Corporate governance was also viewed as" a system of checks and balances between the Board, management, and investors to produce an efficiently functioning corporation, ideally geared to produce long-term value." (Brancato et al (2003). Therefore in its simplest form, corporate governance was the set of systems and processes to direct and control an organization in order to increase performance and achieve sustainable shareholder value. (Fahy et al 2004). According to Blaire and Stout (2001) the main purpose of corporate governance was to align the interest of the individuals, corporations and the society.

Conflict of Interest: UNCTAD (2008) – Guidance on good practices on corporate governance disclosures, required that conflict of interest affecting Board members should at least be disclosed, if they could not be avoided. The Board of directors should disclose whether it had a formal procedure for addressing such situations, as well as the hierarchy of obligations to which directors would be subjected to. The company should disclose all conflicts of interest, along with what the Board decided to do in the specific situation and the relevant director involved along with the nature of his/ her interest.

Forbes and Milliken (1999) observed that a Board's inability to perform its various roles would affect firm's performance directly. Zahra and Pearce (1989), stated that from the agency perspective, the Board's contribution to firm's performance should be assessed by reducing agency costs arising from established goals and procedures (Board monitoring role) and through strategic

decision-making. According to Sunderamurthy and Lewis (2003), from the stewardship perspective, the Board's advisory service, to enhance Board's - management and decision – making, could contribute to firm's performance.

Goodstein, Gautom and Boeker (1994); Pfeffer, (1972) and Provan (1980) emphasized the resource dependency theory. It was stated that the directors, because of their prestige in profession and communities, would be able to extract resources for company operations.

Proxy Advisors in corporate Governance: The institutional investors invest in several companies in different industry range across the globe. The legal systems and regulations are not uniform all over the world, as they are regulated by different regulatory bodies and laws in operation. Therefore, they may give rise to legal complexities and the requirement of proxy advisors. **Proxy Advisor** is one who helps the investors about the rationale for a proposed resolution be passed by the company and accordingly facilitates them to vote 'for' or 'against' the motion. They provide valuable suggestions for taking informed decisions relating to the corporate governance of that country, in which investments are made. Their recommendations to the investors may have significant impact on the outcome of the company's voting results. The role of proxy advisory firms are prominent in the big corporates, when the proposed resolutions in the members meeting do not result in the expected manner of the company. Exxon Mobil corporation ,US (2012) expressed that Proxy advisors hold a position of unparalled influence and said that 20-25% of the votes in Exxon were casted based on the recommendations of proxy advisors.

Why proxy advisors: The concept of proxy advisors exists mainly for better shareholders' participation with sufficient/ requisite information in annual general body meetings. According to OECD Principles (2004), II F.1, " The effectiveness and the credibility of entire corporate governance system and company oversight will---- to large extent depend upon institutional investors that can make informed use of their shareholder rights and effectively exercise their ownership functions in companies in which they invest." The proxy advisors are required on the expectation that the institutional investors are the drivers in corporate governance. These advisors offer services on both analysis of proposal and voting decisions in annual general body meetings. In addition, these advisors assist the investors in understanding of different agenda items and allowing them to optimize their own limited resources and cast their votes in timely and informed manner. More over proxy advisors help investors through their consultancy about the corporate governance specifications of that country in which they have made investments. The proxy advisors mitigate language issues in case of cross boarder voting investors. In the companies, where electronic voting is a pre-requisite proxy advisors may facilitate / enable the investors to have a voting platform for their voting. These advisors suggest the voting decisions to investors who in turn exercise the same in general meetings. In India, the institutional investors hold in between 10-20% of paid-up share capital, which may have impact on company's decisions. Therefore, proxy advisors are supposed to be unbiased. Otherwise they may have an adverse affect on resolutions/ decisions of the company. To avoid this situation, SEBI (Research Analysts) Regulations 2014, are introduced, specifying that, proxy advisors are required to maintain a minimum capital, disclose the extent of reseach behind their recommendations and frame work policies on interacting with and getting responses from the companies on which reports are made.

SEBI (Research Analysts) Regulations 2014: These regulations specified for proxy advisors include: Mandatory Registration ; maintain minimum capital adequacy; the employees of proxy advisors engaged in providing proxy advisory services shall be graduate of any discipline; To disclose the policies and procedures for interacting with issuers, informing issuers about the recommendations and reviewing of recommendations is required; Arm length relationship between the research activities and other activities should be maintained; Management of conflicts

of interest and disclosure requirements; Maintain the records of his voting recommendations and furnish the same to the board on request; and to disclose the extent of research involved in a particular recommendation and the extent and effectiveness of its controls and procedures in ensuring the accuracy of issuer data.

SEC- US, 2014: Securities exchange commission (United States) given guidance relating to proxy advisory firms. It includes investors' responsibilities, who are using proxy advisory services and compliances to be met by proxy advisors. Some of the compliances to be ensured by these advisors include that the investors must have the capacity and competency to analyze proxy issues; they must have robust policies and procedures to identify and address the conflict of interest and these advisors are required to disclose their investor clients to whom they have given the recommendations.

Effect of proxy advisory services on corporate governance: Foreign institutional investment inflows also are increasing in India and is viewed as an attractive emerging market destination. It resulted in improvements in corporate reporting systems for the benefit of investors. With reforms to improve the shareholders' participation in the governance of the corporate, has increased the role of proxy advisors. They are influencing the voting rights of shareholders. In some cases, it rises to conflict of interest. However, the regulatory bodies and competition among proxy advisory firms will mitigate such conflict of interest. As long as the proxy advisors make unbiased and justified recommendations to their investors, the same may not be as per the expectations of the company. Therefore the company may not predict the votes of institutional investors, as they are participating in the meetings in informed manner. It alarms corporate to be cautious / rational in each item of the business. The general body meetings are no more formal meetings and controlled by few, but directors have to tune themselves as per the expectations of proxy advisors who are behind the institutional investors.

Conclusion: Foreign institutional investment inflows also are increasing all over the globe in general and India in particular. A key element of good governance is transparency projected through a code of good governance which incorporates a system of checks and balances between all stakeholders. The concept of proxy advisors exists mainly for better shareholders' participation with sufficient/ requisite information in annual general body meetings. More over proxy advisors help investors through their consultancy about the corporate governance specifications of that country in which they have made investments. The general body meetings are no more formal meetings for compliance under Laws and controlled by few, but directors have to tune themselves in the meetings as per the expectations of proxy advisors who are guiders of institutional investors.

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