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Fresh challenges for PSUs electing independent directors

Synopsis
The development comes at a time when shareholders are increasingly turning wary about independent directors being proposed by the government. In 2020, at least half a dozen public sector undertakings (PSUs), including Container Corporation, Mahanagar Gas, Petronet and HUDCO, have seen strong opposition from minority investors during board nominations.


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PSUs have not been the best amongst the Indian listed companies when it comes to implementation of various corporate governance rules.

Shareholder activism could well come to the fore at some state-run entities if the proposed rules on appointing independent directors take effect. Until now, an independent director could be appointed if the majority of the shareholders voted in favour, but the proposed norms require a listed firm to get the majority of its minority investors to vote in favour of such appointments.

The development comes at a time when shareholders are increasingly turning wary about independent directors being proposed by the government. In 2020, at least half a dozen public sector undertakings (PSUs), including Container Corporation, Mahanagar Gas, Petronet and HUDCO, have seen strong opposition from minority investors during board nominations.

“They (PSUs) need to put up able and qualified candidates for independent director positions rather than putting up ex-bureaucrats and unknown chartered accountants,” said Shriram Subramanian, founder, InGovern Research Services, a proxy advisory firm. “Investors are disappointed with the lacklustre returns that PSU stocks have given, partly due to poor governance practices. PSUs need to constitute able boards where independent directors can question the decisions taken by the management.”

Until now, passing of the resolution for appointment of independent directors was not a big problem for these PSUs since the government owned large chunks of stake and it voted in favour of the resolutions.

To understand the change, consider a PSU wherein the government owns 70% of the stake while rest is with minority investors, including mutual funds, off-shore funds and retail investors. Under the old rules, 51% of the shareholder votes were required for ratifying the appointment. Assuming the worst-case scenario wherein all the 30% of the minority shareholders have voted against the resolution, it would still pass since the government itself holds 70%.

Under the proposed rules, this voting process will continue to be complied with. However, there will be additional requirements – approval from the majority of minority shareholders. So, in the example above, at least half of the 30% minority investors (roughly 15.1% of total shareholders) will also have to vote in favour.

"For PSUs, the approval by 'majority of the minority' would be a challenging task and they would be required to take proactive steps in appointment of Independent Directors," said Gaurav Pingle, founder of company secretaries firm Gaurav Pingle & Associates " If the proposed rules are implemented without any exception, streamlining independent directors' appointment would be an herculean task for PSUs, but definitely in the interest of corporate governance."

PSUs have not been the best amongst the Indian listed companies when it comes to implementation of various corporate governance rules. Several PSUs continue to be in violation of Sebi's new board composition requirements that were floated in 2019. Many smaller ones are still to comply with the minimum public shareholding norms that were introduced way back in 2014. Also, one frequent complaint of shareholders has been that the independent directors of PSUs don't attend the board meetings.

"Government nominees on Boards have been far less regular in attending AGMs, with the attendance in AGMs held in 2018 and 2019 being abysmal. For the largest shareholder to have its Nominee Director not present at the AGMs can give rise to adverse conclusions, and set a bad example," said Excellence Enablers, a corporate governance firm founded by former Sebi chairman M Damodaran, in a recent report.