30 YEARS
PRIME DATABASE
THE PRIMARY MARKET MONITOR

THE PRIME DIRECTORY 2023

COVERING PRIMARY CAPITAL MARKET & ITS INTERMEDIARIES

NSE

NSDL
Technology, Trust & Reach

CO-SPONSORS

CDSL
Convenient • Dependable • Secure
25TH YEAR
Empowering Atmanirbharta

Nippon india Mutual Fund
Wealth sets you free

kotak Investment Banking

TRUST
In Partnership. With Trust.

MCX
METAL & ENERGY
Trade with Trust

Role of Institutional Investors in Ensuring Better Corporate Governance

Atul Sobti
Director General
Standing Conference of Public Enterprises

The concept of corporations was incepted during the period of industrialization, when the prime motive of business was profit maximization. Profitability is thus, an inherent part of these organizations. However, there is a drastic shift in the corporate landscape today. Owing to the massive constraint on resources and increase in aw,reness, there is a heightened need for corporations to adopt a more holistic approach and consider their impact on the people and the planet. This is where the need for corporate governance becomes most pertinent especially in the present dynamic business environment where not only expectations of all stakeholders has to be fulfilled but has to be fulfilled 'responsibly'.

While, we all understand what corporate governance is, it essentially, encompasses a system by which companies are directed and controlled, providing a framework for decision-making. It rests on the four pillars of fairness, transparency, accountability and responsibility, acting as a control mechanism to keep a check on the actions of the organizations.

The traditional corporate governance structure rests solely on the management team of these organizations. However, over time it has been realised that the quest to provide high returns to the investors could lead to a possible oversight in ensuring fair and just operations, often causing the investors to suffer in the long run. Hence, in today's scenario, the role of corporate governance is more prevalent as it can serve as an anchor to reinforce functioning of the organizations in a cohesive manner. In this regard, introduction of a third-party in the dynamic business environment became imperative, one that would nudge the management in the right direction thereby giving rise to the concept of institutional investors.

The innate limitation of the conventional corporate governance structure has called for modifications to curb the organization's myopic focus on financial objectives. In this regard, need for an independent third significant party emerged which could exercise significant influence over the management. This gave rise to institutional investors.

Institutional investors and corporate governance

Institutional investors, one of the key stakeholders in the corporate ecosystem, are considered to be the ideal choice for ensuring adherence to highest forms of corporate governance. These investors are typically large financial institutions such as pension funds, mutual funds, insurance companies and asset management firms. A large part of their job entails handling funds of the public, which gives them access to a wide market as they explore investment opportunities across different companies in multiple sectors. This enables these institutions to obtain a deep understanding of the markets and the best practices therein and helps foster transparency, accountability, and responsible decision-making, which are essential for the long-term success of corporations.

In India, institutional investors play a crucial role in the financial markets and economy. They are significant stakeholders that contribute to the development and growth of various industries.

Let's look at some specific ways in which Institutional investors contribute to better corporate governance:

- *Active ownership and stewardship*: Institutional investors exercise their ownership rights by actively participating in shareholder meetings, voting on important resolutions, and engaging with company management and boards. By greater engagement they provide valuable inputs on strategic decisions, and other governance-related matters.
- *Engagement and dialogue*: Institutional investors engage in constructive dialogue with company management and boards to address governance concerns and advocate for necessary changes. Further, the institutional investors have dedicated teams that undertake thorough research and analysis for the purpose of undertaking investment decisions. This well-laid out mechanism serves as a way for the institutions to stay up-to date on the latest developments in the industry.
- *Disclosure and transparency*: Institutional investors encourage companies to enhance disclosure and transparency practices by advocating for clear and accurate reporting of financial and non-financial information, including ESG factors. Through their efforts, vital information of the organisations is shared with the investors thereby enabling theme to make informed decisions and assess the governance practices and risks associated with their investments.

Institutional investors continuously monitor the companies they invest in, assess their performance, governance practices, and adherence to ESG criteria. By holding companies accountable, they incentivize management to maintain high standards of corporate governance.

Growing role of Institutional investors in India

India is one of the fastest-growing major economies in the world, offering significant growth potential to investors. This has been balanced by implementation of several reforms by the Government to attract foreign and large investments including ease of doing business, opening up sectors to FDIs etc. These reforms have created a more investor-friendly environment, making it easier for institutional investors to enter the Indian market. Also, the reforms have been coupled with policies which has resulted in improvements in corporate governance practices amongst organisations leading to enhanced transparency and accountability in Indian companies, making them more appealing to institutional investors who seek well-managed and ethical businesses.

Another very important reason for growth of institutional investors in India can be attributed to the attractiveness of the Indian market in the globe. With India gaining significant position on the world map, institutional investors are attracted for investment as they often seek to diversify their portfolios across different geographies to manage risks effectively. Hence, investing in emerging markets like India provides them with exposure to different economic cycles and potentially higher returns.

Given the attractiveness of the Indian markets, presence of institutional investors has witnessed an upward trend in the recent years which can be seen from the fact that the share of holding of retail investors, domestic institutional investors and high net worth individuals in listed companies has reached an all time high of over 24% as of December 2022 and if we see only share of domestic institutional investors in listed companies, it was over 15% of December 2022.

Some of the prominent institutional players in the Indian market include Life Insurance Corporation of India (LIC), General Insurance Corporation of India (GIC), large Banking institutions like ICICI Bank.

Institutional Investors have become popular in India for several reasons, which are primarily driven by the country's economic growth, market potential, and regulatory reforms.

Stewardship Code 2019 – strengthening Institutional Investors

The institutional investors invest in organisations with the intention of gaining positive returns on their investment. The fulfilment of the objectives of these institutions is dependent on the success of the organisations as well as the satisfaction of their stakeholders, thereby creating a strong motive for the institutional investors to act in the best interest of both parties i.e. organisations and the stakeholders. This advocates the case for these institutions to be the perfect catalyst for driving better corporate governance.

However, there might be doubts over the suitability of the institutional investors to be involved in managerial decisions. One might argue that they lack the expertise to be involved in the administrative decisions of the company. Further, owing to the demanding nature of their job that necessitates continuous rebalancing of portfolios, they can also be touted to lack the time to be actively involved in the decision-making process.

The robust financial institutions in our country anticipated these challenges while also acknowledging the potential and importance of the role of institutional investors. In this regard, the Stewardship Code was introduced by SEBI in 2019. This code inflicts stewardship responsibility on the institutional investors to ensure the upkeep of corporate governance in investee companies, thereby encouraging active monitoring in the interest of beneficiaries. It specifies the institutional investors to formulate a comprehensive policy on the discharge of their stewardship responsibilities that should be disclosed publicly and reviewed and updated periodically. Among other responsibilities, the code also directs the institutional investors to include monitoring of investee companies and having clear policies for intervention whenever required.

However, for the institutional investors to execute better corporate governance in an effective manner, enthusiastic participation from the corporations is also required. The corporations might view the involvement of the institutional investors as an intrusion in their working. But, they must remember that firming up the corporate governance framework works in their interest too, as this would translate to positive investor sentiment and eventually, longevity of the business. They must therefore, not be resistant in sharing relevant information and paying heed to the suggestions provided by the institutional investors therein.

Over the years, there have been considerable reforms in the field of corporate governance. However, with the substantially changing business scenario, the role of institutional investors will gain more importance in the coming time, making it imperative to initiate action in this regard.

Future outlook

Institutional investors play a crucial role in India's financial markets and economy. These investors are entities that pool large sums of money from various sources, such as pension funds, insurance companies, mutual funds, hedge funds, and other large financial institutions, to invest in a diversified portfolio of assets. Since, they contribute towards capital formation, enhance market liquidity and also act as stabilizing forces in times of market volatility, they have greater say in the corporate governance matters. Through their diverse role in the organisations, they ensure transparent and fair dealing of the companies thereby safeguarding the interests of the investors. This would create a ripple effect in the market as an ethical and transparent conduct on the part of the companies would lead to building of trust in the minds of investors. A happy investor would be more willing to invest more of their hard-earned money, giving a boost to the market in the process. Overall, presence of institutional investors would create a win-win situation for all the stakeholders in the corporate ecosystem.

However, it is time that the institutional investors look at their role beyond the traditional 'overseeing role' .One such role could be as educators of the public. Since the financial institutions have access to information about the corporate ecosystem and also have resources in terms analytical expertise, they can share publicly available analytical information about the current performance and prospects of the investee companies with the other investors thereby aiding the public to take informed decisions. This is just an example of a possible solutions that could amp up the efficient monitoring of the corporate governance by the institutions.

The domain of enhancing the role of institutional investors in corporate governance is relatively vast and unexplored. Untapping the immense opportunities that lie within would require the government, institutional investors and the corporations to come forth and engage in deliberations.

To conclude

Intuitional investors carry significant clout in the financial market along with significant influence and leverage over the companies they invest in. Hence, by participating in the governance processes, they can foster better corporate governance practices, encourage long-term value creation, and contribute to sustainable and responsible business practices.

Therefore, in today's dynamic business scenario, it is vital to undertake steps to further the role of institutional investors as corporate monitors in order to augment the corporate governance landscape in the country.