ISSN: P-2455-0515
E- 2394-8450

Educreator Research Journal

VOLUME–XI, ISSUE– I (Special Issue-I) JAN – FEB 2024

Original Research Article

ROLE OF PROXY ADVISORY FIRMS IN STRENGTHENING CORPORATE GOVERNANCE

*** Rajkumar Dwarkaprasad Varma,**

* Asst. Professor, SGASGPCC, Shivle, Murbad.

Abstract:

The need for corporate governance arises because of the market-related economy, which is prevalent in the current years. Corporate governance is essential and significant because of globalization. Corporate governance practices help in adding value to internal and external stakeholders comprising of company management, executives, Board of directors, employees, shareholders, debtors, creditors, suppliers, and customers. Corporate governance practices ensure that all stakeholders' interest is safeguarded to ensure balanced and robust economic development. The scope of corporate governance practices is extensive and encompasses the need of the investors, institutions, and society. Corporate governance practices encourage an ethical, moral, and trustworthy environment. Principles of corporate governance practices focus on forward thinking on the prospects of the company, evaluation of current management performance, creation of long-term shareholder value, evaluate risks, valuations, financial and operational planning, and growth of the company. Proxy Advisory Firms are independent analysts providing advisory services to investors and recommending to them the effect of their vote in their shareholding and other corporate decisions. Proxy advisory firms basically safeguard the shareholders' rights which lead to good corporate governance. They advise institutional investors on how to vote on the thousands of shareholder resolutions that arise every year. Thus, they are expected to act as catalyst in strengthening corporate governance. This paper involves in studying the role of proxy advisors in strengthening corporate governance.

Keyword : *Corporate governance, Proxy advisor Firms, finance and investors*

Introduction:

Proxy advisors are defined under regulation 2(p) of the Securities and Exchange Board of India Research Analysts Regulations, 2014 "**SEBI Research Analyst Regulations**", as "*any person who provides advice, through any means, to institutional investor or shareholder of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items*". Proxy advisors in India are primarily regulated by the SEBI Research Analyst Regulations and the Procedural Guidelines for Proxy Advisors, while their counterparts in other jurisdictions are largely unregulated.

Proxy advisory firms have become a means for shareholders to outsource key decision making to third party experts, and unlike the shareholders themselves, such firms may not have any skin in the game. Companies should ensure that prior to conducting shareholder meetings, they take into account corporate governance standards and ensure that the resolutions are as detailed as can be, without disclosing confidential information.

ISSN: P-2455-0515
E- 2394-8450

Educreator Research Journal

VOLUME–XI, ISSUE– I (Special Issue-I) JAN – FEB 2024

Original Research Article

It is crucial that companies start putting in place mitigation strategies to respond to unfavourable reports recommendations by proxy advisory firms.

Objectives:

To study the services of proxy advisor firms to investors and to companies

To study the connection between corporate governance in India and proxy advisory firms.

To study the challenges faced by the proxy advisory industry.

Literature review:

1. Hetal Dalal in her research paper states that Investors are moving beyond discussing governance and are focussed on ESG, with several ESG funds being created. Proxy advisors are working with investors in helping them assess ESG performance of companies and helping them embed ESG metrics into their investment decisions.
2. Prof Biju Varkkey of IIM Ahmedabad states "Indian corporate realm has observed a general apathy among the shareholders when it comes to exercising voting rights. One major lacuna that stops shareholder from voting is the lack of detailed knowledge about finer aspects of the working of the company.
3. J. Copland, D. Larcker and B. Tayan Limited transparency on the process these firms use to amend their proxy voting guidelines, although ISS at least gives some insight into its process. The industry exhibits signs of market failure, in that despite their demonstrated poor track record and questionable practices, the market has not been able to gradually eliminate them and they have in fact thrived.

Services of proxy advisor firms to investors and to companies:

It performs annual governance evaluations of covered companies using governance radar proprietary framework and also perform peer and timeline comparison of CG scores of companies. For investors it gives detailed research and diligence of companies.

Proxy advisors are regarded as governance experts. They can help boards identify governance improvements that increase board effectiveness and improve the board-shareholder relationship.

Proxy firms largely led the charge on board composition and compensation, ensuring boards remain responsive to the desire among shareholders for greater board diversity and fair remuneration the universal proxy rule will encourage more shareholders to express their views. Proxy firms keep boards abreast of changing shareholder sentiment, avoiding any surprise proxy fights come proxy season.

Investors don't always have the time and resources to do the proper research or understand the agendas for numerous shareholder proposals to make informed decisions on voting. Instead, proxy advisory firms complete the analysis and offer recommendations for them.

Shareholder proposals can now surface throughout the year. In many cases, it makes practical sense for investors to rely on the recommendations of their proxy advisors, who are better informed on the distinctions of current and emerging issues.

ISSN: P-2455-0515
E- 2394-8450

Educreator Research Journal

VOLUME–XI, ISSUE– I (Special Issue-I) JAN – FEB 2024

Original Research Article

Board directors listen to what proxy advisors have to say on many matters. Over 70% of board directors and executive officers stated that they examined the guidelines on executive remuneration by ISS and Glass Lewis before making decisions about their executive remuneration packages.

Proxy advisory services are becoming increasingly prevalent in India with institutional investors relying on their recommendations when exercising their voting rights in listed companies. As a result, proxy advisors' recommendations are beginning to influence the actions of listed companies. Illustratively, the Avantha Group had modified a restructuring plan for Crompton Greaves after investors and proxy advisors opposed the shareholding structure contemplated by the original plan.

The connection between corporate governance in India and proxy advisory firms.

The Securities and Exchange Board of India (SEBI) has adopted a light-touch approach to regulating proxy advisors in India. However, the absence of stringent standards and a detailed framework has led to several concerns amongst listed companies and their majority shareholders. India, proxy advisors are regulated by SEBI through the SEBI (Research Analysts) Regulations, 2014 (**SEBI Regulations**) and certain SEBI circulars.

Indian proxy advisors – i.e. persons who provide advice to institutional investors or shareholders of listed companies in relation to their exercise of their rights in the company including recommendations on public offers or voting recommendations on agenda items – must register with SEBI.

Foreign proxy advisors that intend to provide proxy advisory services in respect of Indian listed companies, or Indian companies that are to be listed, do not need to register with SEBI. Instead, they must enter into an agreement with a SEBI-registered proxy advisor in India when providing such services. As a result, foreign proxy advisors may operate in India with relative impunity, and are not required to demonstrate minimum qualifications and, or, India-specific expertise.

SEBI-registered proxy advisors do not need to have any specialist qualifications, and may operate on the basis of a bachelors' degree in any discipline. Where the proxy advisor is an entity, the individuals employed by it to provide proxy advisory services must satisfy this minimum qualification requirement.

The SEBI Regulations do not require that Indian proxy advisors have any expertise in business, commerce, economics, finance, accountancy, law, etc. As a result, proxy advisors may make recommendations on matters that they are not technically qualified to opine on.

Conversely, SEBI requires that investment advisors have: (i) specialised educational qualifications; and (ii) a track record of activities relating to advice in financial products or securities or fund or asset or portfolio management.

The services provided by investment advisors and proxy advisors are not dissimilar – investment advisors analyse companies prior to investment in, or exit, from a company, while proxy advisors analyse companies during the tenure of a person's investment in a company. In both cases, this may amount to strategic advice on investments. Given the strategic nature of advice provided by investment advisors and proxy advisors, proxy advisors should, at minimum, be required to have the same qualifications as investment advisors.

Proxy advisors should also be subject to the same capital adequacy or net worth requirements as investment advisors. However, the capital adequacy or net worth requirements for proxy advisors are significantly lower than those prescribed for investment advisors.

When issuing reports, proxy advisors are required to take steps to ensure that the facts mentioned are based on reliable information. The recommendation policies that they follow when issuing their reports must be publicly disclosed.

At present, there are no restrictions as to the matters in respect of which proxy advisors may make recommendations (e.g. M&A transactions, internal restructuring, disputes, etc.). Although the Working Group on Issues of Proxy Advisors constituted by SEBI (Working Group) had considered (i) this issue; and (ii) and stakeholder representations that proxy advisors do not have the requisite expertise to opine on opine on such matters; in its 2019 report (Working Group Report), the Working Group ultimately concluded that "…there is no reason to restrict the areas of analysis for a proxy advisor based on the evidence available…".

The quality of proxy advisors' analysis is necessarily dependent on their expertise. For instance, if a proxy advisor is making recommendations against the adoption of annual financial statements, they should, ideally, have expert knowledge regarding accounts and accountancy, the industry of which the listed company is a part, and macroeconomics. However, it is often unclear whether the proxy advisor does have the necessary expertise, particularly as the SEBI Regulations do not require the publication of the qualifications of the individuals engaged in the preparation of the report.

While proxy advisors must provide the rationale for their recommendations, and publish their voting guidelines, the merit of, and, or, rationale for, their recommendations are not often clear. In the past, proxy advisors have recommended voting against the adoption of annual accounts seemingly on account of minor violations such as the failure to publish the standalone accounts of a subsidiary on the listed company's website.

Challenges faced by proxy advisory industry:

Accessibility to correct and complete information is essential for the investor protection system. The Acts in India have many ambiguities for disclosures to be made in the prospectus, due to which some companies give misleading information and statements to attract investors, which results in the cheating of small and retail investors. insider trading is another big challenge faced by investors. Insider trading involves the purchase or sale by a person with price-sensitive information regarding the company. The person having insider information has an edge over other ordinary investors, who can potentially make huge profits at the expense of other investors. Insider trading refers to a director, promoter, executive of the company, etc. these are some challenges faced by the investors. Proxy advisory firms guide investors on how they should vote at corporate shareholding meetings, as institutional investors may not have the resources to vote knowledgeably on the thousands of shares they may own. Proxy advisors have been criticized for a lack of competition in the market, little transparency in the process by which proxy advisory firms make recommendations, and potential conflicts of interest that may arise. Congress, the Securities and Exchange Commission, and industry groups have been pushing for heightened oversight of proxy advisory firms.

While proxy advisory firms have served an important role in improving shareholder representation in

ISSN: P-2455-0515
E- 2394-8450

Educreator Research Journal

VOLUME–XI, ISSUE– I (Special Issue-I) JAN – FEB 2024

Original Research Article

corporate governance, their business activities and lack of oversight have prompted both lawmakers and regulators to explore opportunities for reform.

Their concerns largely focus on three major issues. First, there exists little to no transparency as to the guidelines and methodologies used by proxy advisory firms when making their recommendations. Second, the proxy advisory firms often face conflicts of interest between their own shareholders and the investment funds and other clients they serve. Third, only two firms dominate the proxy advisory market, leading to significant competition concerns.

Proxy advisory firms do not have to disclose the methodologies used in their research and recommendations, and as a result their clients are left in the dark as to how the proxy firms arrived at a particular conclusion. Firms that believe a proxy advisor's recommendations are flawed are not able to challenge the recommendations. Meanwhile, regulators are similarly ignorant of how to examine proxy advisors' recommendation rationales or ensure they're in compliance with preexisting financial laws.

Areas of support by Proxy Advisory Firms

1. Environment, social and Governance(ESG)
2. Proxy voting
3. Proxy research
4. Executive compensation model
5. Board diversity

Conclusion:

Proxy advisors have emerged as useful information intermediaries that facilitate shareholders to exercise their voting rights. Their effectiveness in facilitating shareholders decent is conditioned by firms' ownership composition as well as the prevailing corporate governance system in a given country. The role played by the proxy firms cannot be denied as their advice is based on their research on corporate governance decisions. It is recommended the policies adopted by the form should be aligned with SEBI regulation and the requirement of companies act 2013. Corporate governance is important to shareholders because it tries to ensure treatment of all shareholders including minority and foreign shareholders. To ensure transparency, a strong and balance economic development for the organisation is required. Proxy advisory forms are not only expected to highlight facts, they are also expected to give opinion on several matters. There should be enough safeguards in the law to protect the proxies from being dragged to court. If the proxy advisory forms work considering the best management practice along with compliance of law, all the shareholders will benefit from their service and a good corporate governors of objective will be achieved.

References:

Burhanuddin Dohadwala, Manager, Timothy Lopes, Senior Executive Vinod Kothari & Company on SEBI prescribes stricter regime for Proxy advisors; Issues procedural guidelines to be followed in addition to Code of Conduct.

Keay, A (2017) Stewardship Theory: Is Board Accountability

Procedural Guidelines for Proxy advisorshttps://www.sebi.gov.in/legal/circulars/aug-2020/procedural-guidelines-for-proxy-advisors_47250.html

Grievance Resolution between listed entities and roxyadvisershttps://www.sebi.gov.in/legal/circulars/aug2020/grievance-resolution-etween-listed-entities-and-proxyadvisers_47252.html

Report of the Working Group on Proxy advisorshttps://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxyadvisors-seeking-public-comments_43710.html.

SEBI (Research Analysts) Regulations, 2014- https://www.sebi.gov.in/legal/regulations/sep-2014/securities-and-exchange-board-of-india-research-analystsregulations-2014-last-amended-on-april-17-2020-_34615.html

https://www.bqprime.com/opinion/the-changing-face-of-shareholders-outsourced-governance

https://doi.org/10.1108/IJLMA-11-2016-0118

https://en.wikipedia.org

http://www.epw.in

http://www.glasslewis.com

Cite This Article:

Varma R.D. (2024). ROLE OF PROXY ADVISORY FIRMS IN STRENGTHENING CORPORATE GOVERNANCE. In Educreator Research Journal: Vol. XI (Number I, pp. 133–138).
ERJ. https://doi.org/10.5281/zenodo.10715368