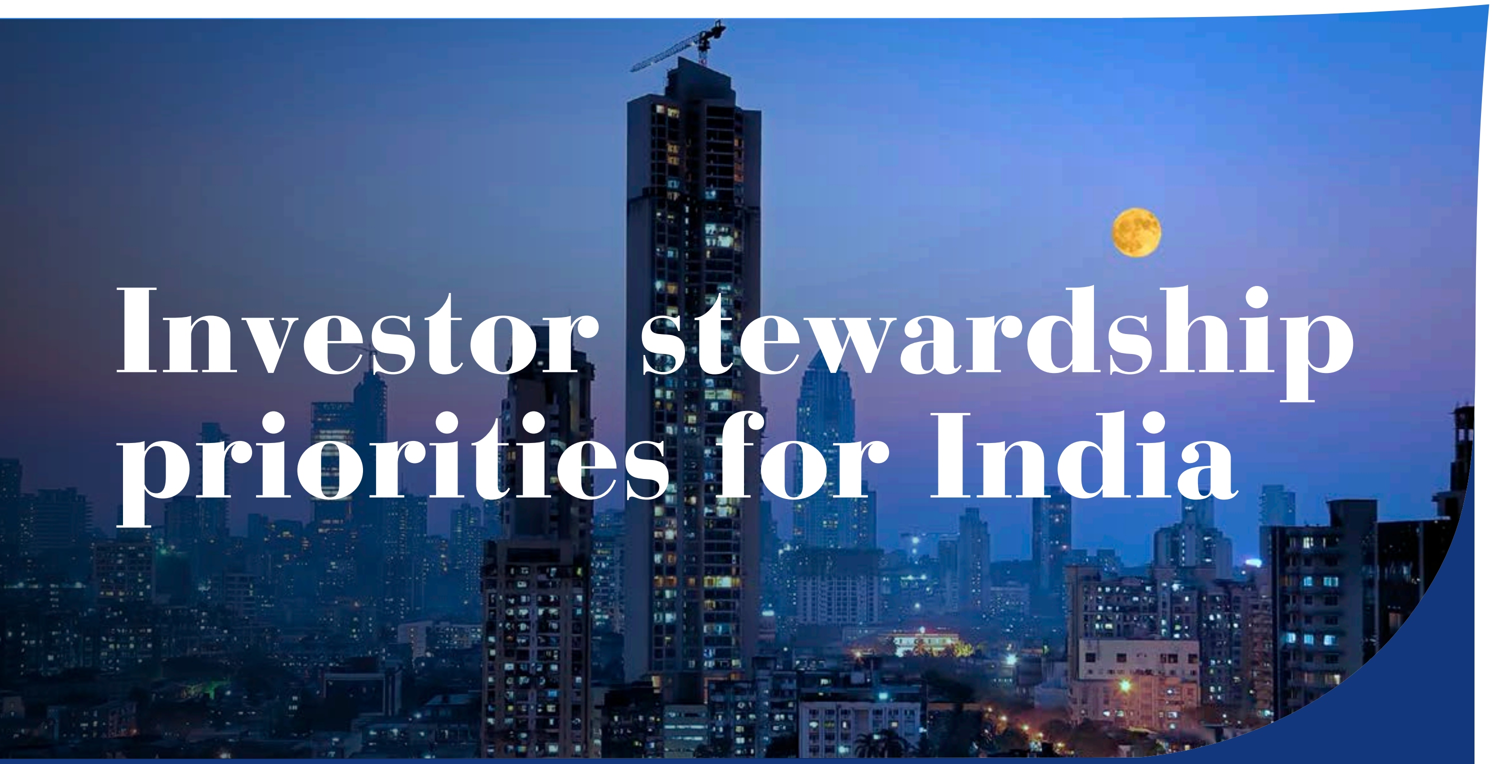

Investor stewardship priorities for India

India can appear attractive to emerging market investors, based on its strong growth opportunities and the variety of listed companies on offer. However, governance challenges, a high exposure to physical climate risk, and cybersecurity issues still present potential pitfalls for the unwary. By Sonya Likhtman, Navishka Pandit and Ross Teverson.

Setting the scene

India is large and diverse, with a rich tapestry of languages, religions and cultures. In recent years, socioeconomic indicators have improved, with India's unemployment rate declining to 4.2% in 2023 from 7.7% in 2013,[1] and a 32% fall in the infant mortality rate over the same period. But basic rights such as access to electricity, adequate sanitation, and clean water remain a challenge for many. Meanwhile, the governance scandals that periodically erupt can wipe billions off a company's market capitalisation in a matter of days.

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India remains a popular emerging market for investors, with listed companies in sectors such as financial services, technology, and manufacturing. The economy is expanding, with GDP growth above 6% a year[2] since the pandemic, significantly higher than most other major economies. It is also the largest country in the world by population, with over 1.4 billion people.

EOS has been engaging with Indian companies, policymakers and standard-setters for over a decade, and in recent years we have seen improvements in certain governance areas. However, there are some specific stewardship challenges within the Indian market that minority shareholders need to navigate to ensure that their own rights are protected.

India still performs poorly in certain social and environmental rankings. For example, India ranked 129th in the World Economic Forum's latest Global Gender Gap Report,[3] with concerns across the categories of women's economic participation and health. Poor air quality also remains a problem, with 42 of the 50 most polluted cities in the world located in India in 2023.[4]

With this economic, social and environmental context, we outline five focus areas for investors seeking opportunities in India.

[1] Unemployment, total (% of total labour force) (modelled ILO estimate) – India | Data.
[2] India Fiscal Year GDP Growth.
[3] WEF_GGGR_2024.pdf.
[4] World's Most Polluted Cities in 2023 – PM2.5 Ranking | IQAir.

Governance and transparency

High-profile allegations[5] of corruption, such as those associated with the Adani Group, serve as a sharp reminder for investors to focus on governance and transparency when adding Indian stocks to a portfolio. A high proportion of Indian companies are still family-owned and led by promoters, a term unique to India, which refers to individuals with direct or indirect control over a company.[6] In some cases, family members and promoters who are interested in ensuring sustained growth may foster a long-term focus, which can be well-aligned with minority shareholder interests.

However, there is increasing scrutiny over related party transactions, which can give rise to potential conflicts of interest, and executive remuneration. Here there is scope to increase transparency, introduce more objectivity into decision-making, and establish pay structures that properly incentivise delivery on long-term strategy. We also continue to track the ratio between CEO and median employee pay, given the high disparities at many companies, and the potential to drive improved employee loyalty and productivity by paying a living wage across the workforce.

Boards and management teams should focus on establishing governance structures that enable long-term value creation. Improvements in governance are likely to increase trust in the market and make India even more attractive to international investors.

Through our policy engagement and market best practice work in India we have sought to drive improvements in governance across the market. For example, we met the capital markets regulator, the Securities and Exchange Board of India (SEBI), in Mumbai as part of the Asian Corporate Governance Association (ACGA) delegation in 2023. We shared views about the importance of separating the chair and CEO roles, the value of having a strong core of genuinely independent directors, and recommendations for executive remuneration.

The role of independent directors

Board independence in India has improved in recent years, following guidance from SEBI. We expect the improved independence on paper to be reflected in genuine independence in practice, with a healthy level of challenge and debate at the board level. Independent directors are well-placed to provide a valuable external perspective and strengthen the quality of deliberation and decision-making on the board. Part of their role includes representing minority shareholder rights, but their active participation on the board is equally beneficial for controlling shareholders.

While board-level engagement is not yet the norm in India, we expect to see a shift in access in coming years, as independent directors begin to recognise that investor dialogue can help them perform effectively.

Independent directors have a responsibility to engage directly with shareholders to exchange views on governance and other strategic matters. While board-level engagement is not yet the norm in India, we expect to see a shift in access in coming years, as independent directors begin to recognise that investor dialogue can help them perform effectively.

As outlined in our white paper *Guiding Principles for an Effective Board*,[7] companies in India should continue to focus on achieving genuine board independence, develop plans to separate the chair and CEO roles, and demonstrate a commitment to continuous improvement.

Gender equality

India's large educated female talent pool presents a significant opportunity for companies to innovate and better serve their customers. Where the current proportion of female employees is low, companies should set ambitious targets and strategies to strengthen women's representation, including at senior levels. This transformation is likely to require a clear tone from the top, improved internal policies, and support to overcome barriers such as returning to work, childcare, and workplace safety. Companies where female participation is already high should focus on retention and ensuring that women are well represented in leadership positions.

Female participation at the board level is critical to bring a broader range of thought and experience to the boardroom, and to strengthen the oversight of management and the company itself. In 2014 SEBI mandated that all listed companies in India should appoint at least one independent female director to the board. Unfortunately, many companies sought only to meet, rather than exceed, this expectation.

[5] $20bn wiped off Adani corporate empire after bribery charges.
[6] Section 2(69).Promoter | Companies Act Integrated Ready Reckoner|Companies Act 2013|CAIRR.
[7] guiding-principles-for-an-effective-board-april-2020.pdf

CASE STUDY

KEC International Limited

KEC International is headquartered in Mumbai, India. It is an engineering, procurement and construction company with projects in power transmission and distribution, railways, civil, urban and smart infrastructure, renewables, oil and gas pipelines, and cables. It has over 300 ongoing projects across countries such as India, Brazil and Mexico.

Our engagement

We started a dialogue with KEC International in May 2023. We initially raised concerns about the board composition, where independence was 36%, largely due to director tenures exceeding 10 years, and women accounted for only 9%, compared with our market guidelines of 50% and 20% respectively. We shared our perspective about the value that improved independence and representation would bring to the board and the company.

We encouraged board refreshment, and for the audit committee to become fully independent, with all committees chaired by independent directors. The company acknowledged our concerns about board independence and long tenures. It explained that some board terms would end in 2024, after which there would be some refreshment.

At the 2023 annual shareholder meeting the CEO was the only director up for election. While we recommended supporting his election to the board, we reiterated our concerns. In November 2023, we continued the discussion about board composition and effectiveness at a meeting in Mumbai. We highlighted that at the time we considered the audit committee to have no independence, which was particularly concerning. The company said that, in its view, the diversity of skills and the quality of dialogue on the board was high, and that a search for independent directors was being conducted.

Changes at the company

In 2024, the company undertook a significant board refreshment by adding four new independent directors, reaching 70% board independence. We were especially pleased to see the audit, nomination and compensation committees become fully independent. We also welcomed the increase in female directors, who now accounted for 20% of the board. We believe that these changes should improve the quality of debate and discussion on the board, including strengthening risk management and oversight at the company.

We now want the company to continue focusing on broadening the range of thought, skills and experience on the board, in alignment with delivery on the company's strategy. For future annual shareholder meetings, we have asked the company to present the director election and remuneration proposals separately, rather than bundling them together, so that shareholders can express their views on these points individually. We will also continue to discuss the transparency and alignment of executive remuneration.

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In our view, companies should move away from a mindset of regulatory compliance and consider the opportunity for leadership. From 2026, we will encourage Indian companies to ensure that women comprise at least 30% of Indian company boards, compared with our current level of at least 20%.

Climate change

India is highly exposed to the physical risks of climate change, particularly intensified water stress, heatwaves and flooding. Mitigating and adapting to climate change must be balanced with achieving universal access to electricity and energy security.

Given the high rate of economic growth, India has significant transition opportunities to leverage. These include export advantages[8] in environmental technology and low-carbon goods, and access to clean and inexpensive renewable energy. India has been investing in renewable energy, particularly solar power, at record rates, with supportive policy measures such as subsidies, improvements to administrative processes, and incentives for domestic production of solar technologies.[9] However, close to 80% of its power generation came from coal as of February 2024[10] and emissions per capita are increasing rapidly, although they remain comparatively low.[11]

India has a target to reach net-zero emissions by 2070, which is one of the latest dates set by a major economy and 20 years later than scientific guidance for global emissions. India's timeline reflects the ongoing need for economic development and improved access to electricity.

In our view, many Indian companies could work towards a 2050 or earlier timeline, helping to strengthen the resilience of their business model. We believe that companies should set short, medium and long-term science-based emissions reduction targets and develop transition plans to tackle climate-related risks throughout their value chains. In the context of India's industrial strategy, companies should also consider opportunities to develop commercial strategies for providing low-carbon products and services.

For example, we are engaging with natural gas company GAIL India on emissions reduction and methane in its supplier due diligence and public reporting. We have also started talking to the company about human capital management and its strategy to hire and retain the best talent.

Environmental issues in India should be addressed holistically, meaning that nature degradation, pollution of the air, soil and water, and broader water-related issues should remain a focus for companies alongside climate change.

Data privacy, cybersecurity and artificial intelligence

Data breaches across public and private sector entities in India have been relatively frequent in recent years, exposing companies to financial, regulatory and reputational risks. The banking system is undergoing a digitalisation-led transformation, posing cybersecurity and data privacy challenges. SEBI issued a new Cybersecurity and Cyber Resilience Framework[12] for financial institutions and other regulated entities in August 2024.

We believe that companies should establish strong oversight of technology-related risks, including ensuring that directors have the relevant expertise and providing ongoing director education on these matters. Risk management capabilities should be supported by systems, processes and capacity building throughout companies.

In 2025, we plan to engage with several Indian banks on their approach to cybersecurity and data privacy. We will cover topics including the governance and oversight of these issues, balancing the risks and opportunities of digitalisation, and the approach to training and capacity building for employees and the board.

Businesses that are deploying artificial intelligence (AI), particularly generative AI tools, in any meaningful way should publish ethical AI and data governance principles addressing transparency and accountability, fairness and bias, privacy, and other salient risks. We also encourage companies to work towards integrating a culture of responsibility throughout, reinforced by training and regular solicitation of feedback from a range of stakeholders. Taking these steps should support the mitigation of risks associated with digital services and AI, as well as the identification of emerging opportunities.

Conclusion

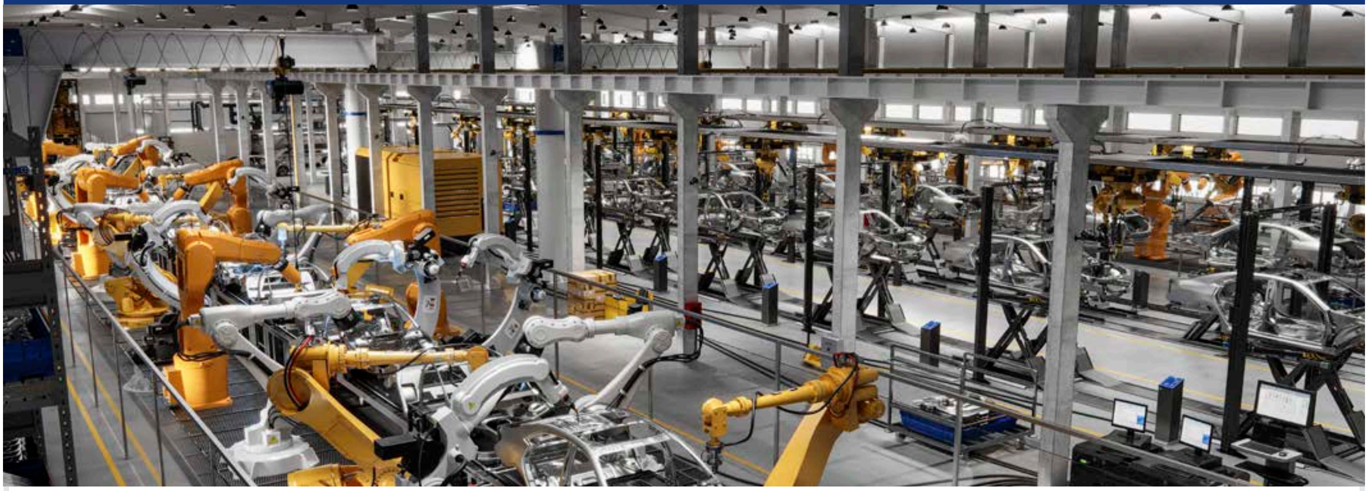
Companies should prioritise establishing good governance structures and effective boards if they are to profit from some of the opportunities that will be central to the next chapter in India's growth story. We look forward to continuing to engage with companies and regulators on these topics in 2025 and beyond.

India is highly exposed to the physical risks of climate change, particularly intensified water stress, heatwaves and flooding.

[8] Climate Is the Future of the U.S.-India Trade Relationship – Center for American Progress.
[9] India | Climate Action Tracker.
[10] Q&A: What do India's elections mean for coal communities and climate change?
[11] India: CO_2 Country Profile – Our World in Data.
[12] SEBI | Cybersecurity and Cyber Resilience Framework (CSCRF) for SEBI Regulated Entities (REs).

CASE STUDY

Samvardhana Motherson International Ltd



Samvardhana Motherson International (Motherson) is one of the world's largest manufacturers of components for the automotive industry. There are 12 business divisions, with the four major divisions that contribute over 90% of group revenues being wiring harness, vision systems, modules and polymer products, and integrated assemblies.

Our engagement

In 2022, the company set a target to reduce its Scope 1 and 2 emissions to net zero by 2040. In a call with the chief sustainability officer in 2022, we suggested setting interim emissions reduction targets that support the goal of limiting global warming to 1.5°C. Ideally, this would be validated by an external party, such as the Science-Based Targets initiative (SBTi). We also encouraged the company to disclose its Scope 3 emissions, by far the most significant category, as a first step towards setting Scope 3 emission reduction targets.

In February 2023, our Federated Hermes Limited fund manager colleagues visited the company's head office in Delhi to meet the chief operating officer, the former CFO and an investor relations representative. In a call later in 2023, we put forward the view that the company's plan for a "milestone review" of its operational emissions in 2030, was not sufficient. We also discussed what the company was doing to ensure that each division's climate transition plan was sufficiently ambitious and how it was holding its divisions to account. Early in 2024, we wrote to the company to reiterate our concerns.

Changes at the company

In 2024, the company committed to an interim Scope 1 and 2 emissions reduction target of a 50% reduction by 2030 versus financial year 2022-2023. The target is to be achieved primarily by sourcing renewable energy in the countries where it has manufacturing sites. The company also said it had mapped 80% of purchased goods by value (excluding directed material spend that is not included in financial consolidation) for Scope 3 emissions more accurately.

It is now working to develop strategies with all required stakeholders to address the major contributing factors. This follows the publication of its initial estimated Scope 3 emissions number the previous year as part of India's Business Responsibility & Sustainability Reporting (BRSR) regulatory requirements.

We believe that establishing an interim reduction target for its Scope 1 and 2 emissions and improving transparency for its Scope 3 emissions will help the company to understand and manage its climate-related risks and opportunities, including aligning with its customers' emissions reduction commitments. As the Scope 3 emissions significantly outweigh the operational emissions, we will also continue asking the company to develop a comprehensive strategy, with targets, for how the most material Scope 3 emissions will be reduced.

We also look forward to continuing our dialogue on Motherson's approach to human rights due diligence in its supply chain, the need for goals and targets on circularity, and female representation at the board level.

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Federated Hermes

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