Speech at Corporate Governance Summit: Gatekeepers of Governance

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Introductory Remarks

Dear Friends,

I am grateful to Excellence Enablers for providing me with this opportunity to be one of the speakers at this year's Gatekeepers of Governance Summit.

Established in 2012, Excellence Enablers has evolved as a leading advisory firm in corporate governance. I personally look forward to reading their monthly bulletins which provide a perspective that is so relevant to our markets.

The Summit is being conducted at an opportune time. Earlier this year India became the fourth-largest market in terms of market capitalization. As I speak the market capitalisation is around USD 5 Trillion after having touched USD 5.5 Trillion.

I am delighted to be here amongst esteemed colleagues and to provide my views on an interesting subject matter: Are Regulators friends, foes or frenemies of the market? This question is more relevant than ever as we navigate the complexities of governance and business.

The Indian securities market has grown exponentially over the last three decades with SEBI as its guardian.

Let me share with you some statistics that illustrate the growth of the securities market in the last 10 years (2014 to today). The **market capitalization** of all listed stocks has surged six times to around Rs. 425 lakh crores today. The number of **demat accounts**, which hold securities electronically, has increased 8 fold, from 2.2 crore to 17.6 crore. The assets under management, or **AUM**, of the mutual fund industry, has also grown over six times, from Rs. 10.9 lakh crore to over Rs. 68 lakh crores. The number of mutual fund folios, which are accounts that hold one or more mutual fund schemes, has increased 5 times from 4.3 crore to 21.7 crore.

This obviously leads us to believe that investors are looking to the capital markets to park their savings for the long term. The trend could also suggest that investors are increasingly showing trust in the securities market. The monthly contribution from SIPs of over Rs 25,000 crore indicate that there is no shortage of capital in the Indian market.

Globally, in the primary issuance space, we are a standout exception. Thus, while around Rs. 1.97 lac crore was raised through the primary market in FY24, the funds raised in current financial year has already crossed Rs. 2 lac crores till September.

With only three per cent of global GDP, India led with a 30% share of all IPOs and raised 12% of the globe's IPO money in the first three quarters of 2024. The Economist has called the Indian stock market as the "*largest-ever experiment in participatory capitalism*".

These numbers give us a glimpse on how the Indian securities market has grown, creating wealth and opportunities for millions of investors, businesses, and the economy.

As more money and small savings enters our capital market, it is important that promoters, directors and senior management of the listed entities discharge their roles and responsibilities to ensure efficient capital formation in the securities market. There is, therefore, a shared responsibility of stakeholders including SEBI to ensure that markets are transparent.

I now come to the topic of this morning's discussion: Regulators - Friends Foes or Frenemies.

In Capital Markets, regulators and market players co-exist.

Regulator as a friend of the market

"*A true friend accepts who you are, but also helps you becomes who you should be*". The regulator acts as a friend by providing a framework within which businesses can operate safely and fairly. The primary goal of a regulator is to ensure fairness, safety and compliance. They act as guardians of public interest, protecting consumers, society, and the economy from potential abuses and malpractices. SEBI ensures the stability of the securities market by setting standards and enforcing compliance, thus maintaining trust in markets and institutions.

At the industry's end, it is important that the companies which come to the markets for raising capital are willing to share benefits with other shareholders/investors and uphold their rights as shareholders. The listed entities should not be looking at the short-term alone. There is ample long-term and patient capital available and companies need to adhere to the corporate governance norms in letter and spirit. There is no case for 'profits mine; losses yours'.

The Board of Directors, particularly independent directors, have a very important role in keeping the best interest of the listed entity and the shareholders. The Directors must ensure that companies do not become personality-driven. If a CEO or promoter is strong, Boards need to be stronger. Boards should not become a proxy for the management.

Board members should ask the right questions to the management. Board members should appreciate that they are speaking for the shareholders and other stakeholders who are not present in the room. Board members are complicit with the management by looking the other way or by not challenging the management thinking.

Regulators perceived as foes

"*A man without enemies is a man without qualities*". Often, regulators are perceived as foes; unwelcome guests. Industry often views regulatory requirements imposed on them as burdensome, adding to the cost, and which stifle innovation. At times, the complexity and rigidity of regulations can hinder growth and competitiveness. For example, stringent corporate governance and disclosure norms might increase operational and compliance costs and discourage companies from getting listed. In such cases, the relationship between regulators and businesses can become adversarial. However, the companies should take into account that better corporate governance leads to a governance premium that ultimately benefits shareholders.

The Indian capital market follows a **disclosure-based regime**. Ensuring transparency is necessary and it is the task of boards and management to comply. Companies should make adequate, accurate and timely disclosures to enable investors to evaluate company's performance and make an informed decision. SEBI has recently mandated disclosure of the most relevant Key Performance Indicators (KPIs) in offer documents. The KPI disclosure framework primarily focuses on ensuring parity of information between investors in the IPO and disclosures/commitments/promises made to pre-IPO investors, disclosure of price at which shares have been issued or transferred in the issuer's recent history and continuity of pre-IPO disclosure practices after listing.

Post listing, instances of inadequate, inaccurate, misleading and delayed disclosures of material events/information by listed entities have been observed. This leads to information asymmetry and rumours circulating in the market which creates a false market sentiment and impact on the securities of the entity. SEBI has recently introduced rumour verification requirements for top 100 listed entities which will be extended to top 250 listed entities i.e. next top 150 listed entities from the 1st of December. SEBI has also introduced materiality threshold for objective identification of material events or information and stricter timelines of disclosure for faster dissemination of material information. Disclosure of agreements binding listed entities, whether the listed entity is part to the agreement or not, has also been mandated to deter promoters to enter into agreements which are not in the interest of the listed entities or its shareholders.

In the recent times, support provided by proxy advisors and stewardship of institutional investors has been on a rise and is welcome. Concerns of lack of transparency and inadequate disclosures by the companies have been raised by such market participants. It is important for the board of directors and the management to consider the concerns raised by such stakeholders.

The board of directors as a whole and the audit committee in particular has a significant role in managing conflicts of interest of management, board and shareholders and monitoring misuse of corporate assets and **abuse in related party transactions**. SEBI has observed instances of diversion of funds/issue proceeds to related parties / connected parties/shell companies. It has also been observed in some entities that the company has booked fraudulent sales and purchases through circular transactions amongst related parties / connected parties. Such concerns require the regulators to step in to ensure that markets operate fairly and efficiently and to protect the interests of investors. Regulators cannot be mute spectators to violations or misconduct in the market. The **Small and Medium Enterprises (SME) platform** of the Stock Exchanges was operationalised in the year 2012 to serve as an alternate source of raising funds for emerging small businesses. Ever since, there has been an increase in the number of SME issues as also the investor participation in such offerings. During the last decade, more than Rs. 14,000 crores have been raised through this platform, of which around Rs. 6,000 crores were raised during the last financial year. Today, companies listed on NSE's and BSE's SME Exchange have a market capitalization of approx. 2 lakh crore. This is a welcome development.

There are major concerns that have been observed in this segment of the capital market. Post listing, some of the SME companies and/or their promoters have been resorting to questionable means that project an unrealistic picture of their company and its operations. Typically, these companies follow this up with various corporate actions such as rights issues, bonus issues, stock splits, preferential allotments, etc. Such kite flying by SME companies when the ground reality is different has raised concerns. The above actions create a positive sentiment amongst investors, which induces them into purchasing such securities. Simultaneously, this also presents an easy opportunity to the promoters to off-load their holdings in such companies at elevated prices. The quest for market capitalisation should not end up as a race to the bottom.

SEBI has issued advisories cautioning investors about potential risks associated with investing in SME companies. SEBI has also taken strict actions against such companies involved in fraudulent and manipulative activities. This includes barring companies and their management from the securities market and impounding illegal gains. These measures are part of SEBI's ongoing efforts to protect investors and maintain the integrity of the securities market. The role of adequate regulation in SME companies is thus critical to protect the investments of the public in such companies. Yet, intermediaries do not get the message. This is unfortunate and avoidable as it hurts the system in the long run, especially the good SMEs that have potential.

Regulators as Frenemies

The reality is that regulators often fall somewhere in between - as frenemies. This relationship is characterized by a mix of cooperation and conflict. Businesses and regulators need each other; businesses require a stable and predictable environment to thrive, while regulators need businesses to comply with laws to achieve their objectives. This dynamic creates a frictional relationship where both parties must navigate their interests carefully.

The key to a healthy relationship between regulators and businesses lies in striking a balance. Regulators must be flexible and adaptive, understanding the challenges and needs of the industries they oversee. On the other hand, businesses should engage constructively with regulators, providing feedback and collaborating on solutions that meet regulatory goals without stifling innovation.

Conclusion

SEBI has been active in its efforts to strengthen the robustness of the market, keeping pace with the growing importance of capital markets in the economy. Our role is a complex one. We will be your friends most of the time. However, as new market dynamics emerge, we will create new regulatory frameworks or modify existing frameworks as required to fulfil our role of investor protection that relies heavily on the impartial and efficient performance of companies, their boards and market participants. The role of SEBI and the businesses must go hand in hand to ensure continued capital formation in the Indian securities market.

Thank you.

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