

CHAPTER 16:

GOVERNANCE INFLUENCERS

QUESTION 1:

Ratin recently completed his MBA from London School of Economics and joined family business. Ratin's father Kesha Bhai was the Managing Director of Ratloi Chemicals Ltd, a chemical manufacturing company and he wanted Ratin to take over the business. As a part of this transition, Ratin was trying to understand the industry and its prospects. Coming from a wider academic exposure, Ratin wanted to build a sustainable ecosystem for his business which also caters to the environmental requirements. He was planning to appoint consultants to do an Environmental, Social and Governance (ESG) study for his chemicals business and transition of the business towards ESG investing. Ratin briefed the Board of Directors about the ESG investing and its impact on the business. Some of the directors were skeptical and asked Ratin to explain, if there will be any challenges. In this background, outline the challenges faced by ESG investments. **(JUNE 2025) (5 MARKS)**

Ans:

- (a) ESG investments also known as “socially responsible investments” or “impact investment” or “sustainable investments”, refers to investing which prioritizes optimal environmental, social and governance (ESG) factors or outcomes.
- (b) It is commonly viewed as a way to invest responsibly by considering the environment, human well-being, and the economy. It is based on the growing belief that a company’s financial performance is more and more influenced by environmental and social factors.

Challenges faced by ESG investments:

- (i) Absence of quality data: For investors, finding concrete data on ESG of any company can be a difficult task and often inaccurate. Thus, The lack of trust in the available information continues to be a major barrier to the growth of ESG investments in India.
- (ii) Absence of measurement standards: There is a need to standardize data collection, measurement methods, & reporting practices, as the current data lacks uniform standards.
- (iii) Traditional mindset: Many investors view ESG as an extra cost that is unnecessary with least consideration towards environment and sustainability
- (iv) Limited track record of ESG: In India, ESG funds have only started gaining attention in the last 2–3 years. As a result, the limited track record of these funds may discourage many investors from considering ESG as a viable investment option.
- (v) Lack of awareness between the investors.

QUESTION 2:

Decisions, whether to vote for or against various resolutions by shareholders at the annual general meetings, are increasingly being driven by what the proxy advisors recommend. Also, voting is largely done by the custodians on behalf of the institutional investors, based on recommendations of the proxy advisors. Institutional investors who are the shareholders of various companies, cannot keep track of the policies and performance of all such companies. This has created the demand for proxy advisory firm’s services. Enumerate the role and functions of Proxy Advisory Firms. (JUNE 2025) (5 MARKS)

Ans:

- (a) “Proxy advisory” refers to any individual or any organization that prepares recommendations and gives advice for the institutional investors or shareholders so as to aid them in the casting of their vote in respect of any policy issues or public offer.
- (b) Some of the functions of proxy advisory firms are given below:
 - (i) It is an independent research outfit. Therefore, first function is to provide voting recommendations to their clients.
 - (ii) Many institutional investors cannot keep a track of various companies they have invested into, so the second function is to monitor the investee company and recommend appropriate actions
 - (iii) When the company takes decision which concerns corporate governance, in such cases many investors lack understanding of its long term impacts, so the third

function is to analyze and advise the investors about the pros and cons of the decision.

- (iv) They act as a proxy when the shareholder cannot attend the meeting.
- (v) They also conduct environmental, social and governance (ESG) analysis.
- (vi) They ensure participation of investors in corporate decision making.
- (vii) They provide a report which represents the corporate governance score of an entity.

QUESTION 3:

Anaya a Senior Company Secretary, has been invited for a panel discussion on the topic ‘Investment trends in India and the role of institutional investors.’ During the discussions, it was highlighted that domestic and foreign institutional investors are pivotal sources of capital and also provide the volume of trades for the markets to thrive. Institutional investors have access to securities and markets of all kinds including few private investment options, which is typically not open for the retail investors, such as institutional real estate, or private stock placements. As a governance influencer, Anaya explained the importance of the institutional investors in the economic spectrum. Narrate the role and importance of institutional investors. (JUNE 2025) (5 MARKS)

Ans:

- (a) Institutional investors are organizations that pool funds from a large number of investors and invest into stocks/bonds as per their investment policy.
- (b) They have many investment options some of which are not available to retail investors also their investment amount is significantly higher than the individual ones.
- (c) Role and Importance of institutional investors include the following:
 - (i) Important Source of Capital: Institutional investors play a key role in providing large amounts of capital to companies, especially during events like IPOs. This reduces the companies’ reliance on many small investors and helps ensure full subscription of shares.
 - (ii) Benefits to Individual Investors: Institutional investors pool funds from many individuals and invest on their behalf. Since they invest large amounts, they can access better investment opportunities. They also have expert teams that manage funds professionally, which benefits individuals who may not have such expertise.
 - (iii) Preferential Treatment: Due to their large investments, institutional investors enjoy benefits like lower transaction costs and faster trade execution. These advantages are also passed on to the individual investors who are part of the investment pool.

- (iv) They influence the corporates to make policies regarding good corporate governance practice and be actively involved in monitoring the same.
- (v) There is a direct relationship between the corporate governance practices adopted by a corporate and the number of institutional investors who would want to invest in it so they act as the biggest motivators to the corporates to inculcate good corporate governance practices.
- (vi) For those institutions which have a good corporate governance mechanism, it requires lesser monitoring which motivates the institutional investors to select those companies which are well governed which in turn motivates the corporates to act responsibly if they want to attract investments.

QUESTION 4:

An Institutional Investor is a legal entity that pools funds of a large number of individual investors or other legal entities and invests in different financial instruments such as stocks, bonds, commodities or any other investment option. There are several different types of Institutional Investors in the market depending upon their specialization in specific asset classes and the investment strategies. State and brief at least five prominent types of Institutional Investors that are in vogue in India. (JUNE 2024) (5 MARKS)

Ans.

- (a) Institutional investors are organizations that pools funds from large number of investors and invest into stock or bonds as per their investment policy.
- (b) Various types of institutional investors includes:
 - (i) **Mutual funds:** They are a very popular investment option. They collect money from various investors and invest it in a range of securities. These funds are managed by qualified professionals. Mutual funds offer flexibility, as they include liquid securities, allowing investors to enter or exit easily. They also help reduce risk by diversifying investments across industries and types.
 - (ii) **Hedge funds:** Hedge funds are another type of institutional investment, where money is pooled from investors and managed by a fund manager. Though similar to mutual funds in using diverse portfolios to reduce risk, hedge funds follow more aggressive strategies. They are usually open to limited investors and considered riskier, but they also offer the possibility of higher returns.
 - (iii) **Insurance companies:** Insurance companies are major institutional investors. They invest the premium collected from policyholders into various securities. As they

manage large sums of money, their investments are significant. The profits made from these investments help them cover insurance claims.

- (iv) Endowment funds: Endowment funds are created by institutions such as schools, universities, hospitals, or charitable organizations. The principal amount remains untouched, and only the income earned from investing it is used to support the organization's goals. For the investor, these funds often act as a tax-deductible investment.
- (v) Pension funds: these are the funds where both employers and employees contribute. The collected money is then invested in various securities. There are two main types of pension funds; One where the pensioner gets a fixed amount, regardless of fund performance or another where returns vary based on how well the fund performs.

