FSSA Investment Managers

Quarterly Manager Views

What "Value Up"?!

July 2024

> "Due to my differing view on leadership accountability and succession planning, I will be resigning from the Board effective June 3rd, 2024."

We review board and management changes within our universe of companies on a weekly basis and, when it comes to justifications, most are inevitably "due to personal reasons". So when we saw the above reason, stated by Nisa Godrej after resigning from the board of a luggage manufacturer in India, we were pleasantly surprised with the candour. However, one only needs to read Nisa's letters in Godrej Consumer's annual reports to see that she is perhaps one of the most transparent corporate leaders in India. One wouldn't expect anything less from her.

That aside, most independent directors typically give ambiguous reasons for their resignation, leaving minority shareholders in the dark about the real issues. The Indian stock market regulator, the Securities and Exchange Board of India (SEBI), has changed that by requiring more detailed disclosures on the resignations of key personnel (in addition to making their resignation letters public). Going forward, if a director resigns due to "personal reasons", he or she would be questioned about continuing to serve on other boards and may even be disallowed from joining a new board for at least a year, which is quite a deterrent.

Still, most corporate resignations will continue to be run-of-the-mill humdrum affairs. But every now and then, shareholders get glimpses of the politics that govern board dynamics in public companies. This is often a marker of corporate culture, which is in itself a key determinant of the long-term performance of any business, in our view. No other emerging market, to our knowledge, is pushing for this level of disclosure.

Indeed, this is a consistent theme. One can always find shortcomings, but broadly speaking and relative to the stage of its economic development, India's financial system is ahead when it comes to protecting the interests of individuals, be they stock market investors, depositors, borrowers or buyers of insurance policies. For instance, the Reserve Bank of India (India's central bank and regulator), recently began clamping down on small-ticket unsecured loans.[1] Typically, by the time we see such actions in other emerging markets, non-performing loans (NPLs) in the system are already surging and the banking system is in need of a bailout. In this case, there are no such issues. NPL ratios in India are at decadal lows. But the regulator had spotted errant activity that, if not nipped in the bud, could have potentially hurt the system and individual borrowers.

Similarly, the Insurance Regulatory and Development Authority recently directed life insurance companies to provide reasonable payouts to customers if they wished to surrender a policy before reaching the minimum investment period specified in their contracts.[2] At present, policyholders get nothing, or receive just a paltry payout, if they discontinue their premiums. This forms a significant chunk of the profits for most Indian life insurance companies, and indeed, many global peers as well. The insurance industry is notorious for being run for the profiteering agents and companies – nobody has ever lobbied for the consumer. The regulator in India intends to pick up the consumer from the back of the queue and place her right up front. Whilst there are perhaps nuances to this which we do not fully comprehend, the intent seems right – and we rarely see this happening in other jurisdictions.

[1] https://www.financialexpress.com/business/banking-finance-rbi-tightens-norms-on-personal-loans-for-banks-nbfcs-3309017/
[2] https://www.financialexpress.com/money/irdais-new-policy-surrender-value-rules-how-will-it-impact-life-insurance-policyholders-3524625/

Whether it is disclosures and rules around tag-along rights, board independence, share pledges or even environmental, social and governance (ESG) data, we consistently find ourselves pleasantly surprised by events in India. It is also encouraging to see shareholders take advantage of the protections afforded to them. For example, when Nestle India’s parent company recently proposed increasing the royalty charge from 4.5% to 5.25%, the proposal had to be voted upon by minority shareholders. 57% voted against the move, thereby directly impacting the company’s future bottom line.[3] And another recent instance of regulators taking a stand was when minority shareholders rejected a proposal by Linde India which severely limited the company’s scope of operations, instead favouring those of Praxair India, given that Linde and Praxair had merged globally. Upon receiving investor complaints that Linde India was effectively disregarding the result of the minority shareholder vote, SEBI appointed an independent valuer to ascertain the appropriateness of related-party transactions between Linde India and Praxair India, ensuring that minority interests were protected.[4]

We often read about investors getting excited about a “Value Up” program in Korea, or similar in Japan, or second-guessing what the regulators might do in China to propel the stock markets there. At the same time, we are constantly asked about the valuations in India for good businesses which are run by good people, who are conscious of return on capital employed and good governance, and are overseen by regulators who are getting better at doing the right thing for all stakeholders. Near-term valuations aside, we find the notion of clubbing India with some other bigger markets in the region and comparing them in same breath sometimes frustrating and often amusing. This is not to say we are oblivious to reality — India’s market capitalisation to gross domestic product (GDP), anecdotally a good measure of broad valuations, is at a decadal high of 150%.[5] Specifically, we notice that valuations of many small and mid-cap companies, and particularly in certain sectors, are questionably high. But as always, we are being prudent; and we are confident in preserving our clients’ capital during tough periods and growing it steadily over the long term.

In conclusion, we all face a choice when it comes to investing in India and the answer depends on our views. Do protections for all stakeholders deserve a premium? Does a higher awareness for capital deserve a premium? Do enterprises which have their long-term destiny in their own hands deserve a premium? Does a country with a young, educated and aspiring population, urbanising at a fast pace, deserve a premium? Does a market where democracy won yet again deserve a premium? You decide…

[3] Glass Lewis Proxy Voting Advisors
[4] https://www.sebi.gov.in/enforcement/orders/apr-2024/interim-order-in-the-matter-of-linde-india-ltd-_83095.html
[5] World Bank DataBank: GDP (current USD) – India, 2023; and BSE Ltd, as at 11 July 2024

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 11 July 2024 or otherwise noted.