

Boardroom Battles & Corporate Governance Turbulence at IndiGo

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ABSTRACT

IndiGo, the airline services arm of InterGlobe Aviation Limited, was co-founded by Rakesh Gangwal (Gangwal) and Rahul Bhatia (Rahul) in 2006. A recent spat between these two co-promoters has raised the question of corporate governance issues in the company. Bitter boardroom battle got triggered when one of the co-promoters Gangwal made critical comments against the company's practices. This issue got raised because of rights abused by Rahul by his considerable powers opined by Gangwal. However, Gangwal was quite okay at the inception of the company. These comments triggered the attention of capital market regulator SEBI. The topics regarding exclusive rights and Related Party Transactions (RTPs) raised red flags. Shareholders got concerned, and the share price nosedived. Experts opined RTPs to be an administrative issue and not that of the airlines. This case uses secondary data from reliable sources. Discussion is centered from the debut of IndiGo to strategies used in becoming a leading domestic carrier and about the recent bitter battle. We then explored the question: What would be the impact of governance issues with the company in the future?

Keywords: Related Party Transactions, Boardroom, Corporate Governance, Indigo, Aviation Sector, India

INTRODUCTION

India's leading airline IndiGo is reported to be suffering from corporate governance issues by none other than one of the promoters of the company. The differences between the two founder-promoters led to a bitter boardroom battle and even called for the attention of the stock market regulator – the Securities and Exchange Board of India (SEBI). This case examines the circumstances that led to the spat, the proposals made, and the attempt to patch up the differences in the context of corporate governance.

INDIAN AVIATION INDUSTRY

India is the home for one of the fastest-growing aviation industries in the world. As many as 158 million travellers flew in 2017, and the count is expected to reach 520 million by 2037,

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according to a report by the International Air Transport Association (IATA)¹. The Indian domestic market is all set to become the third-largest (after the US and China) with a record 90% load factor. Domestic airfares have fallen about 70% since 2005. The key reason for this is: Low-cost carriers sell 70 percent of domestic seats. While India had 486 airports, as many as 406 were participating in unserved airports². The Ude Desh ka Aam Naagrik (UDAN) or the Regional Connectivity Scheme (RCS) helped take the operational airport count to 131 by December 2017. Keeping domestic passenger's demand in view, the Civil Aviation Ministry has planned to build about 100 new airports in the next 10 to 15 years. The cost outlay is at about \$60 billion to the exchequer³. A total of 22 airlines operate in India under different management. Air India and Pawan Hans are from the public sector. There are listed private sector airlines such as Spice Jet and IndiGo and unlisted private airlines such as GoAir, Air Asia, Vistara. These companies together operate 548 aircraft as of December 2017. The Indian aviation industry is a moderately concentrated market and has an HHI Index score of over 2500. Market experts feel the airline market will turn into highly concentrated in the next four years⁴. Ticket discount policies triggered by intensified competition had forced many of the airlines to run their operations in a loss. Global crude prices and the location for refueling have become important factors that determine airline profitability. Some airlines such as Air Deccan, Kingfisher, and Jet Airways have stopped their services having turned unviable to do business.

ABOUT INDIGO

IndiGo is a low-cost airline run by the Gurgaon-headquartered InterGlobal Aviation Limited. Rakesh Gangwal started his airline career with United Airlines in 1984 and rose to become the US Airways Group chief executive and chairman⁵. Rahul Bhatia worked for IBM and later did IT work for United Airlines where he met Gangwal. The two co-founded IndiGo with just one airline that they took delivery of in July 2006. By 2012, it became the leading passenger-carrying airline in India. IndiGo preferred to lease out new aircraft for less number of years and specialized in bulk, as analysts said. IndiGo only had the A320 models as an initial contract and plans to add a long-distance A321neo LR and A321 XLR which yet to release in 2019⁶. Experts opined that, since IndiGo uses only one type of aircraft, it would take less time to get to the next type. Turnaround time between schedules comes down, and so do services go uninterrupted.

The company went public and became a listed company in 2015. Since it is a low-cost carrier, the focus is on keeping costs low and improving efficiency to be viable to carry passengers and maintaining low fares.

IndiGo uses the IATA code 6E and is the largest Indian airline in terms of passenger carriage and fleet size (238 aircraft). It enjoys a 48.1 percent market share as of June 2019 according to company statistics⁷. The airline covers 57 domestic and 19 international destinations and runs 1400+ daily services. IndiGo has a positive reputation for being profitable for the last ten consecutive years⁸ at a time when global airlines are bleeding and on vital financial support to sustain their operations. The airline also won accolades for being an award-winning employer. IndiGo made significant gains during the crash-landed Jet Airways crisis in 2019 in terms of increased domestic business as well as the opening up of international routes. IndiGo seized the opportunity by capturing the short-haul international routes because as much as 83 percent of international routes are for the short-haul, thanks to its A321neos orders.

THE TURBULENCE

On July 8, 2019, co-founder Rakesh Gangwal approached SEBI for its intervention. He alleged lack of proper corporate governance and about certain questionable related-party transactions at InterGlobe Aviation (*Refer to Exhibit I for Related Party Transactions of InterGlobe Aviation*). The Audit Committee members met before the Board Meeting to discuss the RTP issue. They

felt that the contract/terms of all proposed RTPs should be checked before entering into them. In the event of the Company proposing to enter into or amend an existing RTP which is not in the ordinary course of business or not on an “arm’s length” basis, the management shall present it to the Audit Committee. A similar complaint to the Ministry of Corporate Affairs (MCA) is submitted. A copy of the allegations also went to the offices of the Prime Minister and the Finance Minister. The Bhatia group rejected the claims.

Meanwhile, the company stock lost about Rs. 13,000 crores in market cap on the stock exchange between July and August 2019. Fortunately, much of what is lost notionally is regained in no time, which appears to be a manifestation of shareholder’s confidence in the company⁹. An August 2019 report said that SEBI is studying the Shareholders Agreement (SHA) to check for any violation of the rights of minority investors and individual shareholders¹⁰. SHA is a private contract between the two parties of a company. SEBI, in general, is not in favor of bilateral SHAs as seen from its past standpoint of view. It feels SHAs lead to disproportionate rights to one set of shareholders. Hence, SEBI generally desists from interfering to such contracts. Further, SEBI does not invalidate such SHAs either. SEBI interferes only in case the contract compromises the governance or the rights of other shareholders, particularly that of the public shareholders.

Much of the questions and doubts arise from the para 16.16 of the Articles of Association (AoA). It reads: “Each Group shall at all times exercise their voting rights at the meetings of the shareholders and shall cause their nominees on the Board to vote, in order to ensure the implementation of the terms of the AoA - which would include the rights of the IGE Group to nominate the senior management listed in Article 17.4.”. Gangwal questioned this paragraph that said that there shall be no binding obligation on each group to exercise voting rights and that they are to be left free in exercising their voting rights¹¹.

Experts opined the fierce battle might end up before the National Company Law Tribunal (NCLT). NCLT is the rightful platform for judging the rights of shareholders from a legal perspective because of the superior jurisdiction and power of NCLT over SEBI on such matter. In late August 2019, IndiGo’s Chief Financial Officer (CFO) Rohit Philip, who joined the company at the behest of Gangwal announced his resignation. (*Refer to Exhibit II, Recommendation 2 for Letter of Appointment to Director*). The company soon announced that it is replacing Philip with Aditya Pande¹².

THE PROPOSAL

Addressing the related party transaction issue, the Board decided that an external audit committee will approve any transaction over Rs. 2 crores. (*Refer to Exhibit II, Recommendation 10 for Related Party Transactions*)

As per June 2019 shareholding pattern, the promoters hold 74.89 percent shares of the company. Of this, Rakesh & Shoba Gangwal holds 23.07 percent and Chinkerpoo Family Trust for which Shoba Gangwal is a trustee holds 13.59 percent. This combined holding will be 36.66 percent in the company¹³. (*Refer to Exhibit III, Shareholding Pattern*) The Bhatia family (together with the Interglobe Enterprises Private Limited (IGE) that is run by the Bhatias), Asha Mukherjee and Alok Mehta hold nearly 38 percent. (*Refer to Exhibit IV, Promoter & Promoter Shareholding Pattern*) The two groups together hold 75 percent of the company – the maximum promoter holding allowed for a listed company. Some experts opined that having shares carrying differential voting rights (DVR) could be a source of trouble at a later stage. For instance, one of the co-founders could secure DVR’s carrying special rights such as those having more voting rights¹⁴.

The Company's Board later decided to amend the Articles of Association (AoA) by increasing the member count. The AoA is regarded as the Constitution of the Company. It defines the nature of the business, roles, and responsibilities of the Board of Directors. AoA is the means through which shareholders control the Board. The Company's Articles of Association were rewritten and was put before the Annual General Body Meeting (AGM) on August 27, 2019. The AGM room was only half-full. A section of shareholders was unhappy at the absence of Gangwal. The absence further raised corporate governance issues in the minds of the public because it was Gangwal's idea to take the company public when his partner Bhatia was not that keen¹⁵. Increasing the board size to ten members (from six) and having four independent directors (from 2) is amongst the significant resolutions proposed.

The special resolution needs acceptance from 75 percent of members and with Gangwal holding 37 percent, getting it passed will not be easy. However, on July 27, Gangwal pointed out the lack of clarity on the RTP policy. He highlighted certain "loopholes" wherein in the event of the resignation or retirement of the independent directors, a disproportionate strength situation could arise. This could make the situation even more bitter going forward. The Board fixed the loophole by agreeing not to approve any policy, barring specific urgent ones such as those related to Government regulations, without approval from the full board. By doing so, neither Bhatia nor Gangwal groups get policy change approvals without the consent of the other. (*Refer to Exhibit II, Recommendation 8 for Board meetings through Teleconferencing*)

This solution seemed plausible and led to a possible patch-up of the two. Ten members are not a size either Gangwal or Rahul wanted, but the Board decided for it after two days of deliberations. Getting a woman director, as well as an executive director on the Board and keeping all six directors in non-executive, were intended. However, it got revealed that the numbers game seemed not that right. The expanded board will have five nominees from IGE, one from Gangwal and four independent directors, one of whom will be a woman director. Reports say that 84 percent of large public shareholders (which include institutional investors who hold 21 percent of shares) rejected the move to alter the AoA¹⁶. (*Refer to Exhibit II, Recommendation 9 for Executive Sessions*)

The battle turned fierce with Gangwal hiring law firm Khaitan & Co. to assist him in taking legal recourse. Meanwhile, Bhatia engaged legal experts from JSA Law¹⁷.

THE PATCH UP

With the Board composition issue fixed and related party transaction issues closed, Gangwal issued a media statement uploaded to his newly built website. He announced that the loophole pointed out by him was fixed by the board. He further said that it is "gratifying to see progress towards better governance"¹⁸ and that in the "light of positive and important developments," he is supporting for the resolution¹⁹. The exact reason for the patch was however not revealed²⁰. Gangwal, however, kept his cards open by waiting for the inquiry findings from the SEBI and MCA.

Gangwal and independent director Anupam Khanna (who earlier questioned the workings of chairman M. Damodaran's decisions related to the Board's functioning) abstained from attending the AGM. At the AGM, the Chief Executive Officer (CEO) Ronojoy Dutta said that the RTP's between Bhatia's IGE and InterGlobe Aviation now amounts to less than 1% of the annual revenue. The RTP's value is at Rs. 156 crores as against the company revenue of Rs. 30,000 crore. The company duly approved all RTPs²¹. An independent audit is called upon by Chairman Damodaran. EY engaged in the activity has found no significant irregularities. The Chairman said

the company had taken additional safeguards by taking the RTP policy further beyond the two standard requirements. The two standard conditions are: The transaction must be in the ordinary course of business. Second, it must be an arm's length transaction with no favorable pricing with a related party. Speaking about the old RTPs that raised the issue, he said that there are seven or eight transactions done year-after-year with the same related party. These were duly approved by the audit committee every year. He said the question got shifted from RTP to RTP policy and that the policy is now even more strengthened by not allowing the dilution to it without the approval from the independent directors.

In late August, Chairman Damodaran said that SEBI and MCA are not conducting any investigation. Only correspondence is taking place and that the company has provided all documents sought by them. Speaking about the long-lasting truce, he said, *"Truce is certainly sustainable, but the truce is not peace ... I am looking forward to a day, not in the distant future, where we will have peace rather than a truce. The truce is closer to ceasefire than peace is. Peace is when you put everything behind you, and none of these issues survive. What we need to do is look ahead and take the airline to even higher growth"*²².

At this time, it almost appeared that truce came in. Three days after the AGM, on August 30, 2019, Gangwal, through his legal counsel, reiterated some issues previously raised as well as new questions including a demand to remove IGE's controlling rights on the functioning of the airline, the independence of the chairman amongst others. He sent his missive to SEBI and sought its inference on the issue. The list of questions includes on the recently amended AoA, about the refusal to hold an extraordinary general meeting when asked by Gangwal and certain statements made by the CEO. SEBI, in its September 3 letter has sought a reply from the company on the points freshly raised²³. Analysts feel that this new fallout would call for further investigation from the regulator. The result adversely affects investor's sentiments and thereby impacting share prices. The company enjoys strong volume growth and cost advantage against other airlines. This is perhaps what is holding its share process for now²⁴.

LOOKING FORWARD

Despite facing all odds, IndiGo managed to stay in profit and has excellent brand visibility. However, certain irregularities, particularly on corporate governance, have fueled suspicion on the company. So much is the doubt that one of the founder-promoter himself has complained on his other partner. Corporate Governance issues are not new, and the Indian Corporate has had several stories that are popular in management studies. Organizational issues like these, raise doubts in the stakeholder's minds. How will shareholders, regulators, and Government bodies react in these circumstances? How will this impact the future of the company? These unanswered questions will be answered in the days to come as things pan out.

QUESTIONS FOR DISCUSSION

1. Analyze the growth and profitability of IndiGo?
2. What makes IndiGo wipsey to irregularities?
3. What would be the impact of governance issues on the stakeholders?
4. What would be the impact of governance issues on the company in the future?

ENDNOTES

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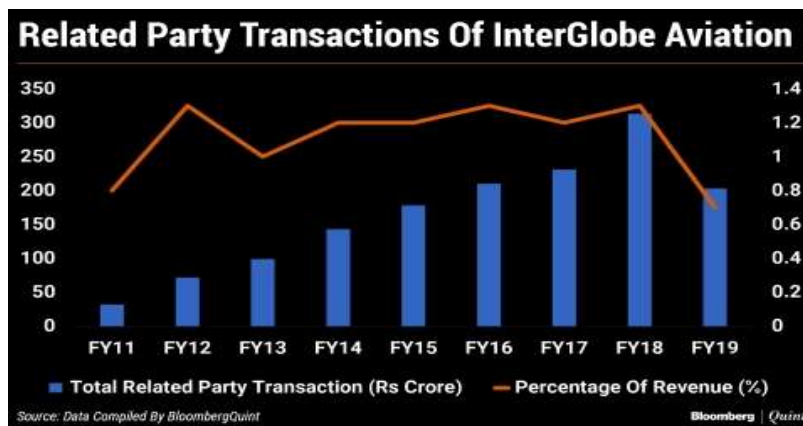
²³ “Sebi seeks IndiGo reply to Gangwal’s missive,” Business Standard, September 5, 2019, Mumbai Edition, Page 2

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EXHIBITS

Exhibit I

Related Party Transactions of InterGlobe Aviation



Source: www.bloombergquint.com/business/indigos-related-party-transactions-fell-in-fy19, August 6, 2019.

Exhibit II

Highlights of the Confederation of Indian Industry Report on Corporate Governance

Recommendation 2: Letter of Appointment to Directors

- Specify the expectation of the Board from the appointed director;
- The Board-level committee(s) in which the director is expected to serve and its tasks;
- The fiduciary duties that come with such an appointment;
- The term of the appointment;
- The Code of Business Ethics that the company expects its directors and employees to follow;
- The list of actions that a director cannot do in the company;
- The liabilities that accompany such a fiduciary position, including whether the concerned director is covered by any Directors and Officers (D&O) insurance; and
- The remuneration, including sitting fees and stock options, if any.¹

Recommendation 8: Board Meetings through Tele-conferencing

If a director cannot be physically present but wants to participate in the proceedings of the board and its committees, then a minuted and signed proceeding of a tele-conference or video conference should constitute proof of his or her participation. Accordingly, this should be treated as presence in the meeting(s). However, minutes of all such meetings or the decisions taken thereat, recorded as circular resolutions, should be signed and confirmed by the director/s who has/have attended the meeting through video conferencing.

Recommendation 9: Executive Sessions

To empower independent directors to serve as a more effective check on management, the independent directors could meet at regularly scheduled executive sessions without management and before the Board or Committee meetings discuss the agenda.

Recommendation 10: Related Party Transactions

Audit Committee, being an independent Committee, should pre-approve all related party transactions which are not in the ordinary course of business or not on "arms length basis" or any amendment of such related party transactions. All other related party transactions should be placed before the Committee for its reference.

*Source: Corporate governance,
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Exhibit III

Shareholding Pattern of InterGlobe Aviation Ltd for the period ending June 2019

Shareholder Category	Shareholding Percentage
(A) Promoter & Promoter group	74.89%
(B) Public	25.11%
(C1) Shares underlying DRs	0%
(C2) Shares held by Employee Trust	0%
(C) Non Promoter-Non Public	0%
Grand Total	100%

*Source: BSEIndia.com,
<https://www.bseindia.com/stock-share-price/interglobe-aviation ltd/indigo/539448/qtrid/102.00/shareholding-pattern/Jun-2019/>*

Exhibit IV

Statement showing the shareholding pattern of the Promoter and Promoter Group for the period ending June 2019

Shareholder Category	Shareholding Percentage
(A1) Indian	
Individuals/Hindu undivided Family	0.35%
ROHINI BHATIA	0.00%
KAPIL BHATIA	0.01%
RAHUL BHATIA	0.01%
ASHA MUKHERJEE	0.01%
ALOK MEHTA	0.33%
Any Other (specify)	37.88%
INTERGLOBE ENTERPRISES PRIVATE LIMITED	37.88%
Sub Total A1	38.23%
A2) Foreign	
Individuals (NonResident Individuals/ Foreign Individuals)	23.07%
SHOBHA GANGWAL	8.40%
RAKESH GANGWAL	14.67%
Any Other (specify)	13.59%
THE CHINKERPOO FAMILY TRUST (TRUSTEE: SHOBHA GANGWAL & J. P. MORGAN TRUST COMPANY OF DELAWARE)	13.59%
Sub Total A2	36.65%
A=A1+A2	74.89%

Source: BSEIndia.com, <https://www.bseindia.com/corporates/shpPromoterNGroup.aspx?scripcid=539448&qtrid=102.00&QtrName=June%202019>