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SEBI study finds that 1 out of 4 times, listed companies paid royalty exceeding 20% of their net profits to Related Parties

SEBI has conducted a study analysing the royalty payments made by listed companies to their Related Parties (RPs).

The study is based on annual, company level information, in respect of 233 listed companies across sectors in India. These companies have made royalty payments, amounting to less than 5% of turnover to their RPs, during the 10-year period from FY 2013-14 to FY 2022-23.

Some of the major findings of the study are as under:

- During the period, there were 1,538 instances of royalty payments within 5% of turnover of the company (i.e., not requiring majority of minority shareholder approval) by 233 listed companies.
- Of these, 1,353 instances of royalty payments were by listed companies that made net profits and 185 instances of royalty payments were by companies that made net losses.

Royalty Payments by Net-Profit making Companies

- 1 out of 4 times, listed companies paid royalty to RPs exceeding 20% of their net profits.
- 1 out of 2 times, listed companies that paid royalty, did not pay dividend or paid more royalty to RPs than dividend paid to non-RP shareholders.

Royalty Payments by Net-Loss making Companies

- During FY14-23, there were 185 instances of royalty payments by 63 companies that made net losses. Such companies made royalty payment of Rs. 1,355 crore to their RPs.

- 10 companies incurred net losses at least for five years while paying royalty amounting to Rs. 228 crore to their RPs.

Consistent Royalty-payers

- 79 companies consistently paid royalty to their RPs during all the 10 years under study. While aggregate royalty payment by these companies kept pace with growth in turnover and net profits till FY19, royalty payments tempered post FY19.
- In the case of 18 companies, royalty payments outpaced both turnover and net profits throughout the period. Aggregate royalty payments by these companies grew at a CAGR of 14.6% over the 10 years, which is more than double the CAGR of turnover (6.5%) and net profits (6.0%) of these companies.
- 11 out of 79 companies consistently paid royalty exceeding 20% of net profits during all the 10 years.

Issues flagged by proxy advisory firms on Royalty related matters:

- Royalty payments by companies have little correlation to their revenue or profits.
- The performance of royalty-paying companies is not of a higher order compared to their peers, including those who are not paying royalty.
- Companies, at times, seek approval for royalty payments in perpetuity, contrary to the principles of corporate governance.
- Companies often make significant payments towards brand usage, despite these companies themselves spending considerably on advertisement, brand promotion and creating/ adding value to the parent brand.
- Cash outflows to RPs (other than royalty or brand payments), are usually termed as 'Management fees', 'Technology License fees' etc. Such payments do not fall within the ambit of royalty from regulatory perspective and quantum of such payments can be uncomfortably large.
- Poor disclosure levels continue to keep a veil on royalty and related payments. Listed companies do not provide adequate justification or rationale for royalty payments, and details of benefits derived in return for such royalty paid.
- In case of MNCs, shareholders of the Indian subsidiary have little information on the rates of royalty being charged from fellow subsidiaries in other geographies.

- Independent fairness opinions by different agencies on royalty payments vary significantly in terms of valuation. This suggests a high degree of subjectivity surrounding the valuation, and the fairness of royalty rates arrived upon.

The study is available on SEBI website www.sebi.gov.in

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