



HUGH SANDEMAN

The author is managing director, Langham Capital. He can be reached at hugh.sandeman@langhamcap.com

Let shareholders say 'no'

The attitude towards rights of minority shareholders in India is complacent

Although foreign institutional shareholders appeared to give a resounding vote of confidence to Indian business with net inflows of \$17 billion last year, a dissenting voice has piped up in Hong Kong to say that the latest boom has brought "a fair degree of complacency towards corporate governance and the rights of minority shareholders" in India.

The Asian Corporate Governance Association's (ACGA) verdict, in its *White Paper on Corporate Governance in India*, deserves a lot more attention than it got in India when it came out in mid-January. It points to areas of corporate governance – how shareholders do (or don't) get to vote at meetings, lack of control of related party transactions, promoters' issues of cheap warrants – that were side-stepped by last year's introspection in India about how to improve corporate governance after the Satyam disaster. These are not the concerns of a few self-appointed experts in corporate governance. The institutions that contributed to the paper – CalPERS, F&C, Fidelity, Franklin Templeton and Prudential – are some of the largest foreign investors in the Indian market.

India's problem in corporate governance is opposite to that of the US or UK. In Western markets, where institutions own most of the shares, the worst flaw is that managers, as agents for shareholders, often fail to see where the interests of shareholders and their own ambitions diverge – for example, when pursuing takeovers at crazy premiums. The challenge is to try to align the interests of owners and managers, a major reason for the fashion for stock options, which made the agency problem worse. In India, things are the other way round: the promoters are owners and managers, and the continuing challenge is to prevent them from taking minority shareholders for a ride.

The ACGA suggests giving shareholders much greater powers to protect their interests from self-dealing by promoters. It is scathing about the weak controls on related party transactions that allowed Satyam's promoter to propose spending all of the company's cash on the basis of a single board resolution. The ACGA's most radical suggestion is that independent shareholders should be able to vote on related party transactions above a certain size.

There are plenty of major markets, including Hong Kong, Singapore and London, where it is accepted that shareholders unconnected with a

promoter or controlling owner should vote on any major deal between their company and a party related to the company or the promoter. In London, Hong Kong and Singapore, for example, the threshold for a vote on a related party deal is 5 per cent of financial metrics like revenue or net tangible assets.

What makes a routine approach to shareholder rights elsewhere look radical when applied to Indian companies are 'the ground realities in India'. That was the phrase the CII used in its detailed recommendations last November on changes in corporate governance following the Satyam collapse. The CII was referring to its proposal that, while the offices of chairman and CEO should be separated, it was unrealistic and unproductive to try to make the chairman of the board of promoter-managed companies in India a non-executive, independent role. This is perfectly understandable, and the ministry for corporate affairs has included this point in its new voluntary guidelines on corporate governance.

But since 'the ground realities in India' really are different, it is indefensible that the protection of minority interests on such crucial issues, as related party transactions, is weaker in India than in many other markets. It should, by the same logic, be much stronger.

There is no point in pretending that a vote by independent shareholders on large transactions between companies in the same promoter group would be seen as anything other than revolutionary by some business leaders in India. In many cases, it would mean that financial manoeuvres within promoter groups would be effectively subject to veto by foreign institutional investors. This is certainly not a proposal that would be greeted with the same comfortable assent as the new voluntary corporate governance guidelines.

It is, however, worth a try. India's economy benefited enormously from the CII's initiative to push aggressively for corporate governance reform at the end of the 1990s, opening the door wider to the colossal capital inflows of the following decade. It is time for Indian corporate governance to move ahead of the curve again. SEBI could start by setting the bar for independent shareholder approval high enough to exclude all but the biggest inter-group deals – a 10 per cent or 15 per cent threshold, perhaps – and move it gradually down from there. ♦