

Investor unfriendly move

Non-voting share does not seem to contribute to anything to strengthen a company and improve its health and growth, says Uttam Gupta



Reportedly, the government is contemplating measures to compensate the non-voting shareholders and safeguard their interests. These include the non-voting shares to be allowed only in companies with good dividend paying record, higher rate of dividend for the non-voting holders and non-voting shares to be converted into voting in the event of mismanagement, etc. All these become meaningless when the situation actually gets out of control for which the seed has been sown by the sheer act of introducing non-voting share.

Where does one go if even the company with good track record becomes sick after introducing non-voting shares? What relevance higher dividend has when the company is making loss or not in a position to declare dividend at all? And, what does the investor do with the voting share after it has turned sick?

Assuming for a moment that every thing goes well the question still remains as to how the non-voting share will be perceived in the stock market? Can it appreciate as much as the voting share? Will it have as much liquidity? In the event of bonus/rights issue, can the non-voting holder get voting shares? The government has not divulged its mind on these issues. Howev-

er, *prima facie*, it would appear that without the voting power, holders of these shares will be at a serious disadvantage in all these respects.

Mutual funds (MFs) are emerging as an important class of investors. In fact, they represent the interests of the big family of individual investors who, on their own, are not competent enough to decide where to invest and how to protect their interest. MFs are putting a major share of their corpus in equity of body corporates and must know as to how well these are managed and even influence the management decisions. This is necessary to ensure that these companies remain healthy, pay good dividends so that the MFs, in turn, can service their unit holders handsomely.

In a bid to support them in these endeavours, the government has even allowed the MFs and venture capital funds (VCFs), the right to vote in companies where they have invested in equity capital. This objective will get defeated by introducing non-voting shares.

The Guidelines in regard to FIIs investment have been modified to allow any single FII have equity in an Indian company up to a maximum of 10 per cent (against 5 per cent ceiling until hitherto) subject to an

overall ceiling of 24 per cent for all the FIIs put together. It is unlikely that they will acquire additional stake by way of non-voting shares. True, many of them may not be interested in having a say in the management so long as they are assured of good dividend. But, even for this, they cannot afford not to be watchful. Mere watching without the ability to strike when necessary has no meaning. That is why voting share is absolutely essential.

In asking for non-voting shares, the Indian industrialists have made their intention abundantly clear. With lesser financial stake, they want to wrest/maintain management control. In the context of the Central PSUs and state level undertakings, even the government does not seem to be lagging behind. Reportedly, it is contemplating divesting its holding in the PSUs through issue of non-voting share so that it gets funds without having to shed management control. For instance, even after divesting 61.75 per cent of the equity, it can still retain majority control of 51 per cent.

This, however, goes against the spirit of disinvestment, i.e., it should result in a set-up/management which is autonomous and free from government control. Failing this, the objective of turning PSUs into efficient, competitive and growing enterprises capable of meeting the challenges of liberalisation would remain a distant dream.

Non-voting share is a concept bad in letter and spirit. It does not promise anything that would contribute to strengthening the company and improving its health and growth. On the contrary, by vesting disproportionate controlling power with the promoters, it may even produce adverse results. In the state sector, this will militate against the health of the PSUs and state level enterprises by perpetuating government control over them.

In view of this and considering the highly inequitable and discriminatory character (it is even against the principles of natural justice), the government should refrain from implementing the concept of non-voting share. If the promoters/government (the latter in respect of PSUs) are genuinely interested in promoting the health and growth of the enterprises, they can do so under the existing dispensation which is only fair and non-discriminatory.

As for the level playing field mentioned in the finance minister's speech, this issue has to be tackled by improving the infrastructure, reducing the cost of basic inputs like petroleum products, power, lowering interest rates, taxes and duties and, above all, by carrying out administrative/institutional reforms to provide timely support and efficient services to the industry.

The author is chief economist, the fertiliser association of India

In a major move, the government has announced its decision in the Union budget for 1996-97, to allow non-voting shares in a company up to 25 per cent of the issued equity capital. An investor holding a non-voting share, by definition, does not have a voting right. This, in effect, means that he will have no say in the constitution of the board of directors/management nor will he have any right to question managements' decision.

The proposed amendment does not merely involve abrogation of the voting right by the holder of the non-voting share, it also results in the enhancement of the voting right and consequently, management control of the holders of voting share. The latter's role in the management will be disproportionate to its contribution to the risk capital. In fact, it gets raised in the ratio of 1.33 (100/75).

Thus, a voting share of 10 per cent in the equity, will have an effective voting right of 13.33 per cent and so on. Extending the logic further, it will turn out that with a share of only 38.25 per cent in the equity capital, any single investor or a group of investors can have majority control of 51 per cent in the company.

The resultant augmentation in the strength of the voting share will enable the promoter in strengthening its grip over the company without pumping additional funds. However, this need not result in better management and improved financial performance. On the contrary, the company may even be mismanaged. This is because unlike the existing dispensation wherein actions/decisions of the management are under the watchful eyes of all the investors, in the proposed set-up, accountability is compromised. In fact, the very right to ask question is taken away from a substantial chunk of the shareholders.

It is often argued that many of the shareholders especially those in the individual category, do not participate in the AGMs of the companies where crucial decisions/resolutions are put to vote. So, how does it matter whether they have a vote or not? This is an over-simplistic view. The lack of participation may be due to problems of logistics, the costs involved in reaching /attending the meetings and inability to find time. But, this is no ground for taking away from them the right to vote/question. Irrespective of whether the shareholders actually exercise this right or not, the very existence by itself, is a sufficient deterrent against the possibility of mismanagement.

There are umpteen instances of companies in the private/public sector turning sick. And, the reason is not always adverse change of government policies or unfavourable market conditions. Much of the trouble can be sourced to mismanagement.