Thumb on the scale

Investors are making themselves heard, be it through engagement or their vote on resolutions. And regulations, for long, supportive of minority investors are tweaked to help them further. Even so, both investors and regulations still have some way to go.

The recent attempt by investors to defenestrate managements and directors and a series of resolutions being voted down, has markets animated about shareholder activism. And while the investor crusade has taken root and is here to stay, you should expect to see the occasional flare-ups that will sparkle brighter than before no doubt - and more often too, but not an endless firework display.

This is so for a few reasons. First, just 8% of the NSE-500 companies are institutionally owned and widely held. Add at max, another 50 companies where promoter holding is at 27% or below (- I will come back to why this number), implies that there are only a handful of companies that have their flanks open, and are subject to *activism* as it more commonly defined. That the number of companies, with low or no promoter holding is set to increase, but we are not there yet. The experience with the insolvency regime and some recent episodes in the equity market are evidence of the challenges of prising away incumbent owner-managers.

Exhibit: Ownership and voting FY21

	Shares	Shares Voted **(%)**	Votes FOR	Votes AGAINST	Shares Voted %	**FOR** %	**AGAINST** %	% of total voting
Promoters	55.96	51.26	51.25	0.02	91.61	99.97	0.03	66.99
Institutions	26.83	20.70	19.84	0.86	77.14	95.85	4.15	27.04
Others	17.21	4.57	4.50	0.06	26.52	98.61	1.39	5.97
	100.00	76.53	75.59	0.94				100.00

Note: Data for NSE500
2.23 percent of NIFTY500 is held by various depositaries / ADRs / GDRs which has been classified as "others"
Source: IiAS ADRIAN, BSE Data feed

Two, while the narrative about the narrowing gap between the *promoter's* equity holding and that of the institutions is driven by the market cap numbers, the share ownership numbers speak a different story when aggregated across listed companies. The market cap figures, for the NSE-500 tells us that over the past decade, family ownership has come down from 60% to 50%, while that of institutional shareholders has increased from 22% to 35%. In contrast, counting each share tells us that for the last five years, promoter ownership has been at around 55%, while that of the institutional shareholders at 27% (- explains why this number is used above). This ownership pattern determines voting outcomes.

Third is the actual voting itself. In FY21, promoters as a category in aggregate voted 91.6% of their shares, institutional shareholders 77.2%, and others which includes retail, voted just 26.6% of their holding. Put differently, 67% of the total votes cast are by promoters, and just under half this number by institutional investors (27%) and others (6%).

Now overlay this with how all three categories have voted. In FY21, almost the entire promoter votes are *for* the resolution being proposed (99.9%) – unless there is family spat - institutional shareholders (95.8%) and *others* (96.8%) are habitually supportive of managements. Such voting behaviour is to be expected, since what is in the interest of the largest shareholder, must be in the interest of the minority. Its where such alignments are broken, that investors need to raise their voice. The likelihood of all promoters voting as one cannot be a given. They have different business strategies, purchase price, and exit price targets. Haplessly, the data shows, even if all shareholders are opposed to the promoters, the promoters are still more likely to prevail. Still investors sometime do!

This explains what might normally be considered an egregious resolution getting approved or why the handful of resolutions that are defeated make headlines: 194 of the 48,000+ resolutions (less than 0.5%) assessed by IiAS in the last six years have been turned down.

In India, the regulators' focus, rightly, is on control through the voting mechanism. They use two approaches. One, special resolutions which need 75% of the votes in favor. The other is 'majority of minority', where only the 'uninterested' investors get to vote. (- a variation in some markets is dual voting, where you need majority of both promoters and non-promoters supporting a resolution).

Should regulators endorse a voting structure where populist vote subverts shareholder democracy? Should they ignore the vote and focus on the process? There is no right answer. But if promoters have their thumb on the voting scale, regulators have no option, but to raise the guardrails.

Regulations need to revisit which voting threshold should a particular resolution cross? Currently, related party transactions need majority of minority shareholder to approve a resolution and from the next calendar year, all independent directors will be via a special resolution. What about compensation paid to promoters? Currently, these are ordinary resolutions and need simple majority to carry. Should these continue as ordinary resolutions? Ought such approvals be by way of a special resolution? Or should the promoters not be allowed to vote on their salary increase i.e., seek majority of minority vote or should these all be special resolutions? Many other resolutions need a relook. Further, such change will need to be squared with the proposed shift in regulations, from 'promoter' to controlling shareholder.

Meanwhile, the activist investor will contentedly watch the number of institutionally owned professionally managed companies go up, institutional voting percentages rise, with the *against* vote inching up. To them these numbers are an important yardstick, but more critical is that attitudes are changing. They will surely, from now have the tailwind behind them.

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A modified version of this blog by Amit Tandon, titled 'Thumb on the scale' appeared in Business Standard on 30 September 2021. You can access it by clicking this link: https://www.business-standard.com/article/opinion/thumb-on-the-scale-121092901458_1.html

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