Why investors should vote

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The role of institutional investors in corporate governance is shifting center stage. The circular issued in March 2010 by the Securities and Exchange Board (SEBI), India's market regulator, asking asset managers to make public their voting policy and publish their voting record, is a clear pointer that institutional investors don't just have the right, but have a duty to engage with companies in which they invest.

Clearly this dialogue has to take a different form from that in the Anglo-American world. In American-English companies, management and ownership is cleaved. Consequently the dialogue is between a company's shareholders and its management is through its board. The board is expected to hire the 'right' CEO and senior management (Virginia Rometty, IBM), fire the wrong one (Carol Bartz, Yahoo Inc.), ensure compensation is fair (Steve Ballmer at Microsoft only got half his potential bonus for 2010) and provide strategic direction to the company (H-P).

In contrast in India, this dialogue is expected to take place between two sets of shareholders. To the extent both sets are owners of the business, there is a clear convergence of interests. Despite this strategic alignment, both sets may not pull in the same direction. There will be times when there is a conflict of interest, as the interests of the 'controlling' shareholder differ from that of the institutional and small shareholder (collectively referred to as outsider shareholders). This can happen in the case of merging a unlisted company, owned by the 'promoters', with a listed company in the 'group', at an exchange ratio that is detrimental to outsider shareholders (Akzo Nobel). Again the controlling or promoter shareholders can use their dominant position to force through certain resolutions – like preferential allotment of warrants, which enables them to take a free-ride on the stock price over an 18 month period (-PipavDefence and Offshore Engineering Company Limited did this recently when they allotted shares to its promoters and a few friends), issue themselves treasury stock, to tighten control (Escorts),

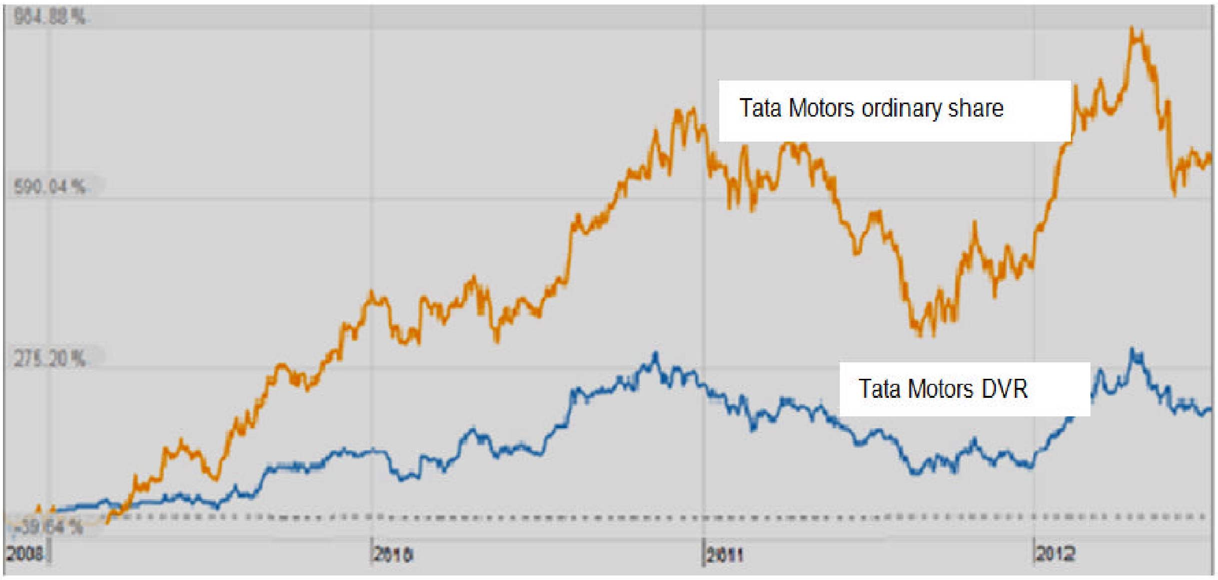
In the past institutional investors in India have been reluctant to vote either for or against resolutions proposed by management. Most funds turn to companies to invest in liquid funds, to help stand-out in the 'assets under management' race. But other reasons are also cited. It is argued that the controlling shareholder has a 'strategic' relationship with the company in question or no direction from 'above', most often the reason is philosophical – my vote does not count (- here I argue that shareholder democracy cannot be at the expense of shareholder value) . In instances where institutional investors do act, they follow Wall Street's advice of voting with their feet i.e. selling a company's shares if they are not happy with the company's management.

While institutional investors stand in front on the voting machine, deciding which button to press, regulators continue to nudge them to do the right thing. SEBI made it easier for investors to vote, when they recently made e-voting mandatory on postal ballots for the top 500 companies. Looking back, this should not come as a surprise. India was the first country in Asia to put forward a comprehensive corporate governance code. CII first set up a task force to prepare a voluntary code (1998-2000). This was followed by the Kumar Mangalam committee, amending the listing guidelines by inserting clause 49, the JJ Irani committee, an update to the voluntary guidelines by the Ministry of Corporate Affairs (2009), and more recently the Godrej committee. Much of what is in these committee recommendations and codes, is expected to find its way in a revised companies bill that is being baked, for tabling to parliament.

There will be times when the benefit of being activist outweighs the cost of an exit. In such instances shareholders need to voice their views and engage with the owner-managers: they have a fiduciary duty to their individual unit holders to do so. Retail investors have placed their savings with institutional investors to earn higher returns. These investors have been given to believe that institutional investors can better protect their interests: institutional investors have a large stake in the business placing them in a better position to monitor company performance. It is also easier for a set of large shareholders, vis-a-vis a dispersed set of individual investors, to get together to protect their investments (- and consequently those of their unit-holders) through exercise of their collective votes.

One final point. Tata Motors limited is one of the few company's listed on the Indian exchanges, that trades both voting and shares with differential voting rights (DVR).

Tata Motors Limited: Trading price of DVR and Ordinary Share



Source: Moneycontrol.com

The relative trading prices tells us that for most of its listing, the DVR share has traded at a discount to the ordinary share (- this discount has been as high as Rs. 500 per share).

Embedded in this is a message to all investors: Your vote has a value, exercise it.

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