



# 2013

## Is there value in Voting ?

Corporate Governance Research  
Proxy Advisory  
Corporate Governance Scores  
Stakeholders' Education



**SES**  
Stakeholders Empowerment Services

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## BACKGROUND

**Mutual Fund voting mandate by SEBI:** Mutual fund industry in India is less than two decades old with the exception of few players and its regulations are still evolving. It is only in 2010 that attention was paid to a most vital right as well as fiduciary duty of mutual funds in respect of participation in investee company management through exercise of its voting right.

SEBI circular published dated 15 March 2010 enumerated guidelines to be followed by all Mutual Funds to increase the role of such Funds in Corporate Governance of Public Listed Companies. The guidelines state, to effect, that the AMCs should disclose their voting policies and the details of votes exercised. In response to the dictate by SEBI, Mutual Funds have adopted a framework to vote and publish their voting patterns annually. Although beginning has been made in the direction as desired in SEBI circular, however a lot more steps are to be taken in forward direction to realise the objective embedded in the SEBI circular and increase shareholders participation in general meetings.

## VOTING – INHIBITION TO PARTICIPATION

Probably the idea that institutional investors can play an important role in governance of a company is yet to sink in fully. SES believes that on one hand improved governance practices can bring increased valuation and improve returns and on the other hand it will reduce avoidable risks from the investments which are result from poor governance of a company. Thus, active participation will not only help investors fulfill fiduciary duty it will also generate better returns for the clients and help grow the capital market.

**Common arguments for not Voting:** An argument prevalent in the industry is that Fund managers do not invest in the companies with poor corporate governance practices and therefore if they find any governance issue(s) in a company they prefer to exit rather than persist with the company and address those issues. While this approach may be good in short term, it is not good for the industry and capital markets in general. Consider this: If every fund follows the abovementioned policy and the pool of investment options is constant, then everybody is either moving in circles or the pool is shrinking. As a result, not only investment options are reduced but also the full potential of investments is not realized. Whatever be the reason, end result is that valuation loss due to poor corporate governance standards hurts all and continues to remain neglected.

We believe that valuation is intertwined with good corporate governance practice. Stakeholders of the company should ensure good governance by participating actively, which would in turn help in long term value generation of the company and thereby enabling the business realize its true potential. Participative approach of all stakeholders in companies where governance is not up to the mark will unlock potentially high intrinsic value of the business by extracting required governance practices from the management.

A further argument prevalent in the industry is that my vote does not count because we are not in majority. This argument is similar to the one prevalent in our democracy. We have to understand that if we do not exercise our vote it will never count.



## GLOBAL REGULATIONS ON VOTING

UK Stewardship Code Principle 1 states that Institutional Investors should publicly disclose their policy on how they will discharge their stewardship responsibilities. Stewardship responsibilities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

Ref: <http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>

UK Stewardship Code Principle 6 states that Institutional investors should have a clear policy on voting and disclosure of voting activity. Institutional investors should seek to vote all shares held. They should not automatically support the board. If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why. Institutional investors should disclose publicly voting records. Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Ref: <http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>

U.S. Securities and Exchange Commission has mandated that registered management investment companies to provide disclosure about how they vote proxies relating to portfolio securities they hold. It requires registered management investment companies to disclose the policies and procedures that they use to determine how to vote proxies relating to portfolio securities. The amendments also require registered management investment companies to file with the Commission and to make available to shareholders the specific proxy votes that they cast in shareholder meetings of issuers of portfolio securities.

Ref: <http://www.sec.gov/rules/final/33-8188.htm>



## IS THERE VALUE IN VOTING?

We try to find out whether the perception that there is no value attached to voting is supported by facts or not.

### Economic Right vs. Political Right:

Ref: 14 Dec '12	Ordinary Share		DVR Share		Additional Dividend (%)	Differential Vote per share
	Price (Rs.)	Vote per share	Price (Rs.)	Vote per share		
<b>Tata Motors</b>	291.90	1	170.45	1/10	5	9/10
<b>Pantaloon Retail</b>	240.70	1	167.70	1/10	5	9/10
<b>Jain irrigation</b>	70.05	1	36.15	1/10	0	9/10

Table 1: Discount in Share Price vs. Differential Voting Rights

	Ordinary Share	DVR Share	Value of an Ordinary Share (in %)	
	Price (Rs.)	Price (Rs.)	X (Economic Right)	Y (Political Right)
<b>Tata Motors</b>	291.90	170.45	51%	49%
<b>Pantaloon retail</b>	240.70	167.70	63%	37%
<b>Jain irrigation</b>	70.05	36.15	46%	54%

Table 2: Economic Right vs. Political Right – Breaking value of share into components

From the table 1 above, we can see that the shares with lower voting rights are quoted at a discount to an ordinary share. Table 2 calculates percentage of share price attributable to voting rights and dividends.

To understand the same let us assume that the share price constitutes dividends as Economic Right (X) and voting rights as Political Right (Y). From Table 1 we can write two equations per share.

So for Tata Motors, Ordinary share equation is  $X + Y = 100\%$  and DVR share equation is  $1.05 X + 0.10 Y = (170.45/291.90)$ . Solving for X and Y, we have  $X = 51\%$  and  $Y = 49\%$ . The percentages indicate that the shareholders' value Economic Rights almost on par with Political Rights.

So, if there is zero value in voting then the markets are not pricing the securities correctly and therefore there is huge upside in the DVRs. But this unrealized upside has been there for long and the shareholders have not exploited it, which means that the markets are valuing their voting rights correctly and paying premium for same.



**SES OPINION: WHY ARE THE SHAREHOLDERS NOT VOTING ACTIVELY?**

Our analysis of shareholders participation in AGM meetings depicts a low attendance consistently across companies. For details please refer to the table in Annexure I.

We believe that the lack of enthusiasm among shareholders is mistaken belief that they cannot bring a change. There is a lack of conviction in the voting power. Some of the common reasons why shareholders do not vote are analyzed below and cross-referenced with their relevance towards institutional investors' behaviour.

**Lack of education and awareness:** At a very basic level, the perception is that shareholders lack education. This gives credence to arguments such as my vote does not count or I will skip one company and pick another company. Majority of shareholders at individual level are not educated enough to judge governance practices at a company and this leads them to rely on market news and can make them susceptible to rumours.

While this could be true for retail investors, this may not be the case for institutional investors. Institutional Investors by definition are sophisticated and market savvy investors who are mandated to manage money on behalf of their clients and have superior knowledge, higher capability and deeper understanding of companies.

**Free Ridership:** Another issue which impacts shareholders' judgment is the Free Rider issue; Shareholders want other shareholders to bear the cost of research and analysis and follow their lead. But, there are sudden traps here as well. It cannot be denied that at times a set of shareholders may work along with promoters or management for their benefit at the cost of other shareholders. If smaller shareholders follow the lead blindly, they may miss out on early warning signs and risk their entire holdings.

To break this cycle Institutional Investors have to done the leaders' role. Additionally, since costs for such research are miniscule as compared to the portfolio sizes, money will not be hindrance.

**Myopia and Irrational Decision Making Behaviour:** Third issue is that shareholders are apathetic to rational decision making. They fail to realize that the cost to empower themselves with requisite knowledge in short term is much lower than the expected benefit in future. The intangible value that can be unlocked by merely improving governance standards and increasing transparency in the company would far outweigh the costs for research and analysis.

Again, institutional investors can be the harbinger of change. The governance standards can improve only in three possible ways: One, the corporate bodies voluntarily adopt good practices. Two, regulators frame regulations based on development and feedback. And three, Institutional investors participate in corporate governance by voting. Instead of reacting after regulations come, investors may act proactively and invest in robust systems to monitor governance standards of a company.

**Information Asymmetry:** A further case can be made regarding information asymmetry. The management may not share complete information with shareholders for various reasons and this leads to passive response from shareholders. But, this should precisely be the reason for the shareholders to participate actively. By voicing their concerns, the shareholders can make sure that they elect a board that is fiercely independent, objective and competitive and that the management implements robust internal control and risk management systems in the company. This will make sure that the instances of management acting against the interests of stakeholders are minimized.



**Institutional Investors – Time Horizon and Performance Pressure:** In addition to certain above mentioned concerns, the institutional investors come with a short-term time horizon. They are primarily concerned with the overall portfolio performances and have varying investment horizons and objectives. They try to achieve their performance targets by active trading, relying on their judgment of the underlying strength of companies and their ability to exploit short term anomalies. Further, the performance of Institutional Investors is judged on the basis of growth in their asset size rather than participation in corporate governance practices.

We believe that there is nothing inherently wrong in this approach as institutional investors are ultimately guided by objectives set by their clients. However, we also believe that without deviating from their approach the institutional investor can better their performance by participating in improving corporate governance standards at invested firms. Lax corporate governance standards lead to reduced valuation of a firm and therefore, irrespective of time horizons, an improvement in governance standards at the firm will benefit the investors.

**Conclusion:** The passive and aloof approach of investors is that of a bygone era. With stringent laws and regulations, the focus will be more on fiduciary duties and enforcement of rights of all stakeholders. Actions will be scrutinized and discussed threadbare and therefore investors will have start voicing their concerns actively, through right channels and on correct forums.

A way forward would be to take a long term view and participate actively in the affairs of a company. Rather than passive investing, a pro-active approach towards participation in Corporate Governance will alleviate a majority of concerns of shareholders. Furthermore, as a check, minority shareholders should also look at the processes and participation records of funds before making investment decisions in such funds. The new investment mantra for all investors should be to look for sustainable business models and to invest in companies which have long term outlook and which have adopted best corporate governance practices.



## ABOUT SES

SES is a not for profit initiative of like-minded people with a **vision to achieve a corporate governance state where all stakeholders are treated in just and fair manner**. We believe that this can be possible only with active participation of all stakeholders.

Our mission is to create an empowered investment community where all stakeholders including creditors, shareholders, lenders, management, employees and society at large are aware of their duties, rights and procedures to carry out or exercise these duties and rights. SES proposes to equip the stakeholders by educating and facilitating the stakeholders and empower them by providing tools that aim to enhance participation in Corporate Governance of listed companies with a view to transform current state of corporate governance to the state envisaged in our vision statement. SES aims to achieve its mission by analyzing Corporate Governance practices prevalent at listed companies, preparing gap statements and providing road map to fill the gaps.

## OUR SERVICES

### PROXY ADVISORY SERVICES

We provide recommendations for resolutions put forth, in meetings, to vote on. Recommendations are provided on a case-by-case method, with in-depth analysis of issues, to enable shareholders to vote in a manner that minimizes governance risks. We provide unbiased and independent recommendations for such proposals in Annual General Meetings (AGM), Extraordinary General Meetings (EGM), Class meetings and Postal Ballots. We conduct our analysis by using publically available information and provide advice/recommendations on the same to our clients. Our services allow investors to understand inherent Corporate Governance risks in their investments and take informed and appropriate action.

### CORPORATE GOVERNANCE SCORES

We use our benchmark proprietary Corporate Governance scoring model to evaluate Indian listed companies' Corporate Governance practices across various parameters such as board structure, board independence, committees, shareholders' ownership, executive compensation, ownership structure, and transparency of disclosures. Based on our analysis, we give scores to the company's Corporate Governance practices and flag practices of companies with poor governance controls. Our Score assist investors and lenders in assessing the long term growth prospects of the company and allow them to incorporate governance risk as a factor in investment decision making process.

### CORPORATE GOVERNANCE RESEARCH

We conduct in-depth analysis of all company disclosures (annual reports, regulatory filings and quarterly reports) analyst reports of reputed research houses and news reports to provide Corporate Governance related recommendations to our clients. Our services allow investors to assess long term performance potential of current/ potential investments and enable lenders to accurately assess the risks involved in their debt investment.

### STAKEHOLDERS' EDUCATION

We provide educational and training services, aimed at increasing awareness about shareholders rights and duties, to individual investors.





## CONTACT US

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**ANNEXURE I**

The below table contains attendance records for Nifty 50 companies. The total representatives are split in two groups Promoter representatives and Public representatives. Readers' should note that the number indicated in the group "Proxy" is the number of proxy representatives present in the meeting and not the number of shareholders they represented.

Company	Total Shareholders	Promoter Representatives			Public Representatives			Total Representatives
		In-person	Proxy	Total Promoter Representatives	In-person	Proxy	Total Public Representative	
Infosys	4,95,169	2	17	19	895	386	1,281	1,300
Maruti Suzuki	1,43,854			1			2,706	2,707
Tata Steel	10,35,004			9			2,829	2,838
L&T	8,95,087			-			1,576	1,576
Hero MotoCorp	70,945			12			1,834	1,846
Wipro	2,27,801	1	6	7	298	235	533	540
ITC	4,13,903			-			2,184	2,184
TCS	6,37,812			11			1,300	1,311
Tata Motors	5,33,728			20			2,149	2,169
RIL	34,33,132			48			1,798	1,846
Jindal Steel & Power	1,41,030	23	22	45	5	299	304	349
HUL								1,771
HDFC Ltd	2,11,793			-			1,613	1,613
ICICI Bank	7,23,629			-			523	523
Sun Pharma								Not Disclosed
GAIL	2,00,750			1			7,182	7,183
ONGC	5,23,652			1			10,993	10,994
NTPC	7,76,992	1	-	1	18,609	950	19,559	19,560
HDFC Bank	4,43,175			2			609	611
Cipla	1,53,483			20			539	559
Bajaj Auto	90,906	31	36	67	151	407	558	625
Dr Reddys								Not Disclosed
M&M	1,96,473			27			916	943
Tata Power	2,09,267			9			1,085	1,094
Coal India								Not Disclosed
Sterlite								247
Hindalco	4,14,285			20			630	650
SBI	8,68,455			1			738	739
BHEL	4,22,304			1			8,664	8,665
Airtel	3,72,839			5			4,066	4,071
ACC								621
Ambuja Cements	1,92,033	2	-	2	55	222	277	279
Asian Paints	61,125			106			433	539



Axis Bank								-
Bank of Baroda	1,83,778			1			375	376
BPCL	84,623			1			240	241
Cairn India	2,45,534			3			465	468
DLF	5,11,068			26			1,395	1,421
Grasim Industries	1,49,757			22			269	291
HCL Technologies	79,165			2			2,419	2,421
IDFC	3,51,525	-	-	-	591	323	914	914
Jaiprakash Associates	6,17,273			38			720	758
Kotak Mahindra Bank	77,974			2			62	64
Power Grid Corporation	9,29,944			2			21,306	21,308
Punjab National Bank	2,06,245			1			331	332
Ranbaxy Laboratories	1,61,115			1			219	220
Reliance Infrastructure	13,20,364			14			653	667
Sesa Goa	2,66,229	3	-	3	51	23	84	87
Siemens								Results Pending
SAIL				1			11,684	11,685

