

**INSTITUTIONAL INVESTORS AS SHAREHOLDERS<sup>1</sup>**

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***Introduction***

The aim of this paper is to study the institutional investors in as shareholders of their investee firm. The first chapter would study the position of IIs in light of the Ambuja Holcim merger depicting how large institutional investors who have a substantial stake in their investee companies too can be sidelined just like the case any ordinary minority shareholder. The paper would then move to discuss the various regulatory framework which governs the various categories of Institutional investors. In the last part the paper would analyse the influence that institutional investors can have by exercising the Hirschmanian notion of 'Voice and Exit' and cite a few recent scenarios where the IIs have voiced their make necessary recommendations which the IIs should adopt in order to ensure that the management adheres to the principles of Corporate Governance.

Institutional investors refer to those organised investors who pool large amounts and invest these sums in various companies. These Institutional investors are the largest investors in the market. The institutional investors in India can be classified broadly into four categories.<sup>2</sup> Developmental financial institutions such as IDBI, ICICI, State financial corporations, IFCI etc. fall in the first category. In the second category insurance companies such as LIC, GIC and their subsidiaries fall. Banks comprise of the third category of Institutional investors.

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<sup>2</sup> Governance, Business Ethics and Sustainability, The Institute of Company Secretaries of India, 2011 Edn., Pg. 220

And Mutual funds including the Unit Trust of India comprise of the fourth category of Institutional investors.

### **Position of Institutional Investors – An Analysis of Holcim case**

The case of Merger between Ambuja-ACC shows the true position of Institutional investors. This case is also significant because it was the first case after SEBI's 'majority of minority' norm<sup>3</sup>. The instant case was a merger between Ambuja & ACC by way of part-shares part-stock.<sup>4</sup> The restructuring was split into two parts. Ambuja was to transfer Rs. 35 billion which amounted to 90% of its Cash as depicted in its balance sheet and in return ambuja would get a 24% shareholding in Holcim India.<sup>5</sup> This will be followed by the merger of Holcim India with Ambuja. In pursuance of this merger Ambuja would issue 584 Million of shares to Holcim India which would represent its ownership of ACC. This would result in cancellation of Holcim India's holding of ACC. This deal was highly favourable for Holcim as because it had not only a cash inflow Rs. 3500 Crores but it also had an increase of its stake in Ambuja from 50% to 61.39%. Although by virtue of this deal the economic interest of Holcim in ACC was somewhat diluted but it still had majority voting control over ACC by virtue of the fact that it had control over ambuja which had over 50% stake in ACC. This proposal petrified the minority shareholders whose interest was diluted by 21.93%<sup>6</sup>. The management of Ambuja argued that this deal would result in

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<sup>3</sup> SEBI Circular, Para 5.16 of Circular No. CIR/CFD/DIL/5/2013 issued by Securities and exchange board of India dated 04.02.2013

States that a special resolution for merger can only be passed in the said scheme receives the assent of 2/3<sup>rd</sup> of Public Shareholders, i.e. 2/3<sup>rd</sup> majority of the minority shareholders

<sup>4</sup> Ambuja Holcim and ACC, Unlocking Synergies, Really?, IIAS, Institutional EYE Governance Research 2013 available at

<<http://iiias.in/downloads/institutional/Institutional%20EYE%20HolcimAmbujaACC.pdf>>

<sup>5</sup> Ibid

<sup>6</sup> Ibid

synergies of Rs. 900 Crores in the next two years which would be divided in between the two companies. This deal became crucial because it was the first such instance where SEBI's 'majority of minority' shareholders norm was put to practical test. As per the Circular issued by SEBI on 4<sup>th</sup> February 2013 for a scheme of merger to be implemented the following two conditions have to be fulfilled. Firstly the scheme should by a special resolution obtain shareholders approval by postal ballot and e-voting. And secondly and most importantly the scheme should have obtained an approval by a 2/3<sup>rd</sup> of the public shareholders by way of a special resolution<sup>7</sup>. Thus for the scheme to get the nod 66.66% of the public shareholders of Ambuja should have vote for this deal. Ambuja had 359 foreign portfolio investors who accounted for 30% of the stake in Ambuja. The domestic institutional investors led by Life Insurance Corporation of India and other state owned insurance companies had around 8.95% stake in Ambuja. Around 72% of the minority shareholders participated in the voting out of which 69% voted for the deal whereas the remaining 31% voted against the deal.<sup>8</sup>

87% of the public financial institutions participated in the voting. It was a tussle between the foreign institutional investors advised by proxy firms like Institutional shareholders services and Glass Lewis to vote for the deal, whereas the Domestic institutional investors led by LIC advised by IIAS and InGovern to vote against this deal. Ultimately 67.95 of the PFIs voted for the deal and 32.05% voted against the deal<sup>9</sup>. Foreign Institutional investors did not show any

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<sup>7</sup> SEBI Circular (n 2)

<sup>8</sup> Palak Shah, Arijit Barman & Shilpy Sinha, Ambuja Holcim deal gets 68% favourable votes from Institutional Investors < [http://articles.economictimes.indiatimes.com/2013-11-22/news/44328041\\_1\\_parent-holcim-ambuja-cements-ambuja-holcim](http://articles.economictimes.indiatimes.com/2013-11-22/news/44328041_1_parent-holcim-ambuja-cements-ambuja-holcim) dated 22 November 2013> Last accessed 12-09-2016

<sup>9</sup>Sajeet Manghat Ambuja Holcim deal pass test, Gets minority Shareholders Nod <[http://www.moneycontrol.com/news/cnbc-tv18-comments/ambuja-holcim-deal-pass-test-get-minority-shareholder-nod\\_994906.html](http://www.moneycontrol.com/news/cnbc-tv18-comments/ambuja-holcim-deal-pass-test-get-minority-shareholder-nod_994906.html)> last accessed 13-09- 2016

resistance to the restructuring whereby their interested was being diluted rather they supported this deal because Most of the FIIs had stakes in both Ambuja and Holcim. This included high profile institutional investors such as Pitcet, J P Morgan, vanguard, UBS, Aberdeen, Black Rock, T RowPrice who had a dominant stake both in Ambuja and Holcim.<sup>10</sup>

The deal was voted for by 90 % of the Shareholders<sup>11</sup> in the Shareholders meeting by way of a special resolution which was well over the 75% requirement by the new SEBI Rules. Consequently the scheme also received the sanction of the High Court<sup>12</sup> for merger under Section 391 & 394 of the Companies Act 1956<sup>13</sup>. The Ambuja-Holcim Merger exposed the loophole of the new ‘majority of minority’ norm of SEBI wherein the DIIs like LIC & GIC despite vehement opposition to their stakes being diluted and Rs. 35 Billion amount to 90% of Ambuja’s cash reserve being transferred could do nothing. The proxy advisory firm IAS contends that by this merger Holcim received shares for free and money for nothing.<sup>14</sup>

### **Regulations governing Institutional Investors**

While institutional investors have the same rights and obligations as regular shareholders when it pertains to voting and like issues, every category of institutional investors have a specific regulatory norm governing their

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<sup>10</sup> Palak (n 7)

<sup>11</sup> P.R. Sanjai, Ambuja gets Shareholders’ approval to buy stake in Holcim <[articles.economicstimes.indiatimes.com/2013-11-22/news/44328041\\_1\\_parent-holcim-ambuja-cements-ambuja-holcim](http://articles.economicstimes.indiatimes.com/2013-11-22/news/44328041_1_parent-holcim-ambuja-cements-ambuja-holcim) dated 22.11.2013> last accessed on 12-09- 2016

<sup>12</sup> Order Dated 14<sup>th</sup> November 2011 in M/S Ambuja Cements India Pvt. Ltd. V. M/S Holcim India Pvt. Ltd Company Petition No 539/2010 filed before the Hon’ble High Court at Delhi

<sup>13</sup> Section 391 & 394 of the Companies Act deal with Power to compromise or make arrangements with creditors and members & Provisions for facilitating amalgamation and reconstruction of companies respectively.

<sup>14</sup> Ambuja (n 3)

functioning. This chapter will in brief discuss the various norms that govern the different categories of institutional investors

### ***Developmental Financial Institutions and Banks***

The DFIs and banks are under the governance of Reserve Bank of India. The primary legislation is the Reserve Bank of India Act of 1934 & Banking Regulation Act, 1949. Prior to 2002 the IDBI and 2004 the UTI were governed by their respective Acts, but those acts were repealed by the Parliament for the facilitation of converting them into banking and mutual fund entity. Ministry of Finance play an implicit role in governance of DFIs & Banks<sup>15</sup>. The RBI issues various directives and guidelines such as acceptance of deposit from public<sup>16</sup> or Fair Practices Code<sup>17</sup>.

### ***Insurance Companies***

Insurance companies are one of the major Institutional Investors in India. The Life Insurance Corporation of India and General insurance Corporation of India, the two major governments owned insurance entities are governed by the Life Insurance Corporation of India Act 1956 and the General Insurance Corporation of India Act, 1972. These institutions are under the supervision of the Insurance Regulatory and Development Authority. Apart from LIC & GIC all other private & public sector insurance companies are governed by Insurance Act, 1938 as well as the various regulation issued by IRDA. Section 6 of the LIC Act

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<sup>15</sup> The Board of Directors of DFIs and Banks have representatives from the Ministry of Finance

<sup>16</sup> Non Banking Financial companies Acceptance of Public Deposits (reserve Bank) Directions, 1998 issued vide Notification No. DFC. 118/DG(SPT)98, Dated 31-01-1998

<sup>17</sup> Master Circular DNBS(PD) CC No. 340/03.10.042/2013-14, dated 01-07-2013 issued by Reserve Bank of India.

empowers LIC to make investments from the funds of Corporation as per its best judgment. The Section also empowers LIC to hold and dispose property<sup>18</sup>.

### Pension Funds

Pension funds including the National Pension scheme are regulated by Pension Fund Regulatory and Development Authority. PFRDA works under the Ministry of Finance. PFRDA issues licenses to Pension Fund Managers supervises their activities, lays down rules on prudential norms, number of market participants, the capital requirement of the managers and the investment criteria. The NPS has been from 1<sup>st</sup> May 2009 extended to all the citizens of India including those who are working in the unorganised sector<sup>19</sup>. PFRDA manages over 58000 Crore of funds and as such it sets up committees to make recommendations to its existing structure from time to time<sup>20</sup>.

### Mutual Funds

Initially the first and only mutual fund in India was the Unit Trust of India which was set up by the Unit Trust of India Act, 1963 and it started its operations from the year 1964<sup>21</sup>. Till 1987 UTI enjoyed monopoly in the mutual funds market. From 1987 the Government of India allowed the PSUs and insurance companies to enter this segment. The Securities and Exchange Board of India in order to

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<sup>18</sup> Section 6 of the Life insurance Corporation of India Act, 1956 deals with the power of LIC in general

<sup>19</sup> PTI, Pension Funds regulator sets up panel to access investment guidelines <<http://profit.ndtv.com/news/your-money/article-pension-fund-regulator-sets-up-panel-to-assess-investment-guidelines-668336>> last accessed 12-09-2016

<sup>20</sup> Falaknaz Syed, Fund managers go slow on NPS Push <<http://www.mydigitalfc.com/insurance/fund-managers-go-slow-nps-push-555> dated 5 October 2014> last visited 11-09-2016

<sup>21</sup> Role of Institutional Investors in the Corporate Governance of their Portfolio Companies. June 2005, The World bank Finance and Private Sector Development Unit, South Asia Region available at <[http://www.nfcgindia.org/final\\_india-june29.pdf](http://www.nfcgindia.org/final_india-june29.pdf)>

pave the way for private sector enterprises in the Mutual Fund Industry passed the Securities and Exchange Board of India (Mutual Fund) Regulations 1993<sup>22</sup>. The Mutual Funds Regulations enforced by SEBI lays down various disclosure norms, the minimum entry requirement, and the net worth standards.

In 1996 by the Securities and Exchange Board of India (Mutual Fund) Regulation 1996 all the Mutual Funds with the sole exception of Unit Trust of India came within the purview of new regulation. UTI continued to be governed by the UTI Act 1963 till 2002, when the Parliament repealed the UTI Act 1963 and brought it under the regulatory regime of SEBI<sup>23</sup>. SEBI has issued a code of Conduct which all the Mutual funds have to abide by.

Besides the SEBI, a non profit organisation Association of Mutual Funds of India was established in the year 1995. AMFI has 44 members. AMFI acts as a liaison between the its members and SEBI in all matters in which its members have an interests. It makes suggestion and recommendation on the best business practices and also lays down a code of conduct which the mutual funds should adhere to.

### **Foreign institution investors**

The first regulations governing foreign institutional Investors were the Securities and Exchange Board of India (Foreign Institutional investors) Regulation 1995. These regulation were made by SEBI on the basis of the guidelines issued by the Government of India in 1992. The 1995 regulation made it compulsory for the FIIs to register themselves with SEBI. Initially the FIIs were granted access to the primary and secondary market subject to 70% minimum contribution in

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<sup>22</sup> SEBI Investor Education Programme (Investments in Mutual Funds)  
<[http://www.sebi.gov.in/faq/mf\\_faq.html](http://www.sebi.gov.in/faq/mf_faq.html)> last accessed 11-09-2016

<sup>23</sup> Role, (n 20)

equity. The access was to mutual funds and securities. Initially the ownership in any firm was limited to 5% for individual FIIs and 24% when there was a group of FIIs. In 2000 the individual ownership were extended to 10% and in September 2001 sectoral caps replaced the ceilings. These sector specific caps were subject to shareholders resolution. The FIIs were permitted to make investments in governments bonds, corporate bonds and derivative securities. With effect from 7<sup>th</sup> January, 2014 SEBI (Foreign Institutional investors) Regulations 1995 has been repealed by the SEBI (Foreign portfolio Investors) Regulation 2014. The new regulation has eased the registration requirements in a bid to boost investments by FIIs. Regulation 21 lists out the areas and the quantum of investments that IIs can make. Purchase of equity shares has been restricted to below 10 % either by a single FII or by a group of FIIs.<sup>24</sup>

### ***Provisions of Companies Act & Listing Agreement***

IIs are also bound by the provisions of the companies Act as well as the listing agreement of SEBI. They are under an obligation to appoint independent directors in their board under the new Act<sup>25</sup> as well as under the listing agreement. Companies Act also empowers these institutions to appoint nominee directors in the board of their investee company<sup>26</sup>.

### **Influence of Institutional Investors : Exit option and Voice**

Despite being a major investor, the IIs have had little influence in their invested companies. This chapter primarily shows the influence of institutional investors

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<sup>24</sup> Regulation 21 (7) of SEBI (foreign portfolio Investors) Regulation 2014

<sup>25</sup> Section 149(4) of the companies act 2013 prescribes that at least one third of the directors of a company must be independent directors.

<sup>26</sup> Section 161 (3) of the Companies Act 2013 deals with the appointment of nominee directors

in the light of Exit and voice theory propounded by Albert O Hirschman<sup>27</sup>. Extending Hirschman's theory to IIs, when the IIs are dissatisfied with the decisions of the company they can influence the decision of the company either by Voice option i.e. expressing their dissatisfaction to the management or through negative votes, or by Exit option i.e. selling their shares<sup>28</sup>. A recent study<sup>29</sup> has suggested that 49% of the institution investors had exercised the exit option when at dissatisfaction with the management while 42% believed that the threat of Exit option made the management change its decision.

Role of IIs in ensuring good governance have been emphasised by all the reports starting from the Cadbury Committee Report of 1992 which put a special responsibility on the IIs to make sure that the companies adopt the recommendations of Cadbury committee.<sup>30</sup>

The Greenbury Report had stressed on the need of institutional investors to exert their influence on the best practices laid down in the Code are properly implemented by the management.<sup>31</sup>

The Hampel Report of 1998 also lays down that it is mainly the IIs who depict the role of shareholders in corporate governance.<sup>32</sup> In the Indian Scenario the

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<sup>27</sup> A.O. Hirschman, *Exit, Voice and Loyalty* Harvard university Press, (1970 Edn.) Cambridge, MA

<sup>28</sup> Richard Baums, Richard M. Baxbaum, *Institutional Investors and corporate governance* Pg. 305

<sup>29</sup> *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, Joseph A. Mccahery, Zacharias Sautner, And Laura T. Starks

<sup>30</sup> Christine A. Mallin, *Corporate Governance*, Oxford university Press Pg. 107

<sup>31</sup> Christine (n 29)

<sup>32</sup> ICSI, *Governance, Business Ethics and Sustainability*, The Institute of Company secretaries of India, 2011 Edn., Pg. 221

Kumar Manglam Birla Committee Report<sup>33</sup> made important observations and recommendations with regards to Institutional Investors for instance the report emphasised that institutional investors being having large stake in companies, own these shares primarily on behalf of their retail shareholders and as such they should play an active role in ensuring that they make their votes count as because it is the IIs to whom the retail investors look upon for a judicious exercise of their voting rights. The institutional investors should also establish a systematic contact with the senior level management and monitor the performance of their investee company. The institutional investors should also show keen interest in composition of the Board of directors of their invested companies.<sup>34</sup> Apart from exercising their voting rights the IIs can also use other tools to monitor the activities of their investee company Such as one to one meeting, focus lists nad corporate governance rating system.

However some institutional investors such as pension funds show little interest in influencing the decision of the management of their portfolio companies this is primarily because their shareholders do not expect much return on investments.<sup>35</sup> However this is in sharp contradiction to the attitude of Financial institutions and insurance companies who generally appoint in the board of their investee company, nominee directors so as to ensure that their interest is preserved. Bank and financial institutions have on an average made sure that 10% of the Board of Directors are their nominee directors.<sup>36</sup> While Companies used

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<sup>33</sup> SEBI, Report of Committee appointed by SEBI on corporate Governance under the chairmanship of Sri Kumar Manglam Birla available at <  
<http://web.sebi.gov.in/commreport/corpgov.html>>

<sup>34</sup> ICSI (n 31)

<sup>35</sup> Institutional Investors and ownership engagement, Serdar Celik and Mats Isaksson OECD Journal : financing Market Trends – Volume 2013/2

<sup>36</sup> Nachane, D M and Ghosh, Saibal and Ray, Partha (2005): *Bank nominee directors and corporate performance: micro evidence for India*. Published in: Economic and Political Weekly , Vol. 40,

to classify such nominee directors as independent directors under Clause 49 of the listing agreement<sup>37</sup>, however although the new Companies Act provides for the appointment of Nominee directors<sup>38</sup>, they are not considered to be independent directors<sup>39</sup>.

### *Instances where IIs have exercised their voice through Voting*

A study<sup>40</sup> revealed that in 2013 Mutual Funds of India participated in 61% of Shareholders Resolution in Sharp from 54% in 2011. Some of the instances where the IIs have exercised their voice in form of voting are the S-atyam Computers deal to acquire Maytas Properties and Maytas infra wherein the IIs forced the deal to be called off. In January 2014 When Suzuki motor Corp tried to change its plan from setting up a factory to investing in the Gujarat plant and from their selling cars to Maruti Suzuki, the IIs, primarily the Domestic Mutual Funds opposed the plan and ultimately Maruti Suzuki had to cancel the proposal<sup>41</sup>. Cadbury India Ltd.'s case is another such instance where the court facilitated a smooth exit of the minority shareholders by increasing the buyback price of stock from Rs. 1,340 per share to Rs. 2,014.50<sup>42</sup>. However when Alastom Transport

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<sup>37</sup> Nominee Directors Still appointed as independent directors, [www.business-standard.com/article/markets/nominees-still-appointed-as-independent-directors-111092900048\\_1.html](http://www.business-standard.com/article/markets/nominees-still-appointed-as-independent-directors-111092900048_1.html)

<sup>38</sup> Section 161 (3) of Companies Act 2013

<sup>39</sup> Changes and new requirements impacting directors, <http://www.ficci.com/events/21798/ISP/Changes-and-new-requirements-impacting-Directors.pdf>

<sup>40</sup> IIAS, Institutional Eye, The new Shareholder active and engaged <[http://iias.in/downloads/institutional/The\\_New\\_Shareholder\\_Active\\_Engaged\\_and\\_Online\\_29Oct2014.pdf](http://iias.in/downloads/institutional/The_New_Shareholder_Active_Engaged_and_Online_29Oct2014.pdf)>

<sup>41</sup> Khushboo Narayan The advent of Shareholder activism in India <<http://www.livemint.com/Companies/hri4Acn53de1Q48RFACNwJ/The-advent-of-shareholder-activism-in-India.html> Dated 27 Nov 2014> last accessed 12-09-2016

<sup>42</sup> ET Bureau, Court directs Cadbury India to pay 50% more than original offer for share buyback <[http://articles.economictimes.indiatimes.com/2014-07-19/news/51744828\\_1\\_cadbury-india-minority-shareholders-share-buyback](http://articles.economictimes.indiatimes.com/2014-07-19/news/51744828_1_cadbury-india-minority-shareholders-share-buyback)> last visited 12-09-2016

India bought the transport division of Alastom India at a price much lower than the sales figure of the past year, 94% of the IIs voted against the deal, yet the deal went through because the promoters held over 68.5% of the shares<sup>43</sup>. Another example where the institutional investors made an effort in vain was when Holcim tried to increase royalty from its subsidiary Ambuja cement. Although an overwhelming majority of minority shareholders (88.6%) voted against the proposal, yet the promoters managed to see the resolution through because they had over 50% shareholding<sup>44</sup>.

***Regulatory factors that have contribute to increased participation by IIs***

SEBI has from 2011 made it compulsory for the Mutual funds to disclose their voting pattern. Also from 2014 SEBI has directed the Mutual Funds to publish the rationale behind their voting decision. From 1<sup>st</sup> October onwards SEBI has made it compulsory for all listed companies to enable E-voting. This has further facilitated the involvement of IIs in Voting on every resolution of the company. SEBI guidelines along with provisions of Companies Act 2013 in many cases prohibit the promoters from voting on those issues in which they are having an interest. These transactions include RTPs, mergers within promoters controlled enterprises etc. These provisions have lent a strong voice to the IIs in ensuring proper governance of their invested companies.

**Conclusion**

IIs form the backbone of the corporate governance and as such they have been the focus of all the corporate governance committees. IIs not only act as shareholders of their investee companies but also act as the trustee of their own shareholders. IIs with their large shareholdings can steer their investee firms

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<sup>43</sup> Khushboo (n 40)

<sup>44</sup> Khushboo (n 40)

away from malpractices and mismanagement. IIs have in recent past vehemently raised their voice as evidenced from the Ambuja Holcim merger wherein 87% of the IIs participated in the voting as opposed to retail investors whose participation was a mere 10.36%. However even as of now a large sector of IIs remain nonchalant to the affairs of their investee companies. IIs should not only vote on the resolutions affecting their rights and interests but should also disclose their voting pattern at periodical intervals and their reason behind it to their own Shareholders. Also as evidenced from the Ambuja-Holcim merger the interest of DII and FII may not be in sync with each other and as such SEBI should make regulations to protect the interest of DII in such a situation by limiting the Shareholding of FII in case where the minority votes of DIIs and other domestic investors would lose its effect. Thus Institutional Investors have to take up the role of being the most active Shareholder of their Investee Company.

