IS DOMINANT SHAREHOLDER IN MANAGEMENT AIDED BY RUBBER STAMP BOARD?

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ABSTRACT:

It can be argued that Indian corporate sector makes the corporate governance problem different in compare to US and UK. The main difference between US, UK and Indian corporate governance is that in India the main governing question is distribution of power between Dominant and minority shareholder while in US, UK the main governance problem is essential that of discipline the management who have cased to be effectively accountable to the owner. The Indian corporate sector is divided in three segments: Public Sector Units, Private sectors units and MNCs, where the dominant shareholders are Concern ministry, Families and foreigners. A board which is accountable to the owners would only be one which is accountable to the dominant shareholders not toward to the real owner of the company which are Shareholders. Practicality, Corporate sectors always shows us that the board which works as representative of shareholders is work accordingly to the dominant shareholders. By this paper I have discussed that the softness of BOARD really encourage the Dominant shareholders for decision making.

“The directors of the companies, being manager rather than people’s money than their own, it cannot well be expected that they should watch over with the same anxious vigilance with which the partners in a private business frequently watch their own”.

 Adam smith, wealth of Nations(1776)
INTRODUCTION

India’s SEBI committee on Corporate Governance defines corporate governance as the “acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company”. It has been suggested that the Indian approach is drawn from Gandhian principle of trusteeship and the Directive principle of Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

A board of directors is a body of elected or appointed members who jointly oversee the activities of a company or organization. A group of individual that are elected as, or elected to act as, representative of the stockholders to established corporate management related policies and to make decisions on major company issues such as hiring/firing of executives, dividend policies, option policies and executive compensation.

TYPES OF BOARD

- Rubber Stamp Board

In such kind of Boards, the board members are not even concern about their duties and relation with the other members. Even they are not interested in attending the Board meetings. The decisions are taken by the owner of the company or by the CEO of the company while members just follow the decisions that are made by them.

- Country – Club Board

However the board members are much more interested in their interpersonal relation with the other members while the major task of business decisions are demoted at the low priority. Personal agreement is the primary concerned compare to the actual task given to them. In short business activities goes away.

- Representative Board

Here the emphasis is on business related task but members are only focuses on those tasks which are concerned with those who’s representative are they. In short we can say that they are much for focuses on their part same as political party does in Parliament.

- Professional Boards

Here the members are shows in interpersonal relation as well as focuses on the task which are related with the company. Generally the chairman of the board shows in depth interest in discussion or we can say that in decision making process. Even they show the respect of each and every ones view.
Types of Directors:

- Promoter nominee Directors
- Institutional Nominee
- Independent Director
- Lead Independent Director

Roles and Duties of Board

- Governing the organisation by establishing board policies and objectives
- Selecting, appointing, supporting and reviewing performance of Chief Executive
- Ensuring the availability of adequate financial resources
- Approving annual budgets
- Accounting to the shareholders for the company’s performance
- Setting the salaries and compensation of company management
- Approving distributions of profit proposed by the management board
- Managing the business with care, diligence, and prudence
- Meeting the appropriate interests of its shareholders and relevant stakeholders.

Case of Reliance Demerger Issue

On 23rd Nov. 2004, Mukesh Ambani, Chairman and Managing Director of reliance Industries, in an E-Mail sent to employees stated that “there is no ambiguity in his (Dhirubhai’s) legacy that the Chairman and the Managing director is the final authority on all matters concerning Reliance. Our founder chairman, Shri Dhirubhai had taken all necessary steps to separate ownership from management and had settled all of them within lifetime. When Dhirubhai alive he has equal distribute status, salaries and perks to both the brothers. There is no confusion regarding the allocation of responsibilities and power. But after the death of Dhirubhai whole scenario changed and Mukesh was named as Chairman. As per the rules prevailing in RIL, he has all the powers to control other subsidiaries of group. Hence Mukesh become the sole decision maker in the RIL. In short he has just simply been reduced to the position of just a
professional manager in the group like any other professional manager who could even be fired by the chairman with the support of the board.

Clearly RIL’s board must either be too passive or just plain ignorant about what goes around them. An Independent board would not tolerate this kind of fighting at the top. Power is not concentrated in the hands of the CEO, but is distributed among members of the Board. A cursory glance at Reliance’s board of directors indicates a heavy dependence on family members and those loyal to the family. The main question from this case is that what role board should play in such cases and who will handle such kind of problems or is the board which represent the interest of the entire shareholders responsible for setting such issues.

SHAREHOLDERS RIGHTS, EXPECTATIONS AND INTEREST

Shareholders as owners of the company have rights over the corporation and assets. Being an individual shareholder level hardly raise voice for direction and decisions. Wallace and Zinkin (2005) quote a study undertaken among 1500 companies 1990-1999: “companies can choose to be like democracies- granting great powers to the voters; or they can choose to be like dictatorship- protecting the management from being accountable to the voters. Refer Fig 2.

![Dictatorship –Democracy Relation](image)

According to them, the study revels that ‘Democracies’ appear to have outperformed the ‘Dictatorship’. So we can conclude from such kind of survey that now in current scenario the rights of shareholder are surrendered against definite expectations. Also we can say that the growth in power of directors increased while the rights are just seen on the page only. The benefits to lenders and preference shareholders are fixed, equity shareholders have potential for unlimited benefits while few appreciate the fact the actual control of the upside benefits is totally in the hands of the board of directors, who act as fiduciaries on behalf of Equity holder.(Wallace & Zinkin, 2005)

According to International Corporate Governance Network (ICGN),

- Shareholders are entitled to be consulted before any major change is made to the corporation’s strategic decisions.
• The right to vote.
• Voting results should be disclosed in regular intervals and it should be transparent.
• Divergence from ‘One share, one vote’
• Duty to vote is a fiduciary obligation for institutional shareholder subject to the cost of exercising a vote.

With sufficient shareholders can throw the board, change the remuneration system, differentiate the policies and strategies also can change the decisions but they rarely does such kind of practice. But they can show their power or feelings about the board are to buy or sell the shares of a company. Mutual funds and institutional investors are focuses on the high return on short as well as long term, pension funds demand on long term growth, Individual focuses only on short term return; venture capitalist focuses on long term growth while the corporate persons interested in expansion of the business and ready to make investment as possible as. This whole feeling of an individual confused the Board, how to fulfill the expectations and whom to give priority. Once the board decide such kind of objectives that, company should focuses on long term than accordingly the investors invest and that does not lead towards dissatisfaction of the individual investors.

CONFLICT BETWEEN LARGE AND MONIRITY SHAREHOLDERS

Conflict arises on the use or diversification of profits and decision making power. The major issue is that the up to what amount of profit should be diversified fro the investors and owner. In corporate the major investors, we can say the families, ministry, are in the management board. In India mostly the owner exploits the minority shareholders by rewarding themselves with the higher salaries and other benefits like the commission. These all divert towards to the less distribution of dividend to the minority shareholders. Also “one share, one vote” direct al the decision toward in the favor of the owner. The only avenue open for the minority shareholder is to resort to laws and regulations.

GLIMPSE OF THE THEORIES ON CORPORATE GOVERNANCE

Agency Theory

As we all know that the shareholders are the key owner of the companies and they are having the power of controlling and decision making but actually it does not work as per the rules made while the manager who is not having share of the company but he has all the recourse in his hands. And that’s the reason why we take that the manger will work as manger or as an agent for the shareholder while the principal is owner or majority shareholder. According to theory the principal delegates the work and authority to agent. But agent may not always work in the best for the principal. The agent is also human being with his own ambitions might try to further selfish motives rather than safeguard the interest of the principal.
**Transaction cost Economies Theory**

Transaction Cost theory has close relation with the agency theory. As per the agency theory the agent may be not work as per the principal but being human being he does the being selfish while transaction cost theory says that concept in little different way. Transaction cost theory says that, individual are self interested and opportunist in nature and they will cheat the system if they can. Thus the theory implies that managers should put in place control system and legal mechanism to guard against such opportunistic behavior.

**Stakeholder Theory**

Corporations should attempt to maximize not value of their shares but distributed among all corporate stakeholders including employees, customers, suppliers, local communities and tax collectors. The theory has a perspective of long-term rather than short term in the ‘Value Maximization proportion’. According to theory, we have to pay attention to constituencies of value maximization but simultaneously multiple constituencies competing and with conflicting interest the decision making process for the board and managers become difficult. This theory becomes popular because of their personal short-run interests.

*From above three theories we can conclude that for the value creation in terms of shares price or in being good brand for investors, a corporation should transparent all their decision that they have made. Even Board has to concern with the investors as well as the internal agents who are the real assets of the organisation. Rather than being individual decision maker board has to listen what agent are trying to tell them for improvements. And try to convince the investors that what is ultimate strategy, Is it for short term growth or long term growth. Once the investors having faith and trust in your strategy that directly uplift the value of the each share in stock market.*

### COMPARISON OF CORPORATE GOVERNANCE MODELS

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Anglo-American</th>
<th>Continental European Model</th>
<th>Japanese Model</th>
<th>Indian Model</th>
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</thead>
<tbody>
<tr>
<td><strong>Objective</strong></td>
<td>System of seeking profits For Individualistic Shareholders</td>
<td>System of seeking profits For Pluralistic constituencies</td>
<td>System of seeking profits For Pluralistic</td>
<td>System of seeking profits for majority or promoters</td>
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<tr>
<td><strong>Extent of Regulation</strong></td>
<td>Single Tiered Board Institutional holdings</td>
<td>Cohesive group of insiders with long term stable relationship With the company</td>
<td>To support main Bank Dual Structure of Board</td>
<td>Single tiered Rule of nominee directors of FIs in the Board Founding families and their Allies usually exercise control</td>
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<tr>
<td><strong>Shareholder Influence</strong></td>
<td>Buying and selling company shares Facilitating buying and Selling of a company Shares</td>
<td>Marginal</td>
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<td>Marginal as only a minority stake is floated on the local</td>
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<td>Control</td>
<td>Exchanges.</td>
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<tr>
<td>Select Board members</td>
<td>Minority ownership</td>
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<tr>
<td>Shareholder agreement, discriminatory voting rights</td>
<td>Majority ownership</td>
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<td>By buying and selling Company shares &amp; Thereby exposing the Company to takeovers</td>
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<tr>
<td>By owning an outright majority of voting shares or by owning a significant minority holding</td>
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<tr>
<td>By owning an outright majority of voting shares by institutional investors customers, suppliers</td>
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<th>Conformance</th>
<th>Role</th>
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<tr>
<td>Providing feedback to shareholders</td>
<td>Questioning, judging &amp; supervising management</td>
<td>Establishing rules and norms to guide a firm in achieving its strategic goals.</td>
<td>Consensus management to guide a firm in achieving its strategic goals.</td>
<td>Formulating policies of each subsidiaries by the central Holding company based on Cash needs of other Companies in the group.</td>
</tr>
<tr>
<td>Select Board members</td>
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**BOARD – OWNER REALATIONSHIP**

**Compensation:** Family raises equality; business needs to reward the performance.

**Ownership:** Families passes the ownership to their next generation, irrespective to their performance. Actually who works or performed better those needs more power but actually it does not happen.

**Succession Planning:** Generally families select the eldest one the controller but business needs competent for success. Generally they stop within the family itself.

**Retirement:** Continue till their end of the life, actually business needs more conversant personalities for manage the business operations.

**Control:** Families use the control factor to fulfill their interest rather than fulfilling their business achievements.

**Communication:** Actually this is the positive aspect for the business, mostly all conversion happen during the dinner table, breakfast table. All that time the conversion is knowledge worthy, because their discussion leads the business toward the succession.

**Relationship:** Many of time the conflicts arises as the result of their relation. It is too difficult in business to be unbiased and neutral.

**Speed of Actions:** Most of the families are failed in taking quick and effective decisions. Also families take the more time for think and acceptance ration is also very slow.

**Values:** Most of the business houses adopt the values form their founder.
Most Important question for the families is that what comes first for them: Family or Business

Generally everyone knows that the business comes the first, but not for each and every member of the family. Only some of the family members are taking part in the business while other are busy in just getting the remuneration and other benefits form the business so for them it’s just source of second income means they are not much more interested in decision making strategy formulation etc.

![Fig 3](image)

**Actualization needs:** Stewardship and Social responsibility

**Prestige needs:** Family pride and Being a role Model

**Achievements need:** Market leadership and Strategic Investment

**Social needs:** Social recognition and satisfaction of Employees

**Basic needs:** Family and personal survival marriage and education of children Future Security (Health and retirement)

Source: Corporate Governance, Satheesh Kumar.

**Ownership Motivation**

**SIZE OF THE BOARD MATTERS**

There is no particular rules prevailing in the any law but widely accepted board member numbers are 14 to 15. Mostly in current scenario, in India, the board size should be 14 in 1970 but after that suddenly scenario changed and most of the company believes that the size of the board should be 10 to 12 members only. There are companies like RIL, where 14 members are in board room. But as per the thoughts prevailing in the management that small team of board members can easily solved the problems, less chances for conflicts between members, good relation between them and last but not least they can speak for shareholders. Also one more important thing is that Board should comprise the Independent as well as dependent directors, some specialist and owner. As such as if the firm size increase the effect of that expansion leads towards to the hectic role for the board. **But the main question is that if the company size or if the company value expand at the same rate board also has to expand?**

We know that as the size of the firm increases, the governance issues are also increases at the same rate as the firm size increase. It’s so simple that, handling of the 2 people is easier but
as the number of the people increase to the 10 and so on the management of the human resources is being hard and harder. Same as once the size of the firm increase the governance issues are also increases and that leads toward to the mismanagement. Once the shareholders are not satisfied with board failure in respect for the solving shareholders issues, they show their feeling or emotion by selling/buying shares. So it is worthless for the company to only focus on the size but as size increase we have to also assure that the performance of the board must have to increase. As the as size of the company increase the number of the investors are also increase and mismanagement of the board divert the investors to withdraw their investment. (Refer Fig 4)

Now consider the other dimension that is firm performance. As company performed well each investors having trust in Company and they invest more and more in the company. And they invest more and more in the company. We can understand this by simple logic that, as Indian Cricket team performed well; we all appreciate the team Coach and Captain of the team. Same as if the company performed well it’s definite that one of the main reasons for success of the company is good Governance of the Board. (Refer Fig 5)

From above we can conclude that whenever the firm size increase the performance of the board should not be good. Reason is simple large quantity of the investor expect different return on their investment and that is not possible for Board to fulfill the expectation of each individual but if the performance of the company increase that leads the faith of investors in the company and its create the loyalty of the investors for the company and investors can not worried about the future of the company. In short we can say that the main aspect for board members is to increase the value of the company not to much more focus on the expansion of business. Because expansion cannot give surety to investors that expansion are always profitable. So the suggestion for the board is that try to generate the faith from the investors by performing well in the market. As we conclude that company should focus on the performance rather than expansion, but unfortunately that doesn’t work. Indian business owner always focuses on the expansion first and then try to focuses on the performance but when they really focuses on the performance that’s may be little late and they lost little faith of the investors. But still Indian business tycoons are able to attract the investors from India as well as from abroad. The reason is only expectation of each investor on their investment return and that is not much higher in current condition because
still today shareholder doesn’t know much more about companies performance but he knows that currently India facing the problem of Recession. So he always satisfied with even less return also. So the role of the Board is negligible because investors are not willing for their rights so being human board member focuses on their personal satisfaction by working as per owner.

CONCLUSION

The mentality of the Indian business tycoons is focused on the expansion of the business; they are not focus on performance of the business. But the main problem is that they put performance on next to expansion. They can do such kind of practice because they are having support from the Board member. And board member can practice such kind of things because investors having different expectations. Today the main problem is that government, business world, financial markets and the media always speak on the recession, they have created such a terrible fear in the market that India is Under recession so whatever you get its sufficient for you, not even sufficient but its more than that you actually get. This kind of fear is also be one of the reason that investor are not fight for their rights on selecting bard because they are always busy in recession, meltdown and slowdown and blab la. Another reason is unawareness of the individual investors. Marvadi invest in share market but he is not having enough knowledge about his rights he is only focuses on his investment and return, he is not concern about company’s performance or expansion. At the end of the paper I can suggest that company must have to include the independent directors in the board who is not part of company who is outsider. So he can speak without any expectation or fear.

In last I conclude that today board is only works for the management not for the shareholders. The reason is so simple that owner is always choose expansion first and as business expand the remuneration of the board increased so they are also interested in expansion rather than performance. By this way they become puppet of the owner knowingly or unknowingly.

Bibliography


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