

Activists Seek Clarity to Protect Investors' Interest

New Companies Act doesn't define ordinary course of business, making it difficult to differentiate it from related party transactions, jeopardising shareholders' interests

About seven years ago, the B Ramalinga Raju-run Satyam Computer Services said the company was going to acquire stakes in Maytas Infrastructure and Maytas Properties for a total of about \$1.6 billion. Investors reacted with anger at what they regarded as enrichment of the promoters at their expense and the deal had to be called off. Three weeks later Raju would confess publicly to cooking the books at Satyam for years, but that's another story.

The Satyam-Maytas transaction was a 'related party transaction' (RPT), which covers deals involving companies or people that have business and familial ties. With these having become easier under the new Companies Act, there needs to be more clarity on such activity, investor rights activists have said, particularly in view of the potential conflict of interest.

Under the Act, board and shareholder approval is needed for such transactions unless these happen to occur in the 'ordinary course of business.' "Most companies have just hammered out an RPT policy - they have not explicitly defined ordinary course of business," said Hetal Dalal, chief operating officer of proxy advisor Institutional Investor Advisory Services (IIAS). "This is not violation of any rules, but it certainly does not conform to best practices."

Such information is usually tucked away somewhere on a company website, just enough to ensure compliance with the law but not always containing information that is helpful to shareholders, critics said. Only nine of 30 Sensex companies have explicitly defined these 'ordinary' activities, according to an IIAS report. Lack of proper definition leaves a lot to the discretion of audit committees and the board. This may weaken the concept of full disclosure to stakeholders, the IIAS note suggested.

"Given the potential conflict that may arise out of RPTs, companies must have a set of guiding principles which will help their boards segregate ordinary activities from rare ones," Dalal said.

Among those that have defined 'ordinary course of business' are Dr Reddy's, GAIL, HDFC, Maruti Suzuki, Tata Motors, Tata Power, Hindalco, NTPC and Vedanta, the report said.

The 'ordinary course of business' phrase has not been defined under the Companies Act, adding to the ambiguity. Companies are free to draw up their own list of business transactions that are 'ordinary' in nature. For all other 'rare and non-recurring' business transactions, companies require the consent of 75% minority shareholders. This can be reduced to 50% once the president clears an amendment passed by Parliament.

The transaction could be a business deal, a single financial contract or a series of them or any other arrangement. The parties involved could be a parent company and its subsidiaries or affiliates, employees, principal owners, directors or the management of the company and the subsidiaries, or members of their immediate families. The modified Companies Act requires disclosure at the time of entering into contracts or arrangements with such parties.

Almost all Indian companies maintain close business relations with their subsidiaries or other units in the same group. A utility sells coal to a steel producer, banks rent space to affiliated entities or a tech company even thinks it's a good idea to buy the real estate units controlled by the promoter. The SatyamMaytas episode shows how related-party transactions could harm shareholder value if not kept in check.

But according to some experts, wrongdoing in such related-party deals is not at all common. "One of the key aspects in RTP, particularly within listed companies of a group, is that many of these transactions are negotiated at arm's length, given the imperatives of managerial performance evaluation, board oversight, analysts coverage, media attention, and tax transfer pricing regulations," said Ketan Dalal, managing partner (west), PwC India. "Against this backdrop, one tends to think such regulations often become a case of overlegislation."

A study of BSE 200 companies by Indian Institute Management-Bangalore professor Padmini Srinivasan showed there were more than 7,300 related party transactions in 2011. These mostly involved 95 holding companies, 674 key management personnel, 3,662 subsidiaries and 2,844 associates and relatives of key personnel.

Such numbers do appear to warrant the need for proper regulations to control related party transactions but not everyone thinks so. It's not practical for companies to give details of their 'ordinary course of business' activities, said JN Gupta, managing director, Stakeholders Empowerment Services.

"Transactions can't be defined in black or white. The decision as to whether a transaction is related party or not should be left to the wisdom of the board."

Maruti Suzuki, HDFC and Vedanta have issued functional 'ordinary' activity lists. These help audit committees and management weed out bias and conflicts of interest while forging trading alliances. "It gives clarity to the audit committee and the management on what constitutes ordinary course of business and this minimises the chances of non-compliance while safeguarding shareholder interests," said a Maruti Suzuki spokesperson. "The policy was defined based on judicial precedence and if in the future, should there be significant judicial rulings which require us to change the policy, we are free to consider," the Maruti official says.

Maruti Suzuki recently decided to push ahead with its contentious plan to set up a manufacturing plant in Gujarat owned by its parent as amendments to the Companies Act have made it easier to get shareholder approval. This includes replacing 'special resolution' with 'ordinary resolution' for the approval of related-party transactions by minority shareholders.

A Tata Motors spokesperson said a definition helps the audit committee, auditors and the management to arrive at a consensus on whether the transaction should be classed as being in the 'ordinary course of business' and process the transaction accordingly. This also reduces the scope for litigation and disagreements in this regard, said the spokesperson.

Hero MotoCorp, the country's largest two-wheeler manufacturer, feels it's done a good job of keeping the 'ordinary course of business' clause open-ended.

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