Financial institutions battle royalty squeeze of HUL, others

Financial institutions (FIs), led by the Life Insurance Corporation of India (LIC), are peeved at the way multinationals are raising royalties and technical know-how from their local subsidiaries. This, the FIs say, goes against the spirit of corporate governance norms. With investors giving a big thumbs-down to Hindustan Unilever's (HUL's) stock after the company increased its royalty payment to its promoter, the FIs say they will take up the issue with the HUL management.

"We (the FIs) are going to raise our voice, as we think it's a corporate governance issue and goes against the interest of minority shareholders. There should be an independent study on why Unilever has increased royalty from its Indian arm," says a top official of an Indian FI.

FIs do not have any representation on the board of HUL, as they hold only about seven per cent stake in the company. Foreign institutional investors (FIIs) own 22 per cent, while the retail shareholders own 13.6 per cent. Unilever owns 53 per cent stake.

PAYOUTS OF CONTENTION

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Company Name	Royalty as % of sales (2012)
Maruti Suzuki	5.20
Colgate Palmolive (India)	5.14
ABB	5.03
Procter & Gamble	4.70
Voith Paper Fabrics India	4.35
Nestle India	4.21
Timken India	2.50
Alstom T&D India	1.74
Bosch India	1.58
Hindustan Unilever	1.40
Whirlpool India	1.34
Asahi India Glass	1.21
BASF India	0.87
3M India	0.85
ACC	0.50
Ambuja Cements	0.50

The HUL stock fell 4.4 per cent on the Bombay Stock Exchange on Wednesday after a series of downgrades by marquee broking houses. The National Stock Exchange's (NSE's) CNX multinational index was down two per cent, compared to a flat stock market. Since yesterday's high before the announcement of the royalty, the market capitalisation of the company fell by Rs 10,000 crore by on Wednesday's closing.

The downgrade of the HUL stock followed a surprise move by Unilever on Tuesday to raise royalty from HUL to 3.15 per cent of net sales by 2018. The official says that it is not only the institutions that are short-changed, but employees holding ESOPs (employee stock ownership plans) are also at the receiving end as their stock value has gone down substantially in just two trading sessions.

Yesterday, HUL's Chief Financial Officer R Sridhar justified the royalty payments to Unilever, saying it was lower than that paid by other global players. “This increase is a fair price if we have to compete even more effectively and continue to deliver superior growth and profitability, in an environment that is going to become even more competitive, particularly from global majors,” he says.

The FIs say HUL is not alone in raising royalties from Indian arms. In the recent past, a series of MNCs have increased their royalty payments from their local arms. This includes Maruti Suzuki, ACC, Ambuja Cements and McDonald's Corporation, which will be charging local franchise Westlife Development five per cent of net sales as royalties. Hero MotoCorp, now owned by the Munjals, are expected to pay royalty to former partner Honda till the next financial year.

Business Standard had earlier reported that the independent directors of ACC and Ambuja Cements had resisted the move by their Swiss parent Holcim to increase the technical know-how fees to two per cent of net sales. The technical fees was later bought down to one per cent of net sales after an independent study sought by the independent directors.

Both ACC and Ambuja are also seeking the approval from all shareholders through a postal ballot on Holcim's proposal to increase the technical fees to 1 per cent of net sales after the independent directors asked the companies to seek shareholders' approval to the proposal.

Proxy advisory companies fighting for minority shareholders rights say small investors are increasingly left out by the multinationals.

“The MNCs are increasingly resorting to higher and higher payments of royalty,” says Shriram Subramanian, founder and managing director of InGovern Research Services Pvt Ltd, a proxy advisory company.

According to him, some of these increases are not justifiable. He says that it is not clear whether the independent directors on the boards of these companies sought any inputs or question the reasons for the increased royalty payments. “Board structures of many MNC companies in India are not ideal with many conflicted independent directors and even solicitors and advisors occupying roles of chairmen of audit committees,” says Subramanian.

“HUL should treat the royalty payment as a related party transaction and action it only if voted for by a majority of minority shareholders,” he adds.

(Business Standard)