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OWNERSHIP PATTERN OF THE INDIAN CORPORATE SECTOR
Implications for Corporate Governance

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K S Chalapati Rao[*]
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1. Introduction

Ownership structure has important implications for corporate governance and protection of minority shareholders' interest. Concentrated ownership structures and affiliation of companies with business groups is a common feature of Asian economies (Claessens and Fan, 2002).[1] In Asia, as in most other emerging markets, families typically control groups. While, following the East Asian crisis, family managements have come under severe criticism[2], subsequent empirical exercises suggest that they do have certain merits. For

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1 Their estimate for East Asia places the share of group-affiliated one in listed companies at 70 percent. See: Stijn Claessens and Joseph P.H. Fan, "Corporate Governance in Asia: A Survey", *International Review of Finance*, 3:2, June 2002, pp. 105–129.

2 These ranged from expropriation of minority shareholders, tunneling, greater possibility of inefficient investments, unrelated diversification, etc. Much of this evidence, was, however, indirect. On the basis that deviations of voting from cash-flow rights through the use of pyramiding, cross-holdings, and dual-class shares, are associated with lower market values, it was concluded that the risk of expropriation is the major principal-agent problem for public corporations in East Asia. See: Stijn Claessens, Simeon Djankov, Joseph Fan and Larry Lang, "Expropriation of Minority shareholders: Evidence from East Asia", July 2000. Even Bertrand, *et. al.* who find that a significant amount of tunneling between firms in these groups follow an indirect method they take equity stake of the directors as a proxy for family's cash flow rights. While it may have been unavoidable due to lack of appropriate shareholding data, in case of India, this has serious drawbacks. See: Bertrand, Marianne, Paras Mehta and Sendhil Mullainathan (2002), "Ferreting out tunneling: An application to Indian business groups", *Quarterly Journal of Economics*, pp. 121–148.

instance, Khaemasunun (2003)[3] finds that small tightly managed firms can be well managed by family hierarchies. This was, however, not the case with companies managed by partnerships of different families. Another study of Thai firms finds that family controlled firms, foreign-controlled firms as well as firms with more than one controlling shareholder are associated with better performance, relative to firms with no controlling shareholder. The controlling shareholders' involvement in the management, however, has a negative effect on the performance (Wiwattanakantung, 2001).[4] According to Khanna (1999), performance effects of group affiliation in India are by and large positive because groups could be substituting missing and poorly functioning institutions.[5] Further, Khanna and Palepu (2004) argue that concentrated ownership in India is not entirely associated with the ills that are ascribed to it in emerging markets. As a response to competition, at least some Indian families are seen to have tried to leverage internal markets for capital and talent inherent in business group structures to launch new ventures in environments where external factor markets are deficient. Thus concentrated ownership was found to be a result, rather than a cause, of inefficiencies in markets.[6]

It is possible that groups within a country vary in their extent of efficiency-enhancing versus other modes of operation. Pyramids and cross-holdings facilitate deviations between cash flow and voting rights and pyramid member firms are also subject to the problem of inter-corporate transfer of wealth among pyramid firms to the advantage of the controlling shareholders. The process is called "Tunnelling" (Johnson, *et. al.*, 2000).[7] Tunnelling is said to be weaker in countries with better legal protection for public shareholders and in pyramid firms with large outside investors. In case of China it was

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3 Kamol Khaemasunun, "Do Family Business Perform as proof as is claimed? Evidence from Thai Firms in 1996", College of Business Economics, West Virginia University, Working Paper No. 5, 2003.

4 Yupana, Wiwattanakantung, "Controlling Shareholders and Corporate Value: Evidence from Thailand", Centre for Economic Institutions, Working Paper Series, No. 2001–04, Institute of Economic Research.

5 Tarun Khanna, "Business Groups and Social Welfare in Emerging Markets: Existing Evidence & Unanswered Questions", Harvard Business School, September 1999.

6 Tarun Khanna and Palepu Krishna, "The Evolution of Concentrated Ownership in India—Broad Patterns and a History of the Indian Software Industry", NBER Working paper No. 10613, June 2004.

7 Johnson, Simon, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, "Tunnelling", NBER Working Paper No. 7523, February, 2000. Wolfenzon interprets the existence of pyramiding scheme as a means of expropriation of small shareholders, as it creates a wedge between cash flow and control rights for large block holders. See: Daniel Wolfenzon, "A Theory of Pyramidal Ownership", Harvard University, January 1999.

observed that ownership structure (both the mix and concentration) has significant effects on the performance of companies. Large institutional shareholders are important for corporate governance and performance and there are potential problems in an overly dispersed ownership structure (Xu and Wang, 1997).[8] Spanish firms, those in which control is shared, outperform other firms in terms of return on assets. This may be because multiple large shareholders play a monitoring role that ameliorates the agency problem and a bargaining role that prevents expropriation of the minority (Maria and Tribo, 2002).[9] Identity of large shareholders—both controlling and independent—thus matters in corporate governance.

In India corporate performance has been attempted to be related to the presence of various types of shareholders but the evidence does not seem to be conclusive. For instance, Khanna and Palepu (2000) noted that domestic institutional investors were poor monitors of controlling shareholders while foreign institutional investors (FIIs) were good monitors.[10] Similarly, Mukherjee and Ghosh (2004) noticed that among the institutional investors FIIs were the most consistent in stock picking whereas the performance of the domestic institutional investors was sporadic and volatile at best.[11] Mohanty (2002) however, found that the development financial institutions have lent money to companies with better corporate governance measures. Mutual funds invested money in companies with better corporate governance record. This positive association was both because the mutual funds (development financial institutions) have invested (lent money) in companies with good governance records, and also because their investment has caused the financial performance of the companies to improve.[12] There is, however, no conclusive evidence that institutional investors are active in governance. Lending institutions start monitoring the managements effectively once they have substantial equity holdings in the company and monitoring is reinforced by the extent of

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8 Xiaonian Xu and Yan Wang "Ownership Structure, Corporate Governance and Firms Performance: The Case of Chinese Stock Cos.", May 1997.

9 Maria Gutiérrez and Joseph A Tribo, "Multiple Large Shareholders in Corporate Control: Evidence for Spain", Universidad Carlos III de Madrid, February 2002.

10 Tarun Khanna and Palepu Krishna, "Emerging Market Business Goups, Foreign Intermediaries, and Corporate Governance", in Randall K. Morck (ed.), *Concentrated Corporate Ownership*, The University of Chicago Press, 2000.

11 Diganta Mukherjee and Tajamoy Ghosh, "An Analysis of Corporate Performance and Governance in India: Study of Some Selected Industries", Discussion Paper 04-19, Indian Statistical Institute, Delhi.

12 Pitabas Mohanty, "Institutional Investors and Corporate Governance in India", a study sponsored by the National Stock Exchange of India, September 2002.

debt holdings by these institutions (Sarkar and Sarkar, 2000). It was further observed that block holdings by directors increase company value after a certain level of holdings.[13]

Based on a somewhat more disaggregated ownership characteristics, Douma, *et. al.* (2003) observed that the positive effect of foreign ownership on firm performance was substantially attributable to foreign corporations and not to foreign institutional investors. They found a positive influence of domestic corporations *vis á vis* financial institutions. The impact was, however, lower when the corporations were associated with groups. They did not find Indian financial institutions to be performing the monitoring task.[14] Apart from institutions, the threat to incumbent managements could come mainly in the form of unaffiliated corporate bodies holding shares in the company. Existence of large outside shareholders, therefore, appears to be a necessary condition for monitoring the family managements.

The Asian Development Bank (2000), after noting the negative consequences of concentrated and family-based corporate ownership structures, emphasized the need for regulations in this area. It, however, felt that ownership reforms could be politically sensitive and controversial. The country reports commissioned by it argued that improvements in corporate governance as a result of the introduction of reform measures in other areas will, in the long term, lead to a more rationalized corporate ownership structure. In the short and medium term, they advocated the adoption of piece meal approaches to reforming corporate ownership structure.[15]

In specific, the ADB recommendations regarding ownership structures encompassed:

- examining the possibility of increasing the minimum percentages of outstanding shares required for public listing in the stock exchange to levels compatible with the current development stage of the corporate sector with a view to promoting

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[13] Jayati Sarkar and Subrata Sarkar, "Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India", IGIDR, March 2000. Jayesh Kumar finds a similar relationship with institutional shareholding and performance. See: Jayesh Kumar, "Does ownership Structure Influence from Value? Evidence from India" paper presented at the Global Corporate Governance Forum Regional Research Network Workshop, Indian School of Business, Hyderabad, December 13–14, 2003.

[14] Sytse Douma, Rejie Goerge, Rezaul Kabir, "Foreign and Domestic Ownership, Business Groups and Firm Performance: Evidence from a Large Emerging Market", Tilburg university, October 2003.

[15] Asian Development Bank, "Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand: Volume One (A Consolidated Report)", 2000.

broader corporate ownership and reducing ownership concentration in the longer term;

- applying the new minimum requirements to companies seeking new listing and requiring that the existing listed companies implement the new requirements within three to five years;
- examine the extent of interlocking shareholdings (cross shareholding and pyramiding) and problems associated with these ownership arrangements, and introducing appropriate measures either to regulate, discourage or prohibit such arrangements; and
- introducing or tightening the requirement for prompt disclosures of underlying ownership of shares held by nominees and holding companies and changes in the ownership.

Its other recommendations included:

- appointment of independent directors and external audit sub-committees and mandating their functions and responsibilities to public investors;
- introducing mandatory provisions to allow cumulative voting of directors;
- ensuring that the company laws provide shareholders the right to raise derivative or class action suits against management;
- introducing measures to prevent, detect and penalize insider dealings involving controlling shareholders;
- introducing innovative voting rules that grant minority shareholders with the swing votes or that reward them for voting/participating in corporate decisions;
- requiring minimum majority percentages that exceed the percentage of votes controlled by controlling shareholders;
- mandating the minimum representation of minority shareholders on boards; and
- granting veto powers in favour of minority shareholders over corporate decisions that are potentially detrimental to their welfare (e.g., clear cases of self-dealing)

The limited objective of this paper is to examine the case of India, in the context of the concentrated shareholding with controlling families, the felt need for large outside investors and the recommendations of ADB to ameliorate the ill effects of high family holdings.

2. Evolution of Corporate Governance Code in India

2.1. SEBI

In India, while companies in general have to function within the provisions and rules specified under the *Companies Act, 1956*, administered by the Ministry of Company Affairs, publicly traded companies, in addition, have to comply with the norms and regulations prescribed by the Securities and Exchange Board of India (SEBI), the market regulator. In line with international developments, India has also been gradually moving in the direction of introducing significant changes in corporate governance by amending/introducing appropriate measures in the relevant legislations and rules. Following the recommendations of the Kumar Mangalam Birla Committee's report on corporate governance, in February 2000, SEBI specified principles of corporate governance which listed companies have to follow. Provisions were introduced through Clause 49 of the Listing Agreement which require companies, among others, to have certain minimum proportion of independent directors depending upon whether the chairman was also the chief executive or not[16] and to have board subcommittees to deal with audit, remuneration and investor grievances. These were to be implemented in a phased manner. Some of the provisions like the constitution of a remuneration committee were not mandatory. Interestingly, the code did not refer to nomination/appointment committee.

Evolution of the Code

April 1998	Desirable Corporate Governance: A Code (CII)
1999	Kumar Mangalam Birla Committee Report (SEBI)
February 2000	Clause 49 of Listing Agreement (LA) introduced
February 2003	Narayana Murthy Committee-I (SEBI)
August 2003	SEBI amended the LA and strengthened the criteria of independent directors. However, kept it in abeyance
November 2003	Narayana Murthy Committee-II (SEBI)
October 2004	SEBI Withdrew the amendment and introduced a revised LA with March 2005 as the deadline.
March 2005	The deadline has been extended till December 2005

[16] In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

The experience with the implementation of the code does not, however, seem to be satisfactory. According to the SEBI-appointed Narayana Murthy Committee, SEBI found that the companies by and large complied with the requirements in Clause 49 of the Listing Agreement. However, there was no uniformity in cases such as the nature of qualifications in audit reports, the quality of the corporate governance report itself, and the business transacted and the duration of audit committee meetings. It was underlined that "(V)ariations in the quality of annual reports, including disclosures, raises the question whether compliance is in form or in substance; and emphasise the need to ensure that the laws, rules and regulations do not reduce corporate governance to a mere ritual" (SEBI, 2003).[17] We have noticed that the original Clause 49 gave company boards the freedom to decide about the independence of a director. Many instances have been indeed found where companies overlooked obvious linkages to confer independence on individuals, probably taking advantage of this freedom. While there were no overt protests against Clause 49, the further restrictions sought to be placed by the revised Clause and the Companies Amendment Bill, 2003 were subjected to severe criticism.

In the background of the enactment of *Sarbanes Oxley Act, 2002* in USA and the recommendations of the Naresh Chandra Committee appointed by the Department of Company Affairs, the Narayana Murthy Committee recommended changes in the definition of an independent director. Based on these recommendations, SEBI amended the Listing Agreement in August 2003 to tighten the criteria for the independence of directors. However, following suggestions and representations on the revised criteria, SEBI convened another meeting of the Committee and announced that the implementation of the Revised Clause 49 of the Listing Agreement was being deferred till further notice. In October 2004, SEBI withdrew the August 2003 amendments and announced a further revised Clause which was to be implemented by the existing listed companies by April 1, 2005. In early March 2005, however, the date for ensuring compliance with the Revised Clause 49 of the Listing Agreement was extended up to December 31, 2005 as it was brought to the notice of SEBI that a large number of companies were still not in a state of preparedness to be fully compliant with the requirements.

A reading of the latest version of Clause 49, introduced in October 2004, suggests that it is a compromise at least in respect of the crucial provisions of *(i)* criteria for an independent director; *(ii)* responsibilities of independent directors; *(iii)* audit committee functioning; *(iv)* monitoring of subsidiaries; *(v)* disclosure in respect of related party

[17] Securities and Exchange Board of India, "Report of the SEBI Committee on Corporate Governance, February 2003. Chairman: N.R. Narayana Murthy.

transactions; and *(vi)* putting in place a whistle blower policy (See Table-1). Under the new dispensation, most subsidiaries would remain outside the purview of the corporate governance code. With the freedom to define 'material transactions' and 'ordinary course of business', most related transactions could escape the scrutiny of the audit committee. Given the choice, except for a few, many companies would not venture to formulate a whistle blower policy. Even more importantly, the addition of the words *which may affect independence of the director* will once again give the incumbents some leeway.

Table-1
Important Amendments to Clause 49 of the Listing Agreement

Earlier Provisions (August 2003)	*Changes introduced in October 2004*
Independent Director	
The expression 'independent director' shall mean non-executive director of the company who apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;	The expression 'independent director' shall mean a non-executive director of the company who apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates *which may affect independence of the director*.
Responsibility of Independent Director	
Independent director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defence shall not be permitted on the ground that the independent director was unaware of this responsibility.	--
Subsidiary Companies	
The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies.	At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a *material non listed Indian* subsidiary company.
Related Party Transactions	
A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification.	A statement *in summary form* of transactions with related parties *in the ordinary course of business* shall be placed periodically before the audit committee. Details of material individual transactions with related parties which are not in the

contd...

Earlier Provisions (August 2003)	*Changes introduced in October 2004*
	normal course of business shall be placed before the Audit Committee.
Audit Committee	
The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee.	The audit committee *may invite* such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor *may be present* as invitees for the meetings of the audit committee.
Whistle Blower Policy	
Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.	Non-Mandatory Requirements: The company *may establish a mechanism* for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. Role of Audit Committee: To review the functioning of the Whistle Blower mechanism, *in case the same is existing*.

Source: Based on a comparison of the two versions.

2.2. Companies Act, 1956

Ever since the beginning of the 'nineties, attempts are being made to revamp the *Companies Act, 1956* to reduce its complexity, reduce bureaucratic interference and discretion, and to transfer the decision making authority to companies themselves. The experience of amending/recodifying the Act, however, has been that changes favourable to company managements went through smoothly, at times even through an ordinance. Those seeking to restrict their freedom have been subjected to examination by expert committees, working groups, discussions, debates, and so on. The important changes that had taken place through amendments, relevant for the current discussion include: permitting buyback of shares; freeing inter-corporate investments from government control; relaxing the limits on managerial remuneration; introduction of postal ballot; non-voting shares; representation for small shareholders, etc.

Major Attempts to Revamp the Companies Act

1993 & 1997	Company Bills of these years withdrawn/lapsed. The 1997 Bill was preceded by a Working Group and a Working Draft which were circulated for public debate.
December 2002	Naresh Chandra Committee on Corporate Audit and Governance
2003	Companies Bill 2003 incorporating Naresh Chandra Committee recommendations
August 2004	The 2003 Bill was withdrawn and a Concept Paper was floated by the Government for public debate
December 2004	Expert Committee appointed to examine the Paper
May 2005	Committee report presented

After the abortive Bills of 1993 and 1997, the Companies (Amendment) Bill 2003, sought to extend to scope of independent directors, tighten their criteria, introduce audit committees, impose age restriction on directors, restrict the formation of pyramids, etc. It, however, faced severe criticism and the process of revamping the Act was stalled once again. The Bill was withdrawn and in its place a Concept Paper on the reform of the *Companies Act, 1956* was floated by the government in August 2004. An Expert Committee examined the Paper and submitted its report in May 2005. It was expected that the Act would be amended before the December 2005 deadline. Since, however, there appears to be no possibility of the changes/new act coming into force, SEBI is going ahead with the implementation of Clause 49 with the possibility of synchronising the Clause with the amended Act, whenever it happens. The broad emphasis is to avoid conflict between the Companies Act and the listing guidelines.

3. Induction of Independent Directors

A crucial provision of the CG code is regarding the appointment of independent directors on company boards. It is apparent that even clear-cut legal definitions may not be sufficient, because interested parties are known to find ways of circumventing the same. A director who fully meets the criteria even after the proposed tightening of the provisions need not necessarily act independently and in the interest of non-promoter shareholders and other stakeholders. For example, it is debatable if directors who also happen to be industrialists themselves, or professionals like solicitors and tax consultants who are heavily dependent upon their dealings with business itself, would act in an independent manner. Attitudes do matter. The issue of directors' attitude acquires added significance because most companies in India are closely identified with individuals and families. While in reality certain companies belong to a group, for legal purposes, there are a number of ways in which companies can avoid grouping. This happened even in the case of registration of inter-connected undertakings under the MRTP Act.[18]

It is relevant to note that for electing a director a simple majority is enough. Considering the fact that most ordinary shareholders do not participate in general meetings, the incumbent managements can have their way even with far lower shareholdings. Even though, the Companies Act provides for cumulative voting of shares, since it was optional, this was never known to have been adopted by the companies. Interestingly, the repeated amendments to the act, did not attempt to make this mandatory. Similarly, while representation for small shareholders has been provided, it once again remains non-mandatory. On their part, the earlier guidelines could not bring in genuine independent directors. In view of this and in the context of corporates' tendency not to have genuine independent directors on their boards, we shall proceed to examine the shareholding pattern of listed companies in India.

4. Shareholding Pattern

Non-managerial shareholders' ability to influence corporate functioning depends to a large extent on the shareholding pattern. It is necessary to underline in the present context that many large private sector companies were being controlled by the industrial Houses in spite of having small shareholdings due to the support extended by public financial institutions (Table-2). These managements faced a severe threat of losing control, especially to foreign companies, following liberalisation of the economy. Promoters, therefore, started increasing their stakes almost immediately after liberalization (Tables 3a &3b). In the following we make an attempt to present a broad picture of the present shareholding pattern.

[18] See for instance, S.K. Goyal, *Monopoly Capital and Public Policy: Business and Economic Power*, Allied, Delhi 1979 and K.S. Chalapati Rao, "Inter-Connections under MRTP Act in the Context of Assets Limits Hike", *Economic and Political Weekly*, 1985, Issue No. 27, pp. 1132–46.

Table-2
Share of Public Sector in the Equity of Large Private Sector Cos. (early 1980s)

House	*No. of Cos. Studied*	*Of which, Cos. With at least 25% Public Sector Share*
Tata	15	10
Bangur	9	9
Birla	16	7
Modi	5	3
Kirloskar	5	3
ITC	3	3
Mafatlal	7	2
ICI	4	2
Mahindra	4	2
Singhania	3	1
Other Houses	77	35
Foreign Controlled Cos.	39	11
Other Cos	17	10
Total	**204**	**98**

Source: Based on S.K. Goyal, "Nature and Growth of the Indian Corporate Sector", Prof. Brij Narain Memorial Lecture delivered at Punjab University, Chandigarh, during January 12–14, 1987.

Table-3a
Changes in the Shareholding Pattern of Large Non-Government Companies: Pre- & Post-Liberalisation Periods

(No. of Companies)

Range of Shareholding (%)	*Govt. Controlled Shareholding*		*Foreign Holding*		*Corporate Bodies, Directors and Relatives*	
	Pre-	*Post-*	*Pre-*	*Post-*	*Pre-*	*Post-*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Less than 10%	31	33	118	90	46	43
10 to 25	67	76	18	39	57	36
25 to 40	72	76	24	24	56	67
40 to 50	21	11	27	13	23	30
50 and above	9	4	13	34	18	24
Total	**200**	**200**	**200**	**200**	**200**	**200**

Table-3b

(No. of Companies)

Change in Share (Percentage points)		*Govt. Controlled Shareholding*	*Foreign Holding*	*Other Corporate Bodies, Directors & Relatives*	*Individual Shareholders*
(1)		*(2)*	*(3)*	*(4)*	*(5)*
Decline					
1	Less than or equal to –5	70	20	41	89
2	-5 to –1	44	13	40	41
3	-1	14	22	14	13
	Total Declines (1–3)	128	55	95	143
No Change		-	8	-	-
Increase					
4	Up to 1	12	28	16	9
5	1 to 5	33	30	24	20
6	More than 5	26	79	65	28
	Total Increases (4–6)	72	137	105	57
	All Companies	**200**	**200**	**200**	**200**

Source: Global Capital Flows and the Indian Stock Market, a project sponsored by the Indo-Dutch Programme on Alternatives in Development (IDPAD), ISID, 1999.

One way of looking at the importance of different categories of shareholders is through the total value of their investments at any given point of time (called market capitalisation) instead of the nominal value of shares held by them. According to the data available from the Prowess database, market capitalisation (MCAP) of 3,016 listed companies as on September 30 2005 was Rs. 22,53,576 crores.[19] Leaving aside the listed public enterprises, in which the government would in any case have a majority shareholding, market capitalisation of 2,953 non-government listed companies for which shareholding data was available works out to Rs. 17,31,814 crores. From Table-4 it can be seen that the promoters—both Indian and foreign as also entities acting in concert with them—own nearly half of the total market capitalisation. A closer look at the disclosures made to the stock exchanges suggests that promoter shareholding could still be hidden in the form of other corporate bodies, individual shareholders and NRI/OCBs.[20] If such

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[19] One crore = ten million.

[20] In one case, the address of a 'non-promoter' corporate shareholder was that of the company's Chairman himself! Promoters indeed are likely to keep certain of their entities out of the ambit for a number of reasons. Apart from narrowing the scope of insider trading investigations, one rationale could be that they would not gain anything by claiming an investor to be associated with the promoter. In some circumstances, fights within controlling families could be responsible for not naming certain entities as promoter shareholdings. It is also possible that the *contd...*

holdings are also taken into account it is likely that overall share of the promoters may well exceed half.

Table-4
Shares of different Categories of Shareholders in Market Capitalisation of Non-Government Companies (As on 30 September 2005)

	Category	*Market Capitalisation (Rs. Crores)*	*Share in Market Capitalisation of non-government companies (%)*
	(1)	*(2)*	*(3)*
A	Market Capitalisation (MCAP) of 3,016 Companies	2253576	
B	MCAP of public enterprises (within A)	521762	
C	MCAP of 2,953 Non-Government Companies	1731814	100.00
1)	Promoters including persons acting in concert with them	811291	46.85
2)	Institutional Investors	466326	26.93
	(a) Foreign Institutional Investors (FIIs)	288337	16.65
	(b) Banks & Financial Institutions	111713	6.45
	(c) Mutual Funds	66274	3.83
3)	General Public: Indian	237052	13.69
4)	Private Corporate bodies	71781	4.14
5)	Non-Resident Indians and Overseas Corporate Bodies (OCBs) controlled by them	52576	3.04
6)	Others (including GDRs)	92786	5.36

Source: Based on Prowess database.

Looking at individual companies, one finds that private promoters[21] control substantial portion of shares of many listed companies (Table-5). In nearly half of the listed companies private promoters already hold majority stakes. In case of companies with Rs. 50 crores or more market capitalisation 57 per cent of the companies are such that the promoters' stake is more than 50 per cent. Since the disclosures in this respect are deficient, promoters could be holding majority stakes in larger number of smaller companies. In the context of many groups controlling multiple companies this phenomenon acquires added significance.

narrowing of the definition of relatives under the *Companies Act* gave the promoters flexibility to keep investments of close relatives outside the promoter category. Keeping certain shareholdings out of the promoter group also helps to ward off the threat of delisting.

[21] Promoter is any person or persons who are directly or indirectly in control of the company.

Table-5
Distribution of Companies According to Promoters' Share and Market Capitalisation

(No. of Companies)

Promoter's Shareholding (%)	*Size of Company in terms of Market Capitalisation (Rs. Cr.)*					*All Cos.#*
	Less than 1	*1 to 10*	*10 to 50*	*50 & above*	*Total*	
76 and more	17.59	4.53	7.14	8.99	7.86	11.86
50.01 to 75.99	25.93	31.59	43.40	48.32	40.57	39.21
Sub-Total	***43.52***	***36.12***	***50.54***	***57.32***	***48.43***	***51.07***
40.01 to 50.00	13.43	21.49	18.73	17.20	18.56	17.09
25.00 to 40.00	24.07	23.81	17.25	17.02	19.57	18.16
10.00 to 24.99	13.43	11.85	8.89	5.20	8.67	8.68
Less than 10	5.56	6.74	4.58	3.26	4.77	5.00
All Companies	100.00	100.00	100.00	100.00	100.00	100.00
No. of Cos.	216	*861*	742	1134	2953	3458

Including those for which market capitalization data are not available.
Source: Based on Prowess database.

The reasons for high promoter stakes are many and range from allowing creeping acquisition of shares by promoters, to very low public offers, buybacks and takeovers. In short, the present situation is due to the following:

i) Limits on inter-corporate investments have been liberalised thereby enabling companies engage in a variety of inter-corporate relationships, the simplest being cross-holding of shares. Cross-holding obviates the need to mobilise additional resources by the managements for strengthening control. It needs to be underlined that corporates have been investing heavily in other enterprises, especially in related ones.[22] (see Tables 6 and 7 for some recent evidence.)

ii) Companies have been allowed to buyback their shares. In this process the controlling interests can increase their stakes without putting their own money.

iii) In a typical takeover case, due to open offer, controlling interests' stake increases because on top of the shareholding acquired from the existing promoters, the new promoters would have to make an open offer to the remaining shareholders.

iv) Creeping Acquisition by promoters was allowed, whereby promoters can increase their stakes gradually without attracting the provisions of the SEBI takeover code.

v) With the relaxation of limits on foreign direct investment (FDI) in individual enterprises, listed affiliates of foreign companies tended to acquire subsidiary

[22] For an elaborate discussion, see: S.K. Goyal, K.S. Chalapati Rao and K.C. Sharma, "Savings and Investment of the Indian Private Corporate Sector during the 'Nineties", a study sponsored by the Union Ministry of Finance, ISID, 2002.

status. Some of them have either got already delisted or are on the verge of delisting.

vi) It was initially felt that the foreign institutional investors (FIIs) could connive with foreign companies in taking over Indian companies. Possibly due to such a perception, ceilings were introduced on overall and individual FII shareholdings. The limits have been, however, increased progressively. While there is a general ceiling of 24 per cent, in individual cases companies can decide to raise the limit up to 49 per cent. Presently, sectoral caps for FDI are also the limits for FII investments.

vii) A conscious effort also has been made to promote mutual funds.

viii) Convertibility clause, whereby term lending institutions had the option to convert certain portion of their loans into equity, has been withdrawn.

ix) As per the public issue guidelines, non-promoter shareholding can be as low as 10 per cent. The ceiling was earlier 25 per cent.

Table-6

Growing Size of Corporate Investments and Relative Share of Group Companies

Year	*Total Investments (Rs. Cr.)*	*Share of Group Cos. in Total Investments (%)*
(1)	*(2)*	*(3)*
1995–96	27,419	58.53
1996–97	31,546	58.68
1997–98	39,035	56.40
1998–99	41,706	64.22
1999–00	53,655	64.91
1999–00	49,718	63.62
2003–04	108,989	58.73

Source: Based on Prowess database.

2545 companies for 1995–96 to 1999–00 and 2555 companies for 1999–00 & 2003–04.

Table-7

Pattern of Deployment of Funds by Non-Government Non-Financial Public Ltd Companies (Average: 2002–03 & 2003–04)

Item	*Share (%)*
Gross Fixed Assets	36.5
Investments	34.0
Loans and Advances to Group Companies	2.5
Loans & Advances to Others	9.0
Inventories	11.1
Others	6.9

Source: RBI, Finances of Public Limited Companies: 2003-04.

Promoter's stake, need not always be held by the promoters themselves in their personal capacity. It could be provided by other companies controlled by the group, some of which could be listed companies themselves. Such investments, while lessening the risk borne by the promoters, enable them exercise disproportionately greater control over the companies involved. A limited analysis of the shareholding pattern of Tata group companies reveals that in a majority of the cases, investments by other listed companies of the group and their subsidiaries contributed significantly to the promoters' stake (Table-8). If the investments of listed companies of the group in Tata Sons and Tata Industries, which in turn hold stakes in many of the group's listed companies, are also taken into account, the group's strategy of using listed companies' money to bolster its control becomes quite evident. At the end of 2000–01, the total cost of acquisition of shares in the two apex companies by some of these listed companies was more than Rs. 400 crores. Interestingly, while TELCO held 4.68 per cent of equity of TISCO, TISCO in turn held 9.37 per cent of TELCO's equity. In one of the most dramatic instances of its type, the shareholding of the group increased in TISCO from about 3 per cent during the 'eighties to 26 per cent now (See Figure-1).

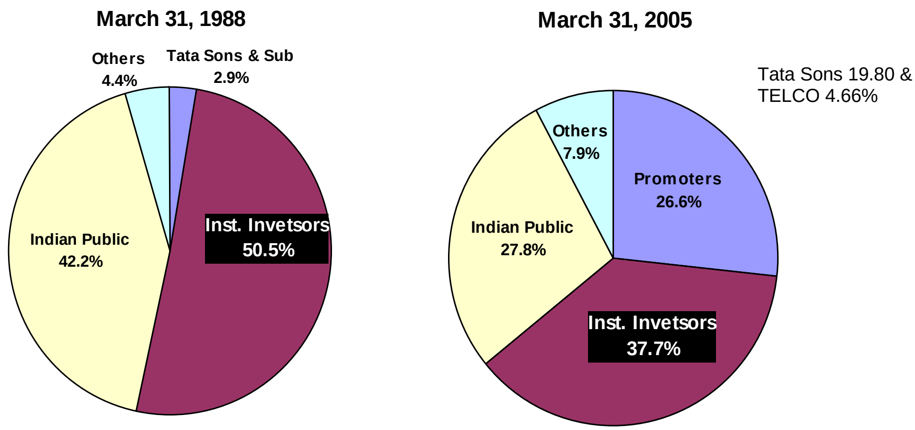
Table-8
Inter-Corporate Investments in Corporate Control: The Case of the Tata House

Share of Other Tata Group Listed Cos' in Equity (%)	*No. of Companies*
Nil	6
Less than 10%	6
10 to 25	7
25 to 40	10
40 to 50	4
More than 50	4
Total No. of Companies Studied	**37**

Source: Based on the shareholding pattern of individual group companies. The exercise was conducted about 2 years back.

If the remaining equity i.e., non-promoter shareholding, is distributed among large number of small investors, the managements, even if these are not in majority, would stand a very high chance of getting their nominees elected. Since, however, promoters have substantial shares in many companies, selection and election of directors cannot be made without the active support of the promoters unless promoters are debarred from exercising their vote in certain Board nominations. In fact, except in case of special resolutions, for passing which the support of a minimum of three-fourths of those present and voting is required, decisions at the general meetings would tend to be mere formalities.

Figure-1
Shareholding Pattern of TISCO: Then & Now



5. Non-Promoter Shareholding

5.1. Institutional Investors

Next in importance in the Indian stock market is the broad category of institutional shareholdings which amounted to close to one-fourth of the total market capitalisation. Within this, foreign institutional investors (FIIs), who are credited with better monitoring abilities, are the most important category followed by banks and financial institutions, and mutual funds (MFs). Out of the 3458 companies, for which shareholding data are available for Septemer 30, 2005, FIIs had no presence in as many as 2510 companies (Table-9). In another 609 companies FII holdings were less than 5 per cent of the total shareholding of the respective companies. In only 217 cases FII holding was above 10 per cent. The situation is slightly better off in case of MFs and banks & financial institutions. Over all, in 72 per cent of the cases, all institutional investors put together hold less than five percent of the total equity capital of the respective companies. Even this equity being distributed among a number of investors, and with ceilings on individual FII investments, it would be unlikely that they would act in a coordinated manner. An important facet of MFs in India is that they could tend to represent corporate investments more rather than individual investors[23] (Table-10). Some of India's business houses have

[23] Evidence indeed points to the dominant role played by large companies in MF transactions. For instance, the total purchases and sales of MF units by Tata Power Co. Ltd. During 2001–02 were about Rs. 8,900 crores. Corresponding figures for Bharti Televentures, Hero Honda Motors and

contd...

promoted asset management companies. It is debatable to what extent mutual funds which are floated by business houses and which depend upon corporates for funds can play the monitoring role.

Table-9
Distribution of Companies According to Shares of Different Categories of Institutional Investors

Share (%)	*No. of Cos. having FII Investments*	*Banks and Financial Institutions*	*Mutual Funds*	*All Institutions*	*Per cent to Total Col. (5)*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
0	2510	1687	1972	1273	36.81
Less than 5	609	1261	1194	1229	35.54
5 to 10	122	226	193	320	9.25
10 to 24	182	229	94	426	12.32
Above 24	35	55	5	210	6.07
All	**3458**	**3458**	**3458**	**3458**	**100.00**

Source: Based on the Prowess database.
Columns (2), (3), and (4) do not add up to (5).

Table-10
Unit Holding Pattern of Mutual Funds (As on March 31, 2003)

	Public Sector	*Private Sector*
Individuals	64. 27	31.68
Companies, Institutions, etc.	34.91	66.11
Others	0.82	2.21
Total	**100.00**	**100.00**

Source: SEBI

5.2. Unaffiliated Corporate Bodies

In Table-4 it was seen that companies other than the ones included under promoters and persons acting in concert, account for 4.14 per cent of the MCAP. Apart from institutional investors, it should be expected that threat to incumbent managements would come mainly in the form of unaffiliated corporate bodies. In most cases, shareholding of other corporate bodies is quite low (See Table-11).

ITC were about Rs. 6,000 crores, Rs. 4,500 crores and Rs. 3,000 crores respectively. Face value of Grasim's dealings were nearly Rs. 900 crores. Interestingly, Hindalco dealt with more than 175 crores units, a significant proportion of which being that of the group's MF.

What is more relevant, however, is that, as noted earlier, in quite a few cases the relationship of these companies with the promoter groups is obvious. For instance, in Ambalal Sarabhai Enterprises (ASE), the 14.78 per cent holding of Sarabhai Piramal Pharmaceuticals Pvt. Ltd (SPP) was shown as non-promoter holding. Both ASE and Nicholas Piramal hold 2,25,00,250 shares of Rs. 10 each of SPP. SPP, could thus be a 50:50 joint venture of the two companies. It would be illogical to expect that SPP would not support the promoter group. The two non-promoter corporate bodies reported in case of Blow Plast also could be traced to Piramals. It does appear that wherever shareholding of private corporate bodies is large, the possibility of such companies being related to promoters is quite high. Obviously, other private corporate bodies could, if at all, perform the monitoring role in a very few companies and that too in smaller ones. And indeed, it is in the smaller ones, the possibility of promoter holding remaining masqueraded as unaffiliated holding is high.

Table-11
Distribution of Companies According to the
Shares of Unaffiliated Corporate Bodies and Market Capitalisation

	Size of Company in terms of Market Capitalisation (Rs. Cr.)				*Total*
	Less than 1	*1 to 10*	*10 to 50*	*50 & above*	
0	175	29	5	0	209
0 to 5	206	331	225	409	1171
5 to 10	76	192	198	350	816
10 to 24	140	219	240	304	903
24 and above	124	90	74	71	359
All	**721**	**861**	**742**	**1134**	**3458**

Source: Based on the Prowess database.

5.3. Postal Ballot

In the background of poor participation of non-promoter shareholders, especially, individuals, in general meetings, postal ballot was introduced in the Companies Act in 2001. through an amendment. On its part, SBI incorporated the provision in the stock exchange listing agreement. It was mandated that for altering the memorandum of association, sale of undertakings, sale of major investments, further issue of shares, entering new businesses, etc. postal ballot should be resorted to. Given the high promoter stakes, however, this provision does not seem to be serving any purpose as far as the listed companies are concerned. In most cases the participation of other shareholders remain limited and on the other, the high stakes ensure smooth passing of the resolutions (Table-12).

Table-12

Illustrative List of Outcomes of Results of Postal Ballots Conducted by Companies

Company	*Purpose for which Postal Ballot was conducted*	*No. of Shares Underlying the Postal Ballots Received*	*Reported Promoters' Shareholding*		*Promoters' shareholding as a % of shares underlying the Postal Ballots (4)/ (3) x 100*	*Resolution passed by (%)*
			No of Shares	*% in Total*		
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
ABB Ltd	Sale of Control Valve Business	28304874	22084057	52.11	78.02	99.95
Associated Cement Cos. Ltd (ACC)	Sale of Mancheriyal Cement Works	68925611	62347866	34.05	90.46	99.62
Bharat Forge Ltd	For furnishing Guarantees	15253779	14888590	35.04	97.61	99.93
CESC Ltd	commencement of a new line of business			38.37		99.98
Dabur India Ltd	Investments, Loans, etc. to Subsidiary Cos.	226508964	219917991	76.73	97.09	99.23
Escorts Ltd #	Change in MOA to incorporate agriculture related business	43699318	21507098	29.77	49.22	99.88
Jaiprakash Associates Ltd.	Approval to provide guarantees up to Rs. 300 Cr.	90221604	80129501	44.87	88.81	94.04
JSW Steel Ltd	Shifting of Regd. Office	Not Reported	65305149	50.61		93.05
Nicholas Piramal India	Sub-division of equity shares	25142901	19324016	50.85	76.85	99.75
Procter & Gamble Hygiene & Health Care	Transfer of Plant to Subsidiary	23939712	22330249	68.79	93.28	98.23
Reliance Energy Ltd	Raising of Funds	136276881	102919963	50.97	75.52	99.99
Tata Power Co. Ltd	Transfer of Undertaking	73281361	64041704	32.36	87.39	99.20
Tata Tea Ltd	Sale of Plantation Operations	26056134	16200069	28.82	62.17	85.29
TCS Ltd	Issue of shares to Employees/Directors under ESPS	401935689	407351000	84.84	101.35	99.92

The two Directors of one of the reportedly unaffiliated corporate bodies (Diamond Leasing & Finance) holding more than 4 per cent share of the company are also directors of Escorts and its other group companies. Another shareholder classified as Indian public having more than 3.5% share is the Trustee of Employee Share Option Scheme (ESOS), and appears to be represented by the Company's Chief Financial Officer.

6. Summing Up

Whether as a deliberate design or inadvertently, India has allowed the promoters to gain/retain control over companies. The main implication of the shareholding pattern is that leaving decision-making to companies shareholders and their boards in effect means giving full freedom to the promoters. In the present ownership pattern there is hardly any threat to incumbent managements of vast majority of companies. In most companies institutional investors, who could have played the monitoring role, have either no presence or are only marginal players. The problem appears to be more severe in case of smaller companies which are generally avoided by institutional investors. There is also the possibility of the liberalised Companies Act encouraged inter-corporate investments which reduce the risk borne by the promoters while increasing their hold. It may seem that India has missed an opportunity to build an ownership structure which while making the promoters genuinely interested, also would have kept them on tight leash.

Private managements probably did not oppose the induction of independent directors initially because first, it was difficult for them to openly oppose the international trend and secondly, they had the freedom to decide on a director's independence. Instances have been found where companies overlooked obvious linkages to confer independence on individuals probably taking advantage of this freedom. Friends, long time associates, partners of legal firms serving the same company have all been termed as independent directors. Promoters being firmly in saddle, the slim possibility of genuine independent directors getting elected to corporate boards has receded even further. It should be kept in mind that companies are being rather forced to introduce such directors. SEBI had to make the CG Code somewhat more palatable to them. The code may be further diluted if the much delayed revisions to the Companies Act, finally materialise.

It is, therefore, debatable to what extent the efforts at improving CG would succeed in the face of high promoter stakes. In fact, the prescribed minimum public shareholding is so low that managements can get through even special resolutions without any hindrance. One has already seen the redundancy of postal ballot. It is easy to let promoters accumulate their holding but difficult to force them to bring it down. Effective steps should be taken at the entry point itself.

If the objective is to have genuine independent directors and constraining the promoters, the recommendations of ADB such as placing restrictions on promoter voting and making cumulative voting and representation of minority shareholders mandatory need a fresh look. On certain matters promoters should be denied the voting rights. Make provisions relating to election of directors more restrictive so that diverse shareholder interests could get representation on corporate boards. For instance, small shareholder representation on company boards could be made mandatory rather than voluntary. Induction of independent directors is only the first step. For the mechanism to be effective, one needs to continually monitor the characteristics of such directors. Otherwise, the whole exercise would be as futile as that of postal ballot.

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