



Articles

SHAREHOLDERS ACTIVISM IN MARUTI SUZUKI

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Introduction: In the recent past “Shareholders Activism” has been the buzz word in the corporate world. It is an attempt made by a shareholder(s) of a company to exercise his rights as an owner; though he is not involved in the day to day running of the business of the company. Such activism can be made by aggressively raising voice against the management's decision, active participation in voting, making other stakeholders aware of the resolution proposed by the Board of Directors (“BoD”) of the company etc. Though, few market analysts have perceived it as an academic or theoretical concept.

Indian Scenario: There are very few occasions when India's minority investors have voiced their opinion aggressively against the management. Some of them are:

1. In 2008, they protested against the inflated valuations when Satyam Computer Services announced its plan to acquire Maytas Properties and Maytas Infra. The deal didn't go through;
2. In 2008, minority shareholders of Sterlite Industries India were adamant that a restructuring proposal floated by parent Vedanta was against their interests;
3. In early 2014, some minority shareholders complained that Siemens AG (German Holding Company) had paid a low price for acquiring additional shares of its Indian subsidiary;
4. And again in early 2014, the minority shareholders have raised their voice against Maruti Suzuki India Limited (“MSIL”) for a proposed transaction (*which has been analysed and explained in this article*).

Global Scenario: The situation in India is quite the opposite of what happens overseas, where institutional investors are very active. For instance, when Walmart Mexico was named in a bribery case, the institutions demanded that the

Chief Executive Officer of Walmart US steps down as he was responsible for the company's global business and hadn't been proactive in checking incidents related to bribery or fraud.

Details of Proposed Transaction in MSIL:

1. The BoD of MSIL in its meeting held on October 29, 2013; approved the purchase of approximately 550 acre land in Vithalpur, and 640 acres of land in Becharaji (both in Gujarat). The purpose of purchasing the lands was to expand the manufacturing facilities of MSIL. But, such expansion was kept on hold due to unfavorable market conditions;
2. MSIL received a proposal from its Parent Company – Suzuki Motors Corporation (“SMC”). According to this proposal; SMC would incorporate a Wholly owned Subsidiary company in Gujarat (“SMC WOS, Gujarat”);
3. MSIL would enter into a Contract Manufacturing Agreement with SMC WOS, Gujarat with the following terms and conditions:
 - i. SMC would provide all finance to SMC WOS, Gujarat for incurring the required Capital Expenditure (“Capex”) that would be incurred to set up a plant in Gujarat;
 - ii. The land (as described above) bought by MSIL would be leased to SMC WOS, Gujarat for production and manufacturing of the related facilities. The rent would be determined on arms' length basis;
 - iii. The production and manufacturing of vehicles of MSIL would be completely shifted to SMC WOS, Gujarat. MSIL would require to give only technical specifications and the requirements for manufacturing vehicles;
 - iv. SMC WOS, Gujarat would manufacture as per the prescribed requirements and would exclusively sell the vehicles to MSIL;
 - v. Selling Price of the vehicles by SMC WOS,



- Gujarat to MSIL would be Cost of Production (+) adequate cash to cover incremental Capex requirements;
- vi. The growth of SMC WOS, Gujarat would be dependent on the business generated, vehicles ordered by MSIL;
 - vii. SMC WOS, Gujarat would function on the basis that it would neither generate surpluses nor make losses.
 - viii. The cost of production of vehicles, produced by SMC WOS, Gujarat, would be calculated in an identical manner to that followed by MSIL, Haryana; and as would have been done if the SMC WOS, Gujarat had been executed by a WOS of MSIL. The cost would not include return on investment and profits;
 - ix. The Capex needs of SMC WOS, Gujarat would be determined jointly by MSIL and SMC WOS, Gujarat; consistent with the production needs of MSIL from the said project;
 - x. The impact of any Direct Tax or Indirect Taxes on account of the Contract Manufacturing Agreement would be assessed before finalizing the same;
4. The above terms and conditions between the proposed arrangement between SMC WOS, Gujarat and MSIL have been approved by the BoD of MSIL in its meeting held on January 28, 2014.
- Potential Commercial & Legal Issues in the transaction:**
1. If the deal goes through, MSIL would be an Automobile Trading Company and would no longer be an Automobile Manufacturing Company. MSIL will only provide technical specifications to SMC WOS, Gujarat and get the vehicles tailor made;
 2. The rent will be paid by SMC WOS, Gujarat to MSIL and the same would be included in the cost of production;
 3. SMC WOS, Gujarat would charge depreciation in its Profit and Loss Account for the Capex that it would incur for setting up the plant for manufacturing automobiles;
 4. Considering Point No. 2 & 3; both rent and depreciation would be added to the cost of production; which would ultimately inflate the vehicles prices and make MSIL less competitive in the market;
5. The concern is that this proposed arrangement will shift value from MSIL to SMC WOS, Gujarat and that MSIL would indirectly be paying for subsequent expansion of SMC WOS, Gujarat;
 6. Is the transaction like: MSIL is funding the entire Capex and reimbursing the cost of manufacture without having any shareholding in SMC WOS, Gujarat? To explain it: SMC WOS, Gujarat will invest in the first phase of Capex. The remaining phases of Capex will be undertaken from the margin SMC WOS, Gujarat makes on selling the cars to MSIL. Effectively, MSIL also funds the remaining capacities at Gujarat, and yet has no ownership of it;
 7. SMC WOS, Gujarat will pay MSIL lease rentals for the use of the Gujarat land. MSIL will reimburse SMC WOS, Gujarat for this lease rental through the cost of car manufacture. In effect, SMC WOS, Gujarat will have free use of the Maruti land in Gujarat.
 8. MSIL's Board, in which 8 of the 12 members effectively represent SMC, Japan has approved the Gujarat plant deal without any consultation with other shareholders. Interestingly, the announcement of the proposed transaction has come before the new Companies Act 2013 comes into force, under which this transaction would need shareholder approval [Under Section 188 of the Companies Act, 2013]. Because, the promoters benefit from this transaction and such transaction would need to be approved by a majority of minority shareholders; thus giving minority an opportunity to have a say.
 9. If the deal is sanctioned by requisite approval; there are serious concern about the inventory levels, vehicles pricing and discounts, dealer network management, post-sale servicing, brand management etc.;



Possible Legal Options for shareholders to revolt against MSIL:

1. **Petition under Section 398 of the Companies Act, 1956:** The requisite members of the company can file a petition with the Company Law Board (CLB) stating that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company [Section 398(1) of the Companies Act, 1956]. For making such petition, following members shall have a right to apply under Section 398:
 - i. Not less than 100 members or
 - ii. Member(s) holding not less than 10% of the issued share capital of the company.

In Institutional shareholding; LIC is the largest shareholder. Therefore, if the petition is proposed to be filed with CLB under Section

398 of the Companies Act, 1956; then other shareholders who intend to oppose this transaction will need the support of LIC (for the purpose of 10% of issued share capital). Also, it's is a very extreme step to file a petition under Section 398 of the Companies Act, 1956 because the decision of the Board of MSIL may be modified / changed and also from the facts given; we can't conclude that the such activity amounts to mismanagement of affairs of the MSIL.

2. **Section 388B of the Companies Act, 1956:** Pursuant to this section, where in the opinion of the Central Government; there are circumstances which suggest that
 - i. Any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or

The latest shareholding pattern of MSIL (i.e. as on December 31, 2013) is as follows:

Sr. No.	Category	Percentage (%) Shareholding	Total Percentage(%) Shareholding
1.	Promoter & Promoters Group (Foreign) – Suzuki Motor Corporation.	--	56.21
2.	Institutional Shareholding		35.45
	(a) Life Insurance Corporation of India (LIC)	6.93	
	(b) HSBC Global Investment Funds A/c HSBC GIF Mauritius Ltd	1.16	
	(c) ICICI Prudential Life Insurance Company Ltd	1.74	
	(d) Credit Suisse (Singapore) Ltd	2.26	
	(e) Government Pension Fund Global	1.03	
	(f) Others	22.32	
3.	Non – Institutional Shareholding [Public Shareholding]		8.34
	TOTAL		100.00



- default or;
- ii. Business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices or;
 - iii. Company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or;
 - iv. Business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

This is a very extreme remedy that the Central Government would refer to CLB under Section 388B of the Companies Act, 1956 and then conduct inquiry as it appears that there is no such activity in MSIL (as mentioned above).

3. Remedies under the SEBI Act, 1992: The basic functions of SEBI are as follows:

- i. To protect the interests of investors in securities;
- ii. To promote the development of the securities market; and
- iii. To regulate the securities market, by such measures as it thinks fit.

Pursuant to the provisions of Section 11B(i) of the SEBI Act, 1992; SEBI has the powers to issue directions for making an enquiry; in the interest of the investors or for the orderly development of the securities market. However, the directions of such enquiry can be issued against securities market intermediaries [Brokers, Sub-Brokers, Share Transfer Agents, Bankers to Issue, Underwriter, Custodian, CRA etc.] or company which proposes issue of share to

public [Rights Issue, Public Issue, Follow on Public Issue]. There is no precise authority for investigation in the present case of MSIL and SMC WOS, Gujarat. But, under Section 11(1) read with Section 11C [“Investigation”] of the SEBI Act, 1992; the SEBI can take necessary steps in matter of MSIL.

Position as on date and possible developments:

Institutional Investors like – Mutual Funds, Domestic Institutional Investors' and Insurance companies have approached SEBI by writing to it about the proposed deal of MSIL. As per media reports, few Institutional Investors have met senior SEBI Officials to discuss the deal of MSIL and proposed that the deal was detrimental to for minority investors. Accordingly, SEBI has asked MSIL to explain the complete transaction.

As the matter develops, it will be interesting to observe how MSIL reacts to such actions taken by the Institutional Investors. Will SMC, Japan revoke the decision of setting up SMC WOS, Gujarat or will the terms and conditions of Contract Management Agreement be changed? Further, it will be interesting to examine and study; under which provisions of the SEBI Act; will SEBI take the steps or will the shareholders activism prevails and then SMC, Japan change the decision. This could probably be the first case where the BoD's decision of either Foreign Holding Company or its Indian subsidiary has been changed due to SEBI's intervention in the matter.

All this will get more interesting in the times to come!!

Notes:

- 1) Source of information:
<http://www.bseindia.com;>
<http://www.nseindia.com;>
<http://www.marutisuzuki.com/>

