SmartLink move not smart enough for shareholders: Experts

Stocks of SmartLink tanked on Thursday after a large sale. The core business of the company was spun-off and sold off to a global player, not warranting any kind of open offer for the minority shareholders. Sandeep Parekh founder of Finsec Law Advisors and Siddharth Shah of Nishith Desai & Associates in an exclusive interview with CNBC-TV18's Udayan Mukherjee and Mitali Mukherjee discuss what such transactions mean to small shareholders.

Parekh believes it is bad corporate governance and says, "A couple of policy issues need to be relooked at including exemptions given in transaction like this. Shah adds that, "One of the things to be looked into is whether the threshold for approval of such substantial assets is an ordinary shareholders resolution, whether it can be raised for the public shareholders to have a say when the company takes such a decision."

Shah also says that one needs to tread the fine line, in terms of ensuring the shareholder protection and at the same time; "it cannot be a hard fast regulation that can actually curtail the corporate flexibility."

As a last word on such incidences, Parekh says the solution lies with the investors itself. "Indian investors, including Indian institutional investors need to pull their socks up and penalize these companies in the long-term." He says investors need to punish such stocks when they come back to the debt or equity market. "Penalizing these companies is the only market discipline that would limit deeds that maybe legal but which cross the boundaries of good corporate governance," he adds.

Below is a verbatim transcript of Sandeep Parekh's and Siddharth Shah's interview with CNBC-TV18. Also watch the accompanying video.

Q: Do you think it is fair keeping with the spirit of how a promoter should treat its minority shareholders?

Parekh: It is very bad corporate governance and bad public relations. The only thing that is good is that unfortunately it not illegal. There are a couple of issues that need to be relooked at from policy making front, in terms of whether you should grant exemptions in cases like these in the first place. In many cases, even if you don't have an exemption because the market price has moved so much from the historical price, these open offers are often below the market price, so, obviously nobody tenders their shares into these offers. Hence, a couple of policy issues need to be relooked at including exemptions given in transaction like this.

Q: You are okay with how this deal was structured?

Shah: It seems to go against the basic corporate philosophy from a shareholder's perspective, being left high and dry, in terms of not getting an exit opportunity when a core asset is being sold out. However, obviously from a corporate flexibility perspective it is perfectly legal. One really needs to look at it to differentiate between whether it is a sale of part of the business or a whole business and then obviously, looking at the facts and circumstances one needs to look at it whether SEBI or the regulator need to deal with this.

One of the things to be looked into is whether the threshold for approval of such substantial assets is an ordinary shareholders resolution, whether it can be raised for the public shareholders to have a say when the company takes such a decision.

Q: How do you bypass that in cases where promoter holding is high?

Shah: An ordinary resolution is an easy option for the promoter which is what it exists today. However, at least a special resolution and in many situations is a possibility that SEBI can explore in a situation where substantial assets are being sold to a certain extent if the public shareholders are given more opportunity to vote, by having maybe the promoters exclude themselves from the voting, if they are vested interest there. For example, the non compete payments talk about vested interest for the promoters and they are conflicted in that sense.

One needs to tread the fine line, in terms of ensuring the shareholder protection and at the same time; it cannot be a hard fast regulation that curtails the corporate flexibility because there may be a genuine situation where flexibility would be useful.

Q: What kinds of claims can minority shareholders make though, because the only expectation is that perhaps you get a hefty dividend?

Parekh: There one way is —SEBI, if it really wants to push the boundaries of law can mean this to a change of control and something that impacts the takeover regulation. However, nothing like that has been done before. The real problem is that cases like this don't fall in the domain of SEBI, because there is neither change of control nor transfer of shares, in which case obviously at most it would be a breach of a – duty of directors.

Now, typically it doesn't fall in the domain of SEBI or at least SEBI is not yet been proactive enough in cases like that. If there is a breach of duty, of course shareholders can approach the court and say that directors have kind of violated the duty to us. Therefore, it is only the legal way that is open for shareholders. However, given the slow pace of the Indian judicial system, I would not be too hopeful.

Q: Could you have a threshold which measures how material the sale of the division is, to the existing revenues of the company?

Shah: I am sure it would have its own challenges, in terms of defining what a substantial interest for a substantial asset would really mean in the context of revenue. However, I would think it is not impossible in that sense and in case of tax laws and several other situations where there are definitions that really lay down. So, it is possible and it is probably for the regulators to take a hard look at the situation and try to put their heads together in terms of defining this.

Q: Is there any way, one can ensure that a large part of the cash gets passed down to the shareholders through whatever form?

Parekh: No there is no way from a legal perspective. The company can indefinitely hold on to this dividend, this money which they don't need to pass on as dividend, because it is the company that decides and it is the board of directors that decides how long to keep this surplus money as reserves in their balance sheets. So, there is absolutely no way a shareholder can approach a court and say we wanted all this cash by way of dividend.

Q: Have this kind of incidents increased? Why is it that the incidence of this kind of what happened on Thursday is repeatedly being seen where it's more about the promoters selling a large chunk and basically sitting on a large kitty of cash?

Parekh: Very often this money goes to promoters through structured holdings. It is not as if in most companies the cash doesn't sit in the companies in the first place. So, there is not much cash to give out. However, the real issue is corporate governance and as you said companies like these typically keep coming back to the market.

Indian investors including Indian institutional investors need to pull their socks up and penalize these companies in the long-term, not just tomorrow morning when the stock price falls but after five years when they come back to the debt or equity market. These kind of companies ought to be penalized and that's the only market discipline which would limit deeds which maybe legal but which may kind of cross the boundaries of good corporate governance.

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