Protecting interest of the minority shareholders

Business, Corporate Governance

In Asian countries including Bangladesh, the controlling ownership of public listed companies are dominated by some families. The problem of minority exploitation may arise when the ownership is highly concentrated in any specific group, especiallyfamilyownership. One of the consequences of this is the expropriation of minority shareholder rights. Apart from family control another limitation of principles of corporate law is the principle of majority rule, sometimes called the “ supremacy of majority” rule.

Those who invested more in the company bear a greater risk in the event of a businessfailure, but simultaneously they have a greater degree of control over the company. There is certainly a risk that the majority will take advantage of the minority and that a company will be run at the expense of the minority shareholders. Any decision of Annual general meeting (AGM) adapted by majority vote and directors are appointed and may be removed from the office at any time by a simple majority at the general meeting.

Thus, the directors are motivated to act in the best interests of the majority who appointed them and who may remove them. Minority shareholder rights expropriation occurred when family ownership directed cash to their own benefit, inefficient projects and connected lending to relatives and friends rather than return it in dividends to minority shareholders. Other expropriation can take the form of profit reallocation, assets misuse, transfer pricing, sell below the market price departments or parts of the firm to other firms that major shareholders own, or acquisition of other firms that major shareholders own at a premium.

The majority shareholders treats the company as his own, and acts accordingly, to the detriment of the other shareholders, or where there is a breakdown in the relationship of the shareholders or any of their number, which gives rise to questions about the future ownership and control of the Company. On the other hand, where a single or small number of shareholders hold a substantial block of shares in the company, say, in excess of 25% of the voting rights, securing managerialaccountabilityto the shareholders or at least to the controlling shareholders through the traditional governance mechanisms of company law can dominate the company.

In some situation, the ‘ non-controlling’ shareholders may collectively hold more voting shares than the ‘ controlling’ shareholders. However, if the non-controlling shares are widely dispersed, effective control of the company will lie in the hands of the block-holder, even if that block consists of less than 50% of the voting shares. The shareholder providing the majority of the capital may sometimes not control the company.

In such a case the majority shareholder is effectively in a minority position with regard to the exercising of controlling rights. The emergence of such a situations are the principal/agent problem between the controlling shareholders and the non-controlling ‘ minority’ shareholders. The corporate management law and policy must have protection of interest of the minority shareholders. The general purpose of minority protection instruments is to prevent the abuse of power by the major shareholders.

There is not an easy solution, to the problem, since the principle of majority rule, in company law and other rules of regulators. It is a long established principle of corporate law that the regulators and courts should not intervene in business decisions due to the nonintervention policy or internal management principle. There is no statutory law of anywhere contains a definition of the minority or majority shareholder. The distinguishing factor between the two is the degree of control over the corporation.

The number of shares owned is not decisive, even a shareholder owning a majority of shares may be a minority shareholder, if other shareholders are well organized and, thus, control the company. The company must follow the principles ‘ partnership’ and consultation aims at balancing the interest between major and minor shareholders, and usually do not infringe minorities rights through guaranteeing at least the following minority rights such asrespectof opinion of major shareholders toward minorities, the right of minorities to be heard on regard of business matters and exit rights.

The limited Liability Companies, which are, in practical terms, run, as if they were a partnership, between the persons who are shareholders of same, might be regarded by the law, as " quasi partnership". The OECD principles on Corporate Governance (2004) provide that: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

The protection comes from better legal protection, stronger structure of the internal control mechanisms and more efficient capital markets and market

for corporate control. One of the methods to ensure the minority rights is to follow good Corporate Governance principles because there exists a relation between the level of protection of minority shareholders and incorporation of good practices of Corporate Governance. The separation of ownership and control in corporations with dispersed ownership structure highlights the agency issue due to conflict between agents (directors) and principals (shareholders).

Due to a different agency problem that arises on account of the conflict between dominant and minority shareholders. The minority shareholders can be empowered by ensuring control over the management and board of directors. The board of directors are accountable to the shareholders as a class is to make it easy for the shareholders to convene meetings to consider the removal of directors, evaluate the board’s performance and remove directors of whom they disapprove.

The minority shareholders are afforded the remedies if the majority shareholders, violate a personal right of a minority shareholder, then he can file a personal action against the wrongdoers to rectify such a violation of the articles of association of the Company or of the terms of any shareholder agreement etc. With increasing instances of corporate fraud around the world, another remedy is provisions for class action suits. Class action is a law suit brought by one or more individuals on behalf of a large group of people who have the same complaint.

In certain circumstances, minority shareholders may bring a common law derivative action, on behalf of the company, against the wrongdoers, who

committed a wrong to the company. Wrongdoers can be shareholders and directors of the company, as well as third parties. In order to be able to proceed with a derivative action at common law, the minority shareholders must have legal options to persuade the courts, that the company’s decisions by majority shareholders are not to pursue a remedy for the wrong done to the company which amounts to a " fraud on the minority" .

Another Statutory remedy is of petition to winding up of the company on a just and equitable ground. There is hearsay that few sponsors / families are responsible for share scams causing huge loss of small investors. Security exchange commission (SEC) has such views with perceived experiences of two share market debacles and issued a notification on November 22, 2011 imposing conditions that all sponsors / promoters and directors of a listed company shall jointly hold minimum 30% share of paid up capital of the company. Moreover, each director shall hold minimum 2% of the paid up capital.

In case of vacancy of anyone holding 5% share shall be entitled to be directors. The publicly listed companies have usually 15 directors and they will hold 75% of the share and voting rights of the company. This means the companies will gradually go under control of few limited persons who have capacity of investment of sufficient amount. SEC has in mind that, mandatory provision of higher shares will prevent such future stock market debacle. But as per investigation report of Mr Khondaker Ibrahim Khaled, accepted by all, there are many organizations including SEC are jointly responsible for disaster in stock market.

The public companies are controlled by few families and the directors are ‘ elected’ from same family by rotation and under full control of families. They retire due to compulsion of retirements as per law. Small shareholders are awarded a gift pack and nominal dividends in AGM and have no say against the decision of these controlling families. Companies go for public share to generate fund for investments but shall fail to generate fund with higher investments of sponsors and directors.

The over investment of sponsors / directors will not bring sufficient share in the market and the market will remain at the present status of low investment. India has totally different legal framework to safeguard interest of small investors. Indian Companies Act 2013 under section -151. A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed. For the purposes of this section “ small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

There is no policy of a designated directorship of choice of minority shareholder nor there do any provision to control, appoint or remove any director. The global law and policy is to protect the rights of minority shareholders but in contrary Bangladesh SEC make legal provision of make the minority shareholder marginalized and have no option to exercise their rights due to majority rule and lose their voice. The decision of higher investment of directors is not good for stock market and should be amended

to find way out to safeguard interest of minor shareholders from the proven experience of other markets.