Mutiny of the Minority Shareholder

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In what would be a first for India, a minority foreign investor, and that too a hedge fund looking for capital gains, has challenged the right of the government to pursue policies it presumes is in the national interest. The company involved here is Coal India, considered one of the world's largest coal producers in a country that has among the largest coal reserves. Not too long back, in October last year, a government in search of receipts from privatisation decided to sell 10 per cent of the equity in India's publicly owned coal-producing giant. The sale, through an initial pubic offering, attracted bids at the top end of the Rs. 225 to Rs. 245 price range, valuing the company at $35 billion.

What is more the issue was oversubscribed to the extent of 12 times the offer on the third day of the IPO. This should not have come as a surprise. The company had recorded profits of close to Rs. 100 billion in the year prior to the issue. It had rights to mine large coal reserves access to which was being eased by relaxing environmental norms whenever required. And it was sitting on a cash reserve of close to Rs. 400 billion, a part of which it claimed was to be invested in acquiring assets globally.

Further, this trophy buy was being put on sale when huge quantities of cheap liquidity had been pumped into the world economy in response to the crisis. Financial institutions with access to near-zero cost funds were rushing into emerging markets that had not done too badly during the crisis years and were open to foreign investment flows. India was one such country and Coal India one such beneficiary.

Among the investors who successfully picked up a stake in Coal India, to emerge the largest foreign investor in the company, was a hedge fund with an unusual name: The Children's Investment Fund (TCI). But it is not TCI's name that has brought it to the attention of the Indian state. Rather it is the fact that the fund, despite being a relatively small minority shareholder with an estimated 2 per cent stake, has decided to challenge Coal India's policies and practices. In a letter sent on March 12, reportedly addressed to the members of Coal India's board (**Financial Times, March 13, 2012**) the fund has accused the company of acting against the interests of its shareholders by "not acting independently of India's government" and through "acquiescence to interference by the Prime Minister's Office" on coal prices, among other things. As evidence it has produced a letter obtained under the Right to Information Act written by the Secretary, Coal, Government of India, instructing the company to reverse a decision that would have hugely enhanced the profits of the coal producing public monopoly.

The main issue here is Coal India's reversal of its early-2012 decision to adopt a pricing mechanism under which coal was to be priced based on its gross calorific value (GCV) rather than its useful heat value (UHV), which was the principle adhered to till then. While justified by Coal India on the grounds that this would ensure parity with international prices, the change in pricing principle was opposed by user industries with the NTPC arguing, for example, that it would raise the price of certain grades of coal by as much as 179 per cent and hike power generation costs by as much as 40 per cent. This was tantamount to Coal India exploiting its monopoly at the expense of the rest of the economy.

Faced with the opposition, and pressure from its parent Ministry, the company decided to go back on that decision at the end of January, resulting in an average 12.5 per cent fall in prices that would be implemented with retrospective effect from January 1, 2012. TCI finds this and other policies unacceptable, on the ground that it works against the interests of minority shareholders and smacks of being "reckless and lacking integrity".

Campaigns such as this are typical of TCI's strategy. The Children's Investment fund was established by a successful hedge fund manager, Christopher Hohn. Son of a Jamaican car mechanic, with degrees from Southampton University and the Harvard Business School, and an enviable track record in the hedge fund business, Hohn was unusual. He established an activist hedge fund with an aggressive strategy. Supported by pension funds, insurance companies and investors like the Yale University endowment, he invested in companies assessed as being capable of increasing shareholder value if they are restructured through mergers or asset sales. He often, therefore, used TCI's presence as a shareholder to force even dramatic changes in company policy, taking on big players if necessary. Thus Hohn is famous for two major activist forays, among others. The first was his campaign in 2005 to stall the bid by Deutsche Börse to merge with the London Stock Exchange, resulting in the exit of Werner Seifert who was then the Chief Executive of the former. The other was his role in 2007 in pushing ABN Amro to sell out to the Royal Bank of Scotland. What was shocking was the ability of Hohn to influence these deals with his own profits in mind, though he was by no means a dominant shareholder. With activism of this kind and an ability to deliver returns of 40 per cent during the good times, Christopher Hohn gained in notoriety.

However, he tempered this aggressiveness through his philanthropic side. He set up along with his wife the Children's Investment Fund Foundation (CIFF), a charity working with children in Africa, Asia and elsewhere to which he diverts a share of the profits derived from TCI. CIFF is now one of Britain's largest charities. As The Economist noted as far back as 2007, "Charity may be good for business. Not that there is any doubt of Mr Hohn's sincerity—close friends say he is passionate about his charity in private—but his philanthropy may prove useful protection. The commercial success of active investors, in the form of both hedge funds and private equity, has made them politically vulnerable. Attacks on the locusts have spread from Germany to Britain, America and Japan over the past year; trade unionists, politicians and journalists have called for their activities to be restricted. In this atmosphere the decision to funnel TCI's profits to the poor looks less like an act of insane generosity than a remarkable piece of far-sightedness."

It is an aggressive player like Mr. Hohn who has now decided to take on the public sector in the form of Coal India. What is important is that he has declared that once the government divests equity in a company to mobilise resources for its budget, then the company can no more act under instructions from the state. In what amounted to a threat, Oscar Veldhuijzen, a partner at TCI reportedly told the Financial Times: "Coal India have to understand that if they mess around and treat their company like a 100 per cent government-owned entity, it will have major implications for the future of Indian capital markets."

The government is unlikely to be immediately cowed down by that threat since it holds too large a stake and has given foreign investors like TCI the right to exit if they are not happy with the functioning of the company. But this is a government that is extremely concerned about the sentiments of foreign investors. Moreover, TCI's protest may be the first shout in what could become a campaign. Foreign investors, even minority ones, who have come in droves into the country and bought into the public sector, may declare any policy that limits profiteering in the interests of development as amounting to oppression of minority shareholders. And that may cow the government down. Liberalisation by definition reduces the policy space open to government. It sets new terms for the relationship between the state and private capital, giving the latter an edge. What this experience suggests is that this can happen when even the capital brought in post-liberalization is a small sum and that capital derives profits from assets created largely with public money.

* This article was originally published in the Hindu on 14 March, 2012.