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EXPERT TAKE | **RAJEEV THAKKAR** CEO, Parag Parikh Financial Advisors

Check Out The Management Before Investing In A Stock

MOST investment analyses relate to numbers. These numbers could be sales, profits, growth or earnings per share in relation to a company or they may be numbers like GDP growth, trade deficit, manufacturing growth, money supply in relation to the economy.

Recent developments have highlighted an often ignored area of analysis. The analysis that I am referring to does not have an output in numbers. It is qualitative in nature. However, it may have far greater importance than numerical analysis when it comes to investments. This refers to the quality and character of management and the inher-ent soundness of a sector.

Whether it is the 2G scam, the bribes-for-loan scam, the mercenaries-to-manipulate stocks scam or Satyam — it was not the financial num-bers that led to the downfall of companies. At the end of the day, it was not whether the reported results met the quarterly forecast in Satyam that mattered. What mattered was whether the reported numbers were accurate. What mattered was whether the man-agement was manipulating their stock prices to the detriment of minority shareholders.

In sectors where even the best-managed companies have to continuously lobby for favours and where there are ever-changing regula-tions, it is hardly a surprise that there are wild fluctuations in the for-tunes of the participa-nts in these sectors. In telecom and real estate, where regulations are complex and change continuously and are also open to different interpretations, how can analysts make financial projections far into the future? It is best to ignore such sectors and re-strict one's investments to more predictable sectors.

Similarly, if there is a case where the promoters of a company are known offenders in criminal, taxation or economic offence matters or have acted against minority shareholders' interests, it is unrealistic to assume that such promoters will not repeat such offences.

There are many cases where the promoters and managers of companies have no dividing line between personal and corporate expenses. All expenses for such individuals come from the company's coffers and minority shareholders are poorer to that extent.

It's not that these points are not well-known to the investing public. Despite knowing the importance of management quality and character, most investors tend to ignore it:

- **How do** we evaluate whether a promoter is honest or not? Today, it is easier than ever before to find out the antecedents of companies and promoters. All regulatory actions and media reports of the past are archived on the internet and a simple web search can give the background of most companies.

- **What's the** guarantee that a promoter appearing honest will not cheat in the future? It's true that there is no protection against first-time offenders. However, we can surely guard against repeat of-fenders. If unscrupulous promoters fool investors once, it is their fault. If they fool them twice, it would be the investing public at fault.

- **These promoters** "only" cheat the government/customers/ suppliers/ employees. They are wealth creators for shareholders. Why should we not invest with them? This is the most ingenious argument put forth by investors. Where a person is a habitual cheater with one stakeholder, the chances are very high that the same treatment will be given to other stakeholders.

In a scenario where the promoters may own more than 50% of the shares and the minority shareholders own a tiny fraction of the share capital, there is very little that the small investor can do to influence company actions. In such a scenario, the only option available to the small investor is to stay away from companies, promoters and sectors which are prone to give negative surprises to investors.

At the annual general meeting (AGM) of a well-known company, the promoter who was irritated by the pesky questions of a minority shareholder told him to sell the shares if he did not like the way the company was being run. A better approach would be to never buy shares in companies which are not run to your liking.