

SHAREHOLDER ACTIVISM IN INDIA - THE NEW WAY FORWARD FOR CORPORATE GOVERNANCE

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Abstract: *Businesses in India have traditionally been organized around strong promoters. Small shareholders have conceded complete control and ownership to the promoters and just hoped that they would make a return on their investment when the company did well. Not only was there little regulation to give them a say in the matters of their investee company, there was also a sense of general lethargy in taking affirmative action to protect their interests. Promoters too have traditionally run their companies fulfilling the bare minimum requirements of being transparent to their institutional and minority shareholders. These minimum requirements have been defined by whatever was required by regulation at different times. More recently, with the primary source of information evolving from mass media to social media, institutional and minority shareholders are becoming increasingly aware of their company's actions. They now have ready access not only to information, but also to the opinions of experts and a combination of these factors is getting them to gravitate towards a larger role in how their investee companies are run. This paper focuses on how Shareholder Activism, a recent phenomenon, has evolved in India and proposes the actions that corporates and promoter managements can take to avoid being a target of shareholder activism.*

Keywords: *Blockchain, Corporate Governance, Proxy Advisory Firms, Shareholder Activism, Shareholder engagement, Minority Shareholder, Institutional Investors.*

Introduction

Oxford defines "Activism" as the policy or action of using vigorous campaigning to bring about political or social change. Activism is primarily about pushing vigorously for change in status quo. When shareholders of a company turn to activism because they believe that the company's management is not acting for the true purpose they were hired for - maximizing the company's potential - this is called Shareholders Activism. Another way of looking at shareholder activism is that this is the way in which those shareholders who are not a part of the company management - assert their power as part-owners of the company. The idea of shareholder activism is not new. In fact, scholars have previously defined Shareholder Activism in the following manner:

Bernard Black defined Shareholder Activism as "any formal or informal effort to monitor corporate managers or to communicate a desire for change in a company's management or policies" or "as a proactive effort to change firms' behaviour or governance rules."

Gillan and Starks (1998) defined Activist Shareholders as "the investor who exercises shareholder activism tries to change the status quo through 'voice' without effecting a change

in corporate control.” They define Shareholder Activism as an intermediate action on a continuum of responses to corporate performance, which has two extreme types of responses (i.e., selling shares and taking over management control).

The end objectives of shareholder activism could range from an intention to replace the entire board of the company, oppose appointment / reappointment of the promoter as managing director, raise environmental or governance concerns, protest profit distribution, change internal culture. It can also be when shareholders propose changes to company policy, or seek disclosures on certain issues, or even urge company’s executives or directors to take certain actions. Shareholder activism could sometimes target an extreme intention to even change the business model of a company.

The shape of shareholder activism is often defined by the type of investor and what they want. It can be in the form of a proxy contest at a company's annual general meeting, threats of litigation, actual litigation in court of law, negotiations with the management or board, running media campaigns to create pressure; all these to force a conversation and bring about change.

Objectives of the Study

The primary objectives of the study are

- a. To explain shareholder activism as a form of forced move to greater corporate governance
- b. To analyse the factors supporting growth of shareholder activism:
 - i. Support from the regulators - Companies Act, 2013 and SEBI.
 - ii. Support from the market forces.
- c. To propose changes that corporates & their promoter-managements can adopt to possibly reduce the need for shareholder activism

Research Methodology

- a. The study analyses the reasons for shareholder activism and how it is manifested in reality.
- b. The study explores the support that shareholder activism in India received from the regulators and from the Proxy Advisory Firms.
- c. The study also lists the impact that shareholder activism has on target management.
- d. The study closes with recommendations to the management on increased transparency in corporate governance to help them avoid expensive shareholder activism.

Scope and Limitations of the Study: The study limits only to shareholder activism in India, the regulatory reforms and proxy advisory firms promoting shareholder activism and the negative impact on promoter managements.

The information is purely gathered from secondary sources.

IV. Analysis and Interpretation

A. Objectives of Shareholder Activism

Shareholder activism tends to address various issues that may be financial or non-financial in nature.

Financial issues range from matters pertaining to distribution of profits, cost cutting, management & directors' remuneration, changing business model to increase shareholder value, address capital inefficiency, management or resource under-performance, etc.

Non-financial needs that lead to shareholder activism may include a greater accountability and transparency of environment degradation and social performance, ensuring good governance within the company, or change in internal structure of the company due to poor management by the board of directors, poor work culture, unethical behaviour of the company, appointment or reappointment of management or board. Activism may also address the issue of an unresponsive management to force them to bring to the table and communicate.

B. Tools Used by Activist Shareholders

Activist shareholders can use different tools to advance their agenda for the desired changes. The choice of these tools are generally decided by the type of investor and how radical a change they are pushing for. The most common forms of shareholder activism include:

1. Shareholder resolution

This is a proposal that can be submitted by the shareholders for a vote at the company's annual general meeting. Generally, the management of companies resist such submissions of shareholder resolutions, this activism method is reasonably effective to engage the attention of other minority shareholders and the public in general.

2. Proxy Fights

When a group of shareholders is not content with the company's management or its actions/decisions, it may engage in a campaign to persuade other shareholders to use their proxy votes to effect the required changes. A proxy vote is a form of voting where a shareholder is not willing or is not able to attend the shareholders' meeting and delegates their voting power to a representative. The Activist Shareholder may collect these proxies and consolidate the voting power they represent to vote against the management.

3. Media campaigns

An activist shareholder may use mass media to draw the public's attention to a problem or issue in a corporation. Such publicity campaigns can be used to put pressure on the company's management. These days, Twitter is an actively used platform for running media campaigns by activist shareholders.

4. Negotiations with management or the board of directors

Sometimes, activist shareholders can reach their goals through a simple negotiation with corporate management or the board. However, getting to such negotiations are sometimes difficult without engaging in the other tools of shareholder activism.

5. Threats of Litigation or Actual Litigation

Activist shareholders can also threaten to initiate or actually initiate legal action against the company's management to push their agenda. However, this option is the least desirable for both parties because this generally results in a significant loss of reputation. And a loss in a company's reputation is essentially detrimental to both - the management and the shareholders (activist and otherwise). The litigation processes are extremely expensive for both parties.

C. Role of Regulators in Empowering Non-Promoter Shareholders

With the development in the capital market, it is now possible for the institutional and individual investors to have some say in the decisions of the investee corporation. With the introduction of new procedures, it is now possible for the investors to express their views and actively work for their interests. The growth of shareholder activism has been aided both by the efforts on the part of the regulators to encourage shareholder participation in corporate decision making, and by the assumption of an activist stance by institutional investors in the Indian market.

1. Electronic Voting

The top 500 listed companies on the BSE and the NSE now provide e-voting facility and gradually are being incorporated by all listed companies. The Companies Act 2013, requires all listed companies under Section 108 to provide for electronic voting on shareholder resolutions, allowing minority stakeholders to put across their thoughts on the agenda without having to travel to distant places.

2. Approval to related party transactions by Minority Shareholders

Section 188 of the Companies Act 2013 requires all related party transactions to be approved by shareholders through special resolution. In November 2014, Siemens India proposed to

sell the company's Metals Technologies Business to its German parent. Since the proposal was a related party transaction, it required approval of minority shareholders, via a special resolution. The minority shareholders rejected the offer price as too little. Consequently, Siemens Germany revised the offer price from Rs 857.2 Cr. to Rs 1,023.27 Cr. Further, In the case of United Spirits, minority shareholders rejected as many as 9 related party transactions with Vijay Mallya entities.

3. Clause 49 of the Listing Agreement

Under the Clause 49 of the listing agreement by SEBI, it has now become mandatory to encourage the participation of the minority shareholders. A regulation in this regard was that all related party transactions were to be approved by 75% of the small shareholders. This was later brought down to 51%.

4. Small Shareholders Director

Section 151 of the Companies Act 2013 requires listed companies to appoint at least one director elected by small shareholders. This requirement is not mandatory and there are certain conditions attached as laid by Rule 7. Small shareholders for this purpose means shareholders holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed. This is in addition to clause 49 of the stock exchange's listing agreement which prescribes for half the board of directors to be independent (in case the chairman of the board is a non-executive director, then at least one-third of the Board should comprise independent directors).

5. Shareholder Class Action Suit

Section 245 of the Companies Act 2013, deals with class action suits that can be filed by a certain number of members, depositors or any class of shareholders or depositors. This section enables investors to file a class action suit before the Tribunal against decisions of the board which might be contrary to the Articles or Memorandum of the Company or which seems to be violating the provisions of the Companies Act. Where the shareholders or depositors seek any damages or compensation or demand any other suitable action against or from an audit firm, the liability shall be of the firm as well as of each partner who was involved in making improper or misleading statements of particulars in the audit report or who acted in a fraudulent, unlawful or who acted in a wrongful manner.

6. Oppression and Mismanagement

These refer to the practices of managing dishonesty or any violation of Memorandum of Association and Articles of Association, Statutory Provisions, Rules, Regulations or any

fraudulent practices The Companies Act 2013 allows any number of minority shareholders to file proceedings against the company under Section 241 of the Act. It is interesting to note that what constitutes minority in this regard is left to the tribunal. If the Central Government comes to a conclusion that affairs of the organisation are being conducted against the interest of the shareholders. It may itself apply to the tribunal for an order.

7. Enhance participation of Institutional Investors

The Government of India and SEBI have made consistent efforts to encourage participation of mutual funds in corporate decision making. In 2010, SEBI issued a circular to mutual funds requiring them to exercise their voting rights in the investee company in an accountable manner. This circular requires the asset management companies of these mutual funds to disclose on their websites and their annual reports, their general policies and procedures regarding the exercise of their votes in the listed companies.

D. Role of Proxy Advisory Firms in supporting Shareholder Activism by Institutional Investors

Data showed that till 2010, the Indian institutional investors had traditionally been concerned with non-routine corporate actions (such as M&As, company restructurings and such) of their investee companies. This data was collected on various parameters including routine businesses like related party transactions, sale of business assets director tenures, appointments, remuneration, etc., role of independent directors, auditor appointments, fundraisings - equity or debt, etc.

However, over time, the Institutional Investors have been feeling the need for taking a more active role in keeping a tab over the management of their investee companies. And if required, these Institutional Investors actively seek to take action to protect their interest in the investee company and indirectly the interest of their own unit-holders.

Now-a-days, institutional investors use proxy advisory firms (“PAF”) for support on such decisions that may take them in the direction of Shareholder Activism. A PAF is defined as a firm that offers voting recommendations to institutional investors (mutual funds, insurance companies, foreign institutional investors, private wealth management firms, etc.) on shareholder meeting resolutions of their investee companies.

The concept of PAFs emerged in the United States with the greater regulation of institutional investors by the Securities and Exchange Commission (“SEC”). When the SEC made it mandatory for institutional investors to vote on ALL items in their companies’ proxy statements, PAF’s stepped in to carry out market research and make recommendations to the

Institutional Investors on such proxy proposals. Today, PAFs are very influential in the United States as the US institutional investors rely heavily on their recommendations when voting.

With the advent of PAF's, the Institutional Investors can now use shareholder activism more effectively as they are now able to effectively club their interests and collectively use of the rights of shareholders to change undesirable state of affairs in the corporate operations or to influence the management in governing the company, as they remain invested in the company and protect their interests.

In 2010, SEBI drew up a mandatory requirement for domestic mutual funds to disclose their voting policies and voting actions at their investee companies. This provided an opportunity for the genesis of PAF's in India. The sphere of influence of PAFs in India is less apparent than in the US, but it is certainly evolving rapidly. There is insufficient empirical data to show how adverse recommendations may have influenced decision-making in Indian companies, it is clear that conceptually PAFs play a key role in promoting dialogues on corporate governance, usually by getting companies to respond to negative voting recommendations.

A relevant example of the role of Indian PAFs could be the negative recommendations that Indian PAFs had made regarding Maruti Suzuki's 2015 proposal to procure auto parts from a manufacturing plant owned by Suzuki, instead of manufacturing them for captive use. Opposing the move, Maruti's institutional investors sought SEBI's intervention to stop this "related-party-agreement" and safeguard the interests of minority shareholders. Private sector mutual funds and insurance companies - owning nearly 7 per cent of the company - led the opposition.

Sensing the adverse shareholder mood that this report created, Maruti Suzuki was forced to publish its rationale for the decision. While ultimately the Maruti Suzuki shareholders approved the proposal with a significant majority, the role of the Indian PAF and the impact of its recommendations on this proposal highlighted the increasing role that the PAF's will increasingly play in shareholder activism in India.

In Govern Research Services is one of the first such PAF's. They started as India's first proxy advisory services company in June 2010. Another significant proxy advisory firm in India is Institutional Investor Advisory Services India Limited (IiAS). Its website informs that it is dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder

resolutions. IiAS has equity participation by Aditya Birla Sunlife AMC, Axis Bank, Fitch Group Inc., HDFC, ICICI Prudential Life Insurance, Kotak Mahindra Bank, RBL Bank Limited, Tata Investment Corporation, UTI Asset Management Company Limited and Yes Bank. IiAS is also SEBI-registered.

Findings / Results

Shareholder Activism is an important aspect of growth of capital markets. As it pushes for increased transparency and pushes the agenda away from benefitting the promoter to benefitting all shareholders, it is an overall value-accretive aspect of capital markets.

Impact of Shareholder Activism on Promoters and Managements

Recent instances of shareholder activism in India and overseas have had a significant change in the mindset of company promoters, directors, managers and institutional investors. Managements and Boards have started to recognize the futility of having activist shareholders run campaigns against them. For management, the adverse impacts of shareholder activism are as follows:

1. In worst cases, activist shareholders can have the complete management replaced with a new one
2. Activist shareholders may make the company vulnerable to hostile takeovers
3. Shareholder activism can lead to expensive litigation
4. If activist shareholders launch adverse marketing campaigns, this can cause significant reputation loss to the company - which may not only have a direct impact on sales but also impact customer and supplier relations.
5. Shareholder activism nearly always leads to a distraction for the company's management away from the day-today running of the operations to managing the activist attacks
6. Such activism may also attract the attention of various regulators - security regulators, labour regulators, environmental regulators, etc. - to the company's operations
7. In most cases, shareholder activism may also cause (in the short term) an erosion in market capitalization, leading further to increased difficulties in tapping capital markets

Therefore, the Boards and Senior Executives are increasingly thinking like activists while making strategic corporate decisions. Companies now take into account a potential activist challenge that they may come across with their decisions impacting capital allocation, corporate governance, operations, environmental impact, ethics, etc.

Impact of Shareholder Activism on Corporate Governance

The growing impact of Shareholder Activism has led to some positive changes in the approach towards corporate governance. Some of these impacts are:

1. Some companies and institutional Investors have shifted their focus from a pure profit-oriented outlook, to a well-rounded approach to investing into companies and projects which have strong positive social and environmental impacts.
2. Managements are increasingly thinking and acting like activist shareholders internally to preempt potential attacks from the outside shareholders.
3. There is an increased two-way communication between the company management and minority / institutional shareholders, thus enhancing shareholder engagement.
4. Managements now have access to new ideas about the utilisation of organisational assets, improvement in operations or enhancement of shareholder value. This is another favourable influence that Shareholder Activism has brought about.
5. An external push for changes to management or management style or company's culture generally has a positive effect in renewing a company's traditional approach.

Recommendations for Managements and the Way Ahead

As the regulators and market forces (like PAF's) help strengthen Shareholder Activism, there are steps that the current managements can take to enhance corporate governance, and thereby preempt the need for shareholder activism. Some of these are proposed below:

1. Setting up of Minority Shareholder Forums to enhance engagement

Companies can set up third-party administered forums for their shareholders to exchange ideas among each other and with the management. These forums will benefit the management by giving them a pulse of shareholder opinions. Once the management is in the know, it can act upfront to please the minority shareholders. However, if the company finds itself in a position where it can not follow shareholders' suggestions and opinions, it can start media campaigns to help change in advance the shareholders' opinions, before they turn into shareholder activism and cause damage to the company's near-term goals.

2. Use of Blockchain Technology in Corporate Governance

Blockchain Technology provides for a decentralised ledger of transactions that can not be controlled by a single person or a group. By virtue of being decentralised and immutable, blockchain technology finds applications across those use cases where the users need to know that there is no manipulation.

Therefore, by being immutable, and completely resistant to external or internal manipulation or hacking, the blockchain technology provides an ideal platform for Corporate Governance solutions.

By implementing blockchain-based applications for shareholders, companies can signal their focus on transparency to their minority and institutional shareholders. Minority and Institutional Investors can, in turn, provide opinions to their management on various matters and therefore help establish a two-way communication that is not a slave to an Annual General Body Meeting.

3. Independent Annual Review Report of Performance of the Board

If boards can adopt an independent review of their performance by an independent third party and this report were to be shared with the shareholders, this would go a long way in calming down shareholders and preventing them from activism. The Board could get itself reviewed on its performance by independent third parties like Credit Rating Agencies (ICRA, CARE, etc.) or even by Proxy Advisory Firms.

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