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“SHAREHOLDER ACTIVISM IN INDIA: AN OVERVIEW.”

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I. ABSTRACT:

“Importance of a shareholder for a company is the same as that of a brain to a human body. It is the shareholders for whose benefit a company runs. It is the shareholders’ money which is used as the capital by the company to achieve its objective which requires a significant role to be played by them in the affairs of the company. The company law framework provides for innumerable rights to the shareholders outlining their significance for the existence of a company by providing them with the required safety for their capital invested. This article highlights the meaning of shareholder activism and the reasons for the increasing trend towards this concept. Also, it outlines various methods by which shareholder activism can be strengthened.

A company is an association of persons. A company being an artificial person acts through those who are capable of taking a decision on its behalf and have a brain, i.e. natural persons. There are various classes of natural persons associated with a company. One such includes the Shareholders. Although even an artificial person can be a shareholder, yet again there are natural persons associated with such a company shareholder. So ultimately it is the natural persons who are behind the working of every artificial person. The role of shareholders is very significant in the working of a company. Their function can be broadly said to be twofold- setting up the governance mechanism of a company and supplying capital to the company to help it achieve its objective. It is the shareholders’ money which is used as the capital by the company to achieve its objective which requires a significant role to be

played by them in the affairs of the company. The company law framework provides for innumerable rights to the shareholders so that their money is not wasted or used in a way not approved by them. CFA Institute, in one of its publications, has preferred the term 'Shareowners' instead of 'Shareholders', giving the reason that share-holding connotes a limited or passive engagement, comparable to the role of a custodian, whereas share owning connotes more participation through exercising one's rights and engaging actively.¹

II. MEANING:

One of the recent developments of the corporate regime is the concept of shareholder activism. Even though not of a recent origin, yet has gained momentum only in the near past. Going by the definitions of some scholars, Shareholder Activism was defined by Bernard Black 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 “proactive effort to change firm behaviour or governance rules”. Hernández-López (2003) defines shareholder activism as “any action a shareholder may take, based on his [sic] rights as a shareholder, with the objective of influencing the management of the corporation”.

Gillan and Starks (1998) maintain “that an investor who exercises shareholder activism tries to change the status quo through ‘voice’ without effecting a change in corporate control. They conceive shareholder activism as an intermediate action on a continuum of responses to corporate performance, which has two extreme types of responses (that is, selling shares and taking over management control)”². A study of all these definitions clearly reveals that shareholder activism is primarily about bringing a change in the company as desired by the shareholders. A change can be desired by the shareholders because they have an important role to play in the company and because they have rights in it by virtue of which they want to influence the management of the company to work at their desired ways.

¹ An Investor’s Guide to Shareholder Meetings in India: Rights, Roles, and Responsibilities, CFA INSTITUTE (May, 2014), <https://www.cfainstitute.org/-/media/documents/article/position-paper/an-investors-guide-to-shareholder-meetings-in-india.ashx>.

² Han-Kyun Rho, On Defining Shareholder Activism: Exploring The Terrain For Research, CORPORATE OWNERSHIP & CONTROL, <https://pdfs.semanticscholar.org/e886/e26294f9e49ebd08ee225e3c1c0734fbd4b5.pdf>

III. WHY SHAREHOLDER ACTIVISM?

Initially, shareholder passivity pervaded especially in the retail shareholders in the corporate sector. Significant control exercised by the controlling shareholders over the management was the prime reason of retail shareholder passivity. Shareholding was seen by the retail shareholder as a mere channel of investment of funds without any real interest in the company's management because of which their participation in the management was nil. Even in exceptional circumstances where they took initiative to assert their influence, they could barely make any dent in the influence of controlling shareholders, who wielded significant control over their companies due to the substantial shareholding they commanded. Minor shareholding is not the only reason behind shareholder passivity. Even the institutional shareholders, who have a considerable shareholding in the company as compared to the retail shareholders, were treated as no threat because of the government and bureaucratic influences and control they were subjected to. Another category of institutional shareholders are foreign portfolio investors who had their shareholding through Foreign Institutional Investment route, seldom exercised their voting power.³

Massive downfall and crises in the corporate and financial sector provoked major reforms in the legal framework of the corporate regime. In the wake of corporate governance reforms, the idea behind any company related regulation is to make it shareholder centered. It is now realized that greater participation of the passive shareholders in the management of the company will help in combating the corporate scams and scandals which are prevalent primarily due to the unruliness of controlling shareholders where the minority shareholders have no say in the decision making of the company. The OECD Principles of Corporate Governance provide for equitable treatment of shareholders. It states "The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights".⁴ The participation of the passive shareholders can be strengthened firstly by making regulations for their minority rights such that even the

³ Umakanth Varottil, The Advent Of Shareholder Activism In India, RESEARCHGATE, (Sept. 16, 2019, 6:20 PM), https://www.researchgate.net/publication/256037311_The_Advent_of_Shareholder_Activism_in_India.

⁴ OECD Principles of Corporate Governance, OECD (2004), <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf>.

minorities have a right to influence the management; Secondly, by giving such passive shareholders the required recognition in the company so that they do not see their shareholding as merely a route for investment. They should be made to feel as an important part of the company by making them realize that they are not merely the investors but the owners of the company and thus have a say in its management. When such classes of shareholders get the right to influence the decision making of the company then the problem of mismanagement in the company will also get solved thus improving the corporate efficiency and ultimately strengthening the national economy. The above factors have majorly affected the Indian corporate legal framework to work in the direction of promoting shareholder participation. The Companies Act of 2013 has been enacted keeping these factors in mind and thus various rights of shareholders are incorporated in the statute. A step by step approach has been adopted by the regulatory reforms to address the issue. **The following reforms have been evolved:**

III.I VOTING METHOD:

Shareholders' most important right by which they take part in the company is the voting right. The meetings of the company are generally conducted at places where the non-promoter or non-outsider controlling shareholder usually reside. This created a problem for retail shareholders scattered in the country or around the world to travel all along to cast their vote. This issue was addressed by the introduction of voting by postal ballots under Section 192 of The Companies Act 1956. The system of postal ballot permits shareholders to send in their votes by post instead of personally attending and voting at a meeting. Certain resolutions were to be mandatorily put to vote by postal ballots.⁵

This provision is incorporated in the Companies Act of 2013 as well, under Section 110. To further alleviate the voting process, voting by electronic means has been introduced. It is incorporated under section 108 of the Companies Act 2013 read with Regulation 44 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and Rule 20 of the Companies (Management and Administration) Rules, 2014. E-voting has been made mandatory for top 500 companies listed on the National Stock Exchange (NSE) and Bombay

⁵ Id.

Stock Exchange (BSE).⁶ Now the shareholders have the option to vote from any place simply by accessing the internet or by any electronic means. This would do away with the cumbersome task of posting the votes. E-voting will also elicit greater participation of institutional shareholders and is also a cost and time-saving method.⁷ A step further, market regulator, SEBI is working on the development of a mobile app for E-voting by retail investors of listed companies to facilitate greater participation in management proposals as revealed by SEBI in its annual report for 2018-19.⁸ However, such a measure also requires transparency to be maintained to prevent the unscrupulous managements to manipulate the votes.⁹

III.II SHAREHOLDER MEETINGS:

For shareholders to make an informed decision in the management of the company, they need to attend the meetings of the company. It is only when they participate in discussions, a conscious decision in exercise of their voting right will be possible. Participating in the meetings would not only help in informed decision making but also will encourage them to put up their views and raise a voice. Mere participation in meetings is not enough but a thorough examination of the resolutions, companies' records and registers are also important. Advancement of technology has again played a significant role here. The regulators have recognized the impracticability of attending all the meetings physically by each shareholder. Provisions of electronic meetings through audio-visual means, video conferencing by companies have been introduced.¹⁰ Participation of shareholders in general meeting through video conferencing was introduced as a green initiative in corporate governance vide its General Circular dated 20th May 2011, under the Act of 1956.¹¹ No such provision is

⁶Umakanth Varottil, Emergence of Shareholder Activism in India, NSE, https://www.nseindia.com/research/content/res_QB1.pdf.

⁷ Lijee Philip, Mandatory E-voting gives Shareholders Upper Hand, THE ECONOMIC TIMES (Sept. 17, 2019 6:35 PM), <https://economictimes.indiatimes.com/news/company/corporate-trends/mandatory-e-voting-gives-shareholders-upper-hand/articleshow/38249628.cms>.

⁸ Sebi Working on Mobile App for E-voting to Facilitate Greater Retail Participation, ET MARKETS, <https://economictimes.indiatimes.com/markets/stocks/news/sebi-working-on-mobile-app-for-e-voting-to-facilitate-greater-retail-participation/articleshow/71034022.cms>.

⁹Postal Ballot: A Tool for Shareholders, FINANCIAL EXPRESS, <https://www.financialexpress.com/archive/postal-ballot-a-tool-for-shareholders/65716/>.

¹⁰ Supra 2.

¹¹ Anuj Sahay, MCA allows Video Conferencing for Board and Shareholder Meetings, PXV LAW PARTNERS, <https://pxvlaw.wordpress.com/2011/05/21/mca-allows-video-conferencing-for-board-and-shareholder-meetings/>.

incorporated in the 2013 Act, but it is still available as an option for the company. Appointment of proxies is yet again a step towards the encouragement of shareholders' participation. When it is not possible for a shareholder to attend a meeting physically and the option of meeting through video conferencing is also not exercised by the company, a proxy may be appointed. Any member of a company entitled to attend and vote at the meeting shall have the right to appoint a proxy to attend the meeting on his behalf under Section 105 of the Companies Act, 2013. A shareholder may appoint any person to attend the meeting as a proxy on his behalf. One person may be proxy for more than one member, provided that one proxy cannot represent more than fifty members or ten per cent of the total share capital of the company carrying voting rights as per Rule 19 of The Companies (Management and Administration) Rules, 2014. A proxy can vote when voting by-poll is demanded.

III.III VOTING AS RESPONSIBILITY:

While giving rights in the company, on one hand, would help achieve the purpose of shareholder activism, enforcing such rights as duties will help enhance the process. It is a well-established fact that when a sanction is attached to an act, its compliance increases as against the compliances towards an act with respect to which a reward is attached. But, since in this case attaching a sanction to not complying with the right to vote, attend the meeting is not practical. However, if the shareholders are made to understand that they have a responsibility or duty towards the company to exercise their rights, would help. The regulatory authorities have begun to adopt market-based approaches to address passivity among institutional investors. In a move that is somewhat unconventional in the Indian context, SEBI has sought to exhort a specific type of institutional investor, i.e. mutual funds, to exercise their voting rights in investee companies in a responsible manner. In 2010, SEBI issued a circular to mutual funds requiring them to “play an active role in ensuring better corporate governance of listed companies.”¹²

III.IV INSPECTION OF RECORDS:

One of the key responsibilities of the shareholders is to install the governance mechanism of the company. There is a divorce of control from ownership so it becomes important to keep a check on how far the installed management is successful to run the company on behalf of its

¹² Supra 2.

owners. This check can be effectively exercised by way of inspection rights given to the shareholders. A shareholder can inspect the minute books of meetings, register of contracts, register of shareholding of directors, key managerial personnel etc. They can also take copies of such records and registers. These records help the shareholders to be thorough with what is going on in the company and how the management is performing and accordingly further decisions is can be made by them.

Although the right of inspection is given to the shareholders under the Companies Act, 2013 but the statute lacks regulations with respect to transparency and accountability in disclosure of information to the shareholders to exercise their rights in a more vigilant manner.

IV. ROLE OF INTERMEDIARIES:

Shareholders may have shares in more than one company. It is not possible for them to exercise their corporate rights in each of the cases. Lack of proper information and professional understanding of the corporate sector for such retail shareholders also act as impediments towards shareholder activism. This issue has been addressed by the introduction of corporate intermediaries who are independent research analysts. They are also called proxy advisors. Proxy advisory firms have gained prominence when although the shareholders became active towards their right but are not able to exercise them. It is very difficult for the institutional investors and shareholder to analyze at their own every policy agenda thoroughly and realize its legal and managerial consequences.

To effectively use their powerful vote and for proper engagement with the company these institutional investors and shareholder outsource their voting decision to proxy advisory firms. They provide advisory services to the investors recommending them the effect of their vote in their shareholding and other corporate decisions. A proxy advisory firm basically protects the shareholders right which leads to good corporate governance.¹³ This concept has helped those shareholders who were not able to make informed decisions, gain professionalism in exercising their rights in a more observant manner. The SEBI (Research

¹³ Atisha Singh, Role of Proxy Advisory Firms in Corporate Governance, LEGAL SERVICES INDIA, <http://www.legalservicesindia.com/article/2303/Role-of-Proxy-Advisory-Firms-In-Corporate-Governance.html>.

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Analysts) Regulations, 2014 gives statutory recognition and regulates the Indian proxy advisory firms. The first proxy advisory firm in India was In Govern Research Services.¹⁴ The recent instance of proxy advisory services is when Housing Development Finance Corporation Ltd. Chairman Deepak Parekh narrowly retained his position as a non-executive director as two U.S. proxy advisory firms ISS and Glass Lewis recommended that institutional investors vote against the resolution for extension of his appointment beyond October 2019. While ISS' concern was that he was on more than six public company boards and hence a busy director prone to "over-boarding", Glass Lewis felt that HDFC's board is not independent enough.¹⁵

While these independent intermediaries do play an important role in shareholder activism but various concerns have been raised in other jurisdictions and India needs to take a lesson from these experiences to further regulate them and take full advantage out of them.¹⁶

V. ROLE OF TRIBUNAL:

A weapon in the form of litigation strategy has been evolved in favour of the minority shareholders. The concept of 'Majority rules Minority' has been overruled and remedies have been brought up to protect the interests of minorities. The remedies include- relief against the act of oppression and mismanagement, class action suit and exit policy. While the last one is the option most conveniently adopted by the controlling shareholders, giving the dissenting ones to exit the company, the former two are counter-actions on the part of minorities.

An act of oppression arises when the affairs of the company are carried out in a way which is prejudicial to the interests of the company, members or public. Act of mismanagement is a material change, not brought in the interests of creditors, which is likely to cause the affairs of the company to be conducted in a way prejudicial to its interests or its members (Section 241 of Companies Act, 2013). In such cases, members or shareholders of a company may

¹⁴ S. Subramaniam, Proxy Advisory Industry in India, 13 CORPORATE OWNERSHIP & CONTROL 317, 374 (2016), https://www.researchgate.net/publication/311621462_Proxy_advisory_industry_in_India.

¹⁵ Umakanth Varottil, The Changing Face of Shareholders: Outsourced Governance, BLOOMBERG QUINT, <https://www.bloomberquint.com/opinion/the-changing-face-of-shareholders-outsourced-governance>.

¹⁶ Supra 2.

apply to the National Company Law Tribunal to a seek remedy. Although there is a prescribed quorum that would give locus standi to the members to apply to the tribunal but the insertion of the waiver clause gives the power to the tribunal to relax the locus standi when there is no prescribed quorum and move ahead with the petition under Section 244 of the Companies Act, 2013.

This waiver clause has been added after the Satyam Scam. Class action suit under section 245 of the Act provides another way by which a class of members may apply to the tribunal for remedy. The tribunal is also invested with vast powers under Section 242 to protect the minority shareholders.

VI. CONCLUSION:

The reforms and efforts made by regulators cannot be said to have gone in vain. The present study reveals that there has been changing trends in shareholder participation in corporate decision making in India. The emergence of various reforms has a paved way and a positive result is witnessed. However, a major impact on the whole corporate governance scenario cannot be determined with certainty at present. But it can be ascertained that shareholder activism will not only help the corporate sector in prospering but also enhance the efficiency of the economy of the country and thus world as a whole.

Although numerous reforms have been incorporated in the legal framework, but until the shareholders do not, on their own understand why their participation is vital to the working of the company, no reform can change the situation. Shareholders will have to take initiative towards the progressiveness. At the same time, a feeling of inclusiveness has to be instilled in the retail and institutional shareholders so that they feel as an integral part of the company like the non-outsider shareholders (promoter).