



THE IMPACT OF SHAREHOLDER ACTIVISM ON CORPORATE GOVERNANCE: RECENT TRENDS AND CHALLENGES

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Abstract

The history of corporates across the world has shown managerial and auditorial shortcomings resulting in various scandals, financial frauds, and the fall of largely traded public companies. Nevertheless, the burden was borne by shareholders, who have been affected the most by corporate failures. With the rise of corporate governance yet incompetent regulatory reforms, the voices of these shareholders have surfaced in the form of activism. This paper examines the regulatory framework since the arrival of the earliest scams and the evolution therein.

It discusses the impact of various laws in place, specifically the provisions of the Company Act, 2013, along with the appraisal of redressal mechanisms like litigation and grievance committees. Lastly, the latest trends are examined, in the wake of the unprecedented pandemic. It is examined if whether decades of evolution have resulted in the true success of shareholder activism.

Keywords: shareholder rights, corporate governance, Companies Act, 2013, activism, board of directors, shareholders

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Introduction

“Never let a good crisis go to waste”- Winston Churchill

This clichéd quote that has been used for centuries, has become more than relevant in today’s pandemic era with shareholders fighting for change despite the setbacks of the new normal. Good governance has always been the need of the hour and societies have invariably pressed for the same. The recent GameStop incident² in USA shows the capability of young shareholders that influenced the stock market overnight.

Shareholder activism consists of such activities undertaken by one or more shareholders of a company that intends to bring about impactful change in the corporation.³ It involves shareholders, often with significant stakes, who try to pressure the management to bring about change when dissatisfied with some aspect of the company’s operations or management, without actual change in control or dismissal of management.⁴ In today’s developing market across the globe, it acts as a catalyst in fostering an atmosphere of good corporate governance and structural stability.

Shareholder activism is not a recent concept, it has been in existence since the 17th century Dutch Republic, popularized by activist shareholders like Isaac Le Maire who was in constant strife for good governance in the Dutch East India company. Early provisions of corporate governance in the U.S included restricted charters, bylaws, and prudent-mean voting rules.⁵ Further, during the 1960s and 70s, the US saw an uprising of shareholder pressure in areas such as product safety, employee rights, and pollution. In the 80s the perspective shifted on anti- takeovers and merger issues. With the alarming rate of climate change since the 90s and the increase in financial crime, activism today is focused on a wide array of issues.

² NYSE, GME, *In January 2021, following a Reddit post, there was a short squeeze of the stock of the US media retailer GameStop, causing major financial consequences for certain hedge funds and large losses for short- sellers.*

³ Mary Ann Cloyd, PricewaterhouseCoopers LLP, *Shareholder Activism: Who, What, When, and How?* (2015)

⁴ Bernard Black, *Shareholder Activism and Corporate Governance in the United States*, (1998), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=45100

⁵ Dunlavy, Colleen A, "Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights" (2007)



The shareholder activism in India, although supported by a plethora of legislation and regulation is however suspected to be not as advent or developed as the US or Europe. With the introduction of the 2013 Companies Act, the listing agreements and the sensations brought by the Satyam Case⁶, to the casual eye, it is evident that shareholder rights are present, however with passivity of shareholders still existent, a shift in shareholding culture is required for practical change.

Literature Review

Shareholder activism has impacted the level of good governance in public limited companies across the world. While companies are required to comply with federal and state regulations, good governance is predominately dependent on self-regulation and externalities such as shareholders. According to Bernard S Black (1998)⁷, although shareholder activism was impactful on corporate performance in the 90s, the overall level of activism was low and institutional investors did not spend adequate capital on activism nor had actively engaged for representation on the companies' boards.

As a pioneer in research regarding the relationship between shareholder activism and corporate governance, this literature is of immense importance to understand the initial limitations of shareholder activism and its relevance today. Black rightly points out the rightful impact of activism. However, he fails to address the reason for low activism in contrast and failed to address the higher levels of activism during the 80s. Roe (1990)⁸ discovered that the enthusiasm of shareholder activism and frequent participation was found to be mainly affected by political and economic forces. He further points out that owing to limiting legislation passed to curb powers of financial intermediaries, their activist role in corporate governance had been concurrently affected.

⁶ Venture Global Engineering v. Satyam Computer Services Ltd. and Ors, AIR 2008 SC 1061

⁷ Black, *Supra* 3

⁸ Roe, M., Political and Legal Restraints on Ownership and Control of Public Companies, *Journal of Financial Economics* 27, (1990)



In contrast, Stuart L. Gillan (2007)⁹, points out that with corporate and regulatory change, shareholder activism was picked back up in the 2000s with hedge and equity funds taking an active role. These authors are crucial to understand the psychology behind passivity, and the evolutionary differences in India. Lastly, several Indian authors like Umakanth Varottil (2012)¹⁰, Sara Pockkathayil Jacob (2012)¹¹, Jayati Sarkar, Subrata Sarkar (2000)¹² have pointed out that Indian Shareholder activism is inadequate due to the lack of implementation of laws under the Companies Act, 1956, such as minority shareholder rights and impractical SEBI guidelines.

Apart from regulatory flaws, the structure of Indian Companies, concentration of control within families or promoters were stated as the main reasons for passivity. These papers are crucial to this study as they demonstrate evolution in the Indian Context, however, written close to the introduction of the 2009 bill and later on the 2013 Act, they lack the foreseeability of future regulatory change.

This paper draws inferences from the above literature that have pointed evidently that shareholder passivity is a result of either lack of regulation or lack of implementation thereof and secondly the mindset of shareholders. It is aimed to analyse the evolution of regulation and rate of implementation; mindset shifts and concurrent effect on the success of activism.

Research Questions

1. How have the regulatory framework and redressal mechanisms evolved to support shareholder participation and encourage corporate governance in India?
2. Are the current trends in shareholder activism reflective of the objective sought by regulation? Is shareholder activism subdued or successful?

⁹ Stuart L. Gillan, *The Evolution of Shareholder Activism in the United States* (2007)

¹⁰ Umakanth Varottil, *The Advent of Shareholder Activism in India*, Vol. 1,(2012)

¹¹ Sara Pockkathayil Jacob, *Shareholders' rights and empowerment in India and US* (2012)

¹² Jayati Sarkar, Subrata Sarkar *Large Shareholder Activism in Corporate Governance in Developing Countries: Evidence from India* (2000)



Analysis

I. Legislative Framework in India

Legislative backing in India is one of the greatest sources to implement corporate governance and an avenue for shareholder empowerment. Unlike India, in the US, although shareholders desire to be active, the majority of power lies in the hand of the Board, with rules denying the intervention of shareholders. The shareholders in the US have the power to merely reject any termination put forward by the Board, i.e., a veto power alone.¹³ They only have the power to veto principal changes, but not the power to direct that they be made.¹⁴ In contrast, the Indian regulatory framework has evolved to be encouraging shareholder activism, especially with the introduction of clause 49 of the listing agreement.

In general, as per section 47 of the Companies Act, 2013 (hereinafter the “2013 Act”) every equity shareholder in a company has the **right to vote and participate in the general meetings**. First developed with the initiation of postal ballots in 2001¹⁵, shareholder participation was difficult and as low as 3% on an average¹⁶. Given the poor participation, the mechanism had improved to now include added benefits such as electronic¹⁷ and proxy¹⁸ voting. Although E-voting had been trending since 2014, 2020-21 saw a steep rise in shareholders availing e-voting facilities and participation in audio-video meetings.¹⁹ All important matters require the approval of shareholders.

To influence governance, shareholder participation and voting is the most direct and crucial tool. Via the meetings, they are able to convey their concerns as well as influence other shareholders to vote in an informed manner. Furthermore, an **extraordinary general meeting**, regarding matters requiring immediate consideration can be called upon by shareholders holding either one-tenth of paid-up capital or one-tenth of the voting power.²⁰

¹³ Bebchuk, The case of Empowering shareholders (2003)

¹⁴ Bebchuk, *Id*

¹⁵ Companies Act no. 1 of 1956 (1956) § 192 A

¹⁶ Welcome to the World of E-Voting, THE FIRM: CORPORATE LAW IN INDIA, (2012)

¹⁷ Companies Act, no. 18 of 2013 (2013) § 108

¹⁸ Companies Act, no. 18 of 2013 (2013) § 105

¹⁹ In Govern, India Proxy season (2020)

²⁰ Companies Act, no. 18 of 2013 (2013) § 100



Moreover, shareholders are also allowed to call the EGM on their own within 21 days if the board does not respond to the requisition notice. However, board participation, especially amongst small shareholders is difficult given the family-controlled or promoter-controlled nature of Indian companies. Intermediaries like proxy advisors and government analysts are strongly required to bring balance ~~to~~ to the board.

On the other hand, The UK legislation allows the shareholders to even intervene directly in company operations, they have the residual right to adopt change in the articles of association. They are also permitted to request the inclusion of any matter of business in the AGM. The Shareholders are also empowered to **appoint or remove directors** of a company in India. As per section 152 of the 2013 Act, the directors are appointed in the general meeting.

Furthermore, the maximum number of directors prescribed by the Act is 15, which can be increased via a special resolution with the participation of shareholders, unlike the 1956 Act which required only the Central Government's approval, this evolution not only brings ease of business, but empowers shareholders to make decisions. Directors can be removed from their position via an ordinary shareholder's resolution. In May 2018 the director of Fortis Healthcare was removed by institutional investors.

Another crucial development in the 2013 Act is the mandatory requirement of an **independent director**, who can be impartial in evaluating corporate affairs, allowing shareholders to have confidence that the board would not put their personal interests over the shareholders'. As per section 152 of the 2013 Act, one-third of all non-independent directors are to retire and be re-elected by rotation every year. However, there exists no mandatory re-election requirement in India. the UK Corporate Governance Code mandatorily requires all FTSE 350 listed companies to annually reappoint directors in order to keep directors in check.

Additionally, **small shareholders** (holding shares of no more than Rs. 20000 worth shares) can also seek representation on the board.²¹ For example, a small shareholder director was sought to be appointed in Alembic Ltd. by Unifi Capital Pvt Ltd along with other small shareholders. However, the board had resisted such appointment on the ground that many small shareholders who sought the appointment had become shareholders only few days prior to the proposal and were connected to certain large shareholders.

²¹ Companies Act, no. 18 of 2013(2013) § 151



Shareholders, additionally have the **power to appoint an auditor** at the general meeting considering the recommendations made by the board and the audit committee. Shareholders can also vote regarding **executive remuneration**. As per section 197 of the Act²² and Regulation 17(6)(c) of the Listing Regulations, if compensation exceeds a certain level, the consent of shareholders is required. For example, in 2018, compensation for the managing director of Apollo group, Neeraj Kanwar was rejected at first, but subsequently approved. Similarly, Infosys was criticized for its magnitude of severance paid to exiting executive directors.

Thus, the legislature has mainly tried to encourage shareholder activism in India through provisions increasing shareholder participation in meetings and voting and removal of procedural and technical hurdles that had impeded their extensive participation in the past. These provisions are therefore aimed at strengthening the representation of minority shareholders including both retail and institutional investors.

II. Legal Remedies and other Redressal Mechanisms

Apart from representation and decision-making power given by the Statute, certain redressal mechanisms are also set in place to aid shareholders. Firstly, a **shareholder grievance committee** under the chairmanship of a non-executive director is mandatorily to be formed as per Clause 49 IV G(iii) of Listing Agreement. This committee is established for the purpose of redressal of shareholder and investor complaints such as share transfer issues, non-disclosure of financial statements, payments of declared dividends, reviewing measures taken for effective voting rights, review of adherence to the service standards etc.

Meetings are compulsorily held at least once a year. Thus, this committee is made to ensure transparency, accountability and protection of shareholder interests. Listed companies must also register themselves with SEBI Complaints Redress System (SCORES) which operates a forum for investors to file complaints with SEBI and keep track of the status of complaints filed.

The provisions against **Oppression and Mismanagement** under sections 241 and 242 of the 2013 Act²³ allow minority shareholders to approach the tribunal in case of oppressive or prejudicial conduct displayed by either directors or majority shareholders against minority shareholders. The objective is to prevent tyranny and bring a balance in power.

²² Companies Act, no. 18 of 2013(2013) § 197

²³ Companies Act, no. 18 of 2013(2013) § 241



Shareholders additionally can also pass a special resolution, resolving that the company be wound up by the Tribunal. In the landmark case of *Tata Sons (P) Ltd. v. Cyrus Investment (P) Ltd.*²⁴ the Supreme court held that minority shareholders however are not automatically entitled to a seat on a private company's board, and the removal of Cyrus Mistry was not oppression of minority shareholders.

Litigation or **class action suits** is another method for shareholders to seek redressal. Under section 245, a class action suit may be sought by shareholders if the management is acting prejudicial to the interests of shareholders or the company. Apart from a class action, derivative suits can be initiated by single shareholders for challenging prejudicial board decisions.

However, through the years litigation has been proved to be less effective as redressal mechanism. For example, the earlier mentioned case of Cyrus Mistry's removal highlighted the difficulties for shareholders in successfully obtaining results through litigation. Similarly, the attempt made by the Children's Investment Fund (TCI) to seek legal remedies against the breach of fiduciary duty by the directors of Coal India, had also failed ultimately leading the appellant to give up and withdraw the case.

Moreover, a more effective way in contrast to litigation has been seeking help from regulatory bodies like the SEBI or RBI. For example, SEBI was sought out to be investigated by the minority shareholders of Bharat Nidhi Limited who objected to a share buy-back scheme, subsequently leading the supreme court to then direct the SEBI to conduct the investigation in four months. Despite several redressal mechanisms, the success of shareholder activism is slim, unless there exists a significantly erroneous situation in a company, activists do not tend to succeed in their endeavors. Although evolved from earlier decades, it is important for sound legal remedies for the success of good corporate governance.

III. Current Trends in India

The current times have shown that investors are picking up the slack by **going digital**, awareness amongst the shareholders have increased thanks to online media. 2021 is a crucial year for activism to contribute to good governance, with the suspension of the **Insolvency and Bankruptcy Code** in 2020, financial stressors are highly likely in the second half of 2021 and beyond.²⁵

²⁴ Tata Sons (P) Ltd. v. Cyrus Investment (P) Ltd., (2020) SCC OnLine SC 595

²⁵ Ingovern, India Proxy Season 2020 An Analysis (2020)



With small and medium cap companies struggling to cope up with the stressors unlike large cap companies, it is an excellent opportunity for activist shareholders to suggest means for getting out of the rut such as **mergers and acquisitions** with the right companies. During the market crash in March 2020, few companies had proposed to **delist** themselves from the stock exchanges. However, one such company called Vedanta was unsuccessful in delisting thanks to the resistance from shareholders, including the institutional shareholder LIC, who resorted to tendering their shares at high prices forcing the promoters to withdraw the offer.

On the other hand, a similar approach was taken by the shareholders of Hexaware but were unsuccessful in stopping the delisting. 2020-21 also saw an insurgence of **proxy advisory firms**, that provide advice to shareholders regarding exercising their rights. For example, in commenting on the infamous leave of absence taken by the CEO of ICICI Bank, during the allegations of impropriety.

Similarly, they were successful in ousting Puneet Bhatia on the board of Shriram Transport Finance Corporation Ltd, due to lack of sufficient attendance. Lastly, **mutual funds** and other long-term investors are required by SEBI²⁶ to vote on resolutions involving their portfolio companies. They have chosen to creatively join hands with the promoters to establish good governance.

²⁶SEBI circulars, SEBI/IMD/CIR No. 18/198647/2010 (2010); CR/IMD/DF/05/2014 (2014); and SEBI/HO/IMD/DF2/CIR/P/2016/68 (2016).



Conclusion

Legislative and other remedial mechanisms have no doubt evolved to support shareholder activism on paper. However, it would be imprudent to assume that these mechanisms alone are sufficient for shareholder activism to succeed. Literature has pointed out that the reasons for the failure of shareholder activism are mainly two-fold, namely the lack of implementation of statutory provisions and secondly the passive mindset of shareholders i.e., apathy of shareholders.²⁷ As previous examples have shown, despite efforts made by shareholders to establish their rights, success has been slim and very difficult to obtain. Nonetheless, this research has pointed out that legislative and redressal mechanisms are indispensable in the implementation of corporative governance.

Historical evidence has shown that India's regulation is on par, if not ahead of western counterparts. Furthermore, current trends have shown a shift in shareholder mindset, despite the low chances of success, India shows great potential in shareholder activism as long as shareholders refuse to be repressed and find creative ways to take action. It is recommended that courts take better notice of shareholder needs and balance them with the interests of management. An increase in SEBI's power is required to meet the level of success in other developed countries. Dissenting shareholders' opinions have also to be taken into account as opposed to just the majority. Despite the positive trajectory, shareholder activism has to be closely monitored in India to ensure success and prevention of wrong use.

²⁷ Umakanth, *Supra* 9