



Shareholder activism and its influence on corporate governance practices in India

Nammrta Singh¹, Manpreet Kaur²

¹LLM, University Institute of Legal Studies, Chandigarh University, Gharuan, Mohali, Punjab, India

² Assistant Professor, University Institute of Legal Studies, Chandigarh University, Gharuan, Mohali, Punjab, India

Abstract

Shareholder activism within corporate law encapsulates the evolving role of shareholders in influencing corporate governance, strategy, and decision-making within companies. This abstract explores the multifaceted nature of shareholder activism, its mechanisms, implications, and its impact on corporate governance dynamics. Shareholder activism denotes the proactive involvement of shareholders in advocating for changes within a company. It manifests through various strategies, including proxy contests, shareholder proposals, engaging in dialogue with management, or even litigation to influence corporate policies and practices.

The motivations behind shareholder activism vary, ranging from pushing for increased transparency, advocating for environmental or social responsibility, enhancing shareholder value, to challenging executive compensation structures. Activists, including institutional investors, hedge funds, or individual shareholders, often leverage their stakes to voice concerns or drive strategic shifts within corporations. This activism has significant implications for corporate governance. It prompts companies to be more responsive to shareholder concerns, fostering greater accountability and transparency. However, it can also lead to conflicts between management and shareholders regarding differing visions for the company's direction and priorities.

Regulatory bodies and legal frameworks play a pivotal role in shaping the landscape of shareholder activism. Proxy rules, disclosure requirements, and shareholder rights provisions influence the strategies and effectiveness of activist interventions. Courts often become arbiters in disputes arising from shareholder activism, setting precedents that define the boundaries of shareholder influence. The impact of shareholder activism extends beyond individual companies, influencing market dynamics, investor perceptions, and corporate best practices. It prompts corporations to reevaluate their governance structures and stakeholder engagement strategies, ultimately aiming for a balance between shareholder interests and broader corporate objectives. Understanding the nuances of shareholder activism in corporate law is crucial for stakeholders—companies, investors, regulators, and legal practitioners alike—to navigate the evolving landscape of corporate governance, shareholder rights, and the interplay between shareholder activism and corporate decision-making processes.

Keywords: Shareholder activism, corporate governance, Indian Context, Shareholder democracy, corporate laws, influence

Introduction

Shareholder activism has emerged as a potent force within corporate governance in India, reshaping the relationship between shareholders and companies. This evolving trend represents a proactive stance by investors, aiming to influence corporate strategies, governance practices, and overall decision-making processes.

In recent years, India has witnessed a significant surge in shareholder activism, reflecting a growing emphasis on shareholder rights and accountability. Activism manifests through various means, including engaging in dialogues with management, leveraging voting power during shareholder meetings, filing resolutions, or even resorting to litigation, all with the goal of advocating for changes within companies.

The motivations driving shareholder activism in India encompass a wide spectrum of concerns. Shareholders, including institutional investors, activist funds, and retail investors, often focus on issues such as improving corporate governance standards, advocating for transparency, challenging executive compensation structures, promoting environmental or social responsibility, or seeking to enhance shareholder value.

The landscape of corporate governance in India has seen alterations due to shareholder activism. Companies are

increasingly prompted to adopt more transparent practices, strengthen their governance frameworks, and be more responsive to investor concerns. Activist interventions have catalyzed regulatory reforms and amendments to ensure better alignment of corporate practices with shareholder interests.

India's legal framework governing corporate governance and shareholder rights plays a pivotal role in shaping the contours of shareholder activism. Provisions related to shareholder meetings, voting rights, disclosure requirements, and board structures significantly impact the effectiveness of shareholder activism strategies.

The impact of shareholder activism in India extends beyond individual companies. It influences market dynamics, shapes investor perceptions, and contributes to the evolution of corporate best practices. As shareholders become more engaged and assertive, companies are prompted to reevaluate their governance structures and stakeholder engagement strategies, aiming for a harmonious balance between shareholder interests and broader corporate objectives.

Understanding the dynamics of shareholder activism in the context of Indian corporate governance is crucial for stakeholders—companies, investors, regulators, and legal practitioners—as it reflects the evolving relationship between

shareholders and corporations. It underscores the significance of investor activism in driving responsible corporate behavior and shaping the landscape of corporate governance in the country.

Research methodology

This paper's comprehensive research is based on the analysis of shareholder activism and providing a comprehensive understanding of the influence of shareholder activism on Indian corporate governance practices.

Reasons to shareholder activism

Activist shareholders enhance and increase the value of their shares by exercising their rights. By taking such action, shareholder activists seek to increase value by acting as a constructive catalyst for the company's expansion.

When a publicly traded subsidiary of a multinational corporation proposed to sell one of its business divisions to a different parent company, shareholder activists created value. The proposal required a special majority of the parent and subsidiary shareholders because it was a related party transaction. However, a low appraisal led to the plan's rejection. The revised plan increased the valuation for the benefit of the stockholders.

If a shareholder wants to ensure a long-term return on investment, they may hold shares in the company for many years. This can be achieved by making sure that management places a high priority on balancing and optimizing long-term returns on the investments made by these shareholders. Activist investors aim to maximize their return on investment by improving the company's performance. Additionally, it encourages efficient and effective management, which raises the organization's long-term value.

Activist shareholders support cost reduction as a means of maximizing profits through the equitable and responsible use of the company's resources.

The number of shareholders voicing their opinions and concerns is rising. For instance, a quarter of the financial conglomerate's shareholders voted against the chairman's retention. A proxy advisory firm advised investors to vote against the motion to reappoint the non-executive chairman of the company because he served on the boards of eight other companies, potentially making it more difficult for him to perform his job effectively.

At a well-known automaker in India, a number of shareholders voiced disapproval over the company's purchase of vehicles from a connected party, sparking shareholder activism. Because of fierce opposition from activist shareholders, the company had to change the terms of the contract in order to receive approval.

Legal framework

A major factor in encouraging shareholders to stop being passive and participate in company decision-making is the Companies Act of 2013. This section will examine Chapter VII of the Act, which mainly deals with management and administration, in order to outline the legal rights granted to shareholders and to promote and strengthen their involvement in board meetings.

Sections 96 and 100 specify how annual general meetings ("AGM") and extraordinary general meetings ("EGM") can be called and carried out, respectively, to allow shareholders

to become informed about the company's affairs and to exercise their voting rights. Sections 97 and 98 specify meetings called by the National Company Law Tribunal. AGMs are required to be held on a regular basis to discuss yearly results such as the adoption of audited financial statements, directors' and auditors' reports, dividend declaration, appointment of auditors and directors, and approval of their remuneration. EGMs, on the other hand, can be called by the Board on its own initiative u/s 100(1) or on the request of members u/s 100(2) to seek shareholder approval on corporate actions. Failure of the Board to follow the procedure outlined in Section 100(2) gives requisitioners the authority to call an EGM themselves. In the case of *LIC of India v. Escorts Ltd.* under the previous Act, the member's authority to call a general meeting by issuing a requisition notice was upheld. This authority was also upheld in one of the most recent instances of shareholder activism, which will be examined in the following section. Section 101 requires a company to give 21 days' clear notice in writing for a general meeting, unless the written consent of the shareholders holding at least 95% of the share capital has been obtained to hold a meeting on a shorter notice.

This is done to ensure that the shareholders have enough time and information to attend the meeting and are aware of its agenda. Additionally, the clause ensures that shareholders are appropriately informed about the date, place, and agenda of the general meeting, keeping them informed about the company's governance. This provision works in tandem with section 102 to achieve this goal. A "bundle of rights" is granted to investors in exchange for their ownership of shares in a company; among these is the ability to exercise their "corporate franchise" and participate in corporate decision-making. It is not required of shareholders to use their voting rights in any particular manner or at all. The Act gives management a wide range of options for recording the votes by covering the different ways that shareholders can cast their votes through sections 107 to 110.

The authorities have made corporate voting accessible due to technological advancements and the availability of electronic voting under Section 108 of the Act, as well as Rule 20 of the Companies (Management & Administration) Rules, 2014.

By requiring the recommended motion to be presented before the shareholders and authorizing it only through the adoption of a special resolution at the general meeting, the statute has thus guaranteed shareholder participation throughout the Act. For example, under Section 152, approval of related party transactions is required; under Section 188, approval of schemes of arrangement or compromise for mergers; and in other specific cases, investor approvals are required. Additionally, fusions under section 230 and so forth.

Notable instances of shareholder activism

This section will highlight the extraordinary shareholder activism that India Inc. has seen over the last few years. Activist investors have taken control of the companies they invest in, and as a result, shareholders have voted against board proposals to increase the compensation of top executives, appoint independent directors, and restrict related party transactions. These actions have helped to map out the changing corporate landscape.

1. The vote of shareholders on executive pay

Since the compensation for three of the company's top executives exceeded the set limits, Tata Motors Ltd. asked its shareholders for permission to pay executive remuneration as early as 2014. The proposal was revoked because the Board was unable to secure the necessary 75% majority to approve a special resolution in support of the increased compensation. But when the Board presented the same plan to the shareholders in January 2015, the investors rejected it. However, this was among the first cases of shareholder activism, with investors arguing that the prior motion was not in line with the company's performance. Last year, there was a noticeable spike in shareholder activism as a result of the financial blow that the Covid-19 pandemic dealt Indian companies to their revenue and profits, as well as the management's lack of transparency. Shareholders challenged the promoters and management of several companies by voting against board proposals to increase executive compensation. For example, in August 2021, Siddhartha Lal, the managing director of Eicher Motor Ltd., was given a 10% pay increase, but the company was unable to secure the necessary votes to approve the special resolution. The proposal to enhance the compensation of Shobha and Ekta Kapoor, promoter-directors of the Balaji Telefilms group company, was rejected by shareholders in a September 2021 vote.

2. The right of shareholders to nominate directors

There is a growing wave of shareholder activism that goes beyond calls for higher executive compensation. Additionally, in 2021, a case involving shareholder activism was brought before the court. The parties involved were Invesco Developing Markets Fund, an institutional shareholder of Zee, and Zee Entertainment Enterprises Private Limited, a listed company. The conflict started when Invesco sent out a requisition notice requesting the removal of three Zee directors and the appointment of six new independent directors to the Zee board. Zee then declined to call a shareholder meeting. Invesco responded by requesting that the requisitioned meeting be called in a petition filed with the NCLT under section 98 of the Act. Zee simultaneously petitioned the Bombay High Court for an injunction to stop Invesco from carrying out the request, and the court granted it. Overturning the Learned Single Judge's decision, the Division Bench maintained that the term "valid requisition" under Section 100(4) should be interpreted literally, limited to "numerical and procedural compliances," and not include any mention of the requisition's "object." The Court based its decision on the Supreme Court's ruling in *LIC v. Escorts*³¹, which was based on the relevant section of the former 1956 Act. It concluded that departing from the precedent established in this case would undermine shareholder democracy by endorsing the Board's restrictive actions. Zee was forced to convene the meeting as a result. Another example of shareholder activism concerns the appointment of Yasir Al-Rumayyan, the chairman of Saudi oil producer Aramco and a governor of Saudi Arabia's Public Investment Fund, as an independent director on Reliance Industries' board. The California State Teachers Retirement System, an institutional shareholder of Reliance Industries, first opposed the appointment on the advice of the proxy advisory firm Glass Lewis. The Public Investment Fund held significant investments in two other Reliance group companies, and Aramco was in negotiations to

acquire a 20% stake in Reliance's oil-to-chemical business, according to the PAF, which argued that there was a potential conflict of interest. Later on, though, the appointment was approved.

3. Say in related party transaction by shareholders

The transactions between the company's related parties have also been closely watched by active investors. For example, in 2017, Raymond Ltd. proposed a related party transaction to its AGM, which included selling the company's property to its controlling shareholders at a discount. Since promoters and other controlling shareholders are prohibited from voting in related party transactions, the resolution was defeated despite the opposition of a small percentage of the total shareholding.

4. Instances where shareholder activism failed

Although there have been cases where activist shareholders have prevailed, boards do not always give in to their demands. Similar to the case of Eicher Motor Ltd., the management of Hero MotoCorp Ltd., Bajaj Auto Ltd., and Balkrishna Industries Ltd. had to deal with minority shareholders rejecting proposals for their chairmen's compensation. Nevertheless, in contrast to Eicher Motor Ltd., the other companies' resolutions regarding compensation payable to their chairs were standard in nature, necessitating only a simple majority of 50%. Therefore, the management's resolutions were passed because higher promoter stakes overrode minority shareholders' opposition.

Types of shareholder activism

Supporting shareholder activism can result in improved corporate governance procedures and increased value addition from businesses. There are many different ways that shareholders can be involved in activist investing, and they can use a variety of strategies to impact the company's decisions. Several primary forms of shareholder activism include:

1. Proxy Contests

When an activist shareholder puts forward candidates to take the place of the outgoing board members, it's known as a proxy contest. Gaining control of the business or applying pressure on the board and management to alter their plans or policies are the two main goals of a proxy fight.

2. Shareholder resolution

Proposals made by shareholders at a shareholder meeting are known as shareholder resolutions. These resolutions can address a range of topics, including the selection of independent directors, executive compensation, social and environmental issues, and other business-related concerns.

3. Litigation

In the event of a breach of fiduciary duties or a violation of securities laws, shareholders may file a lawsuit against the company or its management.

4. Engagement with Management

In order to voice their concerns or recommendations, shareholders can communicate with the company's management through letters, meetings, or other means of correspondence.

5. Media campaigns

Activist shareholders can utilize the media to draw attention to their problems and concerns or to exert pressure on the board and management to act.

These various forms of shareholder activism call for various tools, approaches, and techniques. While some activism is more confrontational, others are more cooperative and aim to establish rapport with the management of the company. Moreover, activist shareholders can use several strategies at once to accomplish their goals. In addition to offering many advantages to both businesses and shareholders, shareholder activism can significantly contribute to the improvement of corporate governance procedures. However, there are also certain restrictions that must be taken into account.

Impact of shareholder activism on corporate governance in India

The Kotak Committee's recommendations were approved by SEBI in 2018 under the direction of Mr. Uday Kotak, the managing director (MD) of Kotak Mahindra Bank. This committee was established in order to propose amended versions of the Companies Act of 2013 and SEBI's LODR of 2015. Numerous flaws in these documents resulted in corporate scandals and scams that severely hampered the development of the nation's economy. The committee's two primary goals were to: a) concentrate on creating long-term value; and b) appropriately safeguard the interests of shareholders. The following modifications were suggested by the committee and put into effect by SEBI-

- Any information pertaining to the appointment or reappointment of auditors, the basis for the recommendation for appointment, the auditor's credentials, the fees due to the auditor, and the reason for the auditor's resignation must be disclosed to shareholders at an annual general meeting (AGM).
- Without the participation of related party shareholders in the voting process, the shareholder must approve all related party transactions through a special resolution.
- Shareholder approval will be necessary for listing entities to pay other entities more than 2% of their consolidated turnovers.

The SEBI has approved these suggestions to be made changes to the listing agreement. However, there are no restrictions on shareholder activism. In India, there are no specific rules governing "shareholder activism." Increased shareholder participation is anticipated, however, as a result of the Covid-19 crisis enabling virtual Annual General Meetings and Extraordinary General Meetings.

Power and influence of shareholder activism on corporate governance practices in India

Under Indian law, directors are primarily responsible for overseeing the company's operations and making decisions. Even though no outside party is allowed to have any influence or meddle in a company's internal affairs, shareholders have some authority to hold the board and management accountable. In May 2018, two significant shareholders of Fortis Healthcare Ltd., who held 12% of the company's shares, successfully removed a director from the board and appointed three new independent directors in their place because they were dissatisfied with the company's ongoing sale process. This incident serves as one of the most recent examples of the role of shareholder

activism. This case is noteworthy in light of the growing trend of shareholder activism because it illustrates the ability of shareholders to alter the makeup of the board, which has a direct impact on the company's management.

Minority shareholders in India experience severe mistreatment and poor corporate governance. Minority shareholders of close corporations, such as private companies or family-run businesses, are particularly vulnerable to this because they do not have the same exit strategy available to shareholders of publicly traded companies in the event that they are dissatisfied with the way in which the company manages their funds and shares. Therefore, the Companies Act of 2013 and the former Companies Act of 1956 protect the interests of minority shareholders. Minority shareholders have access to redress in response to evidence of mistreatment by the company's management and majority shareholders. More than 25% of a company's voting power belongs to minority shareholders, who have the ability to influence a number of transactions requiring approval through special resolutions. Investors now possess the option to file a "class-action suit" on the company's behalf before the National Company Law Tribunal (NCLT) in the event that they witness any instances of mismanagement, oppression, or fraud within the company. ITC, a non-financial investor, and Life Insurance Corporation, a state-owned insurer, contested the asset sale of the Leela Hotels to Brookfield in the 2019 case of J M Financial Asset vs. SEBI, 2019 because some of the deal's shareholders were related parties and therefore were unable to vote in favor of the sale. Even though this challenge and its appeal were rejected, it shows that more shareholders are now attesting to their privileges. Reliance Industries Limited (RIL) offered the shareholders of Reliance Retail Ltd. (a subsidiary of RIL that is not listed on the stock market) shares of RIL in a share swap scheme that would exchange one share of RIL for four shares of Reliance Retail Ltd. This latest shareholder campaign was seen in a Mergers & Acquisition Context in December 2019. Reliance Retail Ltd's minority shareholders threatened to sue the company for failing to provide them with an exit strategy, which would have required RIL to reverse the share swap program's requirement that investors participate in it or face penalties starting in January 2020.

These instances demonstrate that, in the modern business world, shareholders are not only opting to sell their shares when the company is losing money due to dishonest board practices or poor management. Rather, they are also asserting their rights.

Conclusion

In conclusion, shareholder activism in India has significantly reshaped corporate governance practices, emphasizing accountability, transparency, and ethical behavior. Its evolution continues to shape how companies navigate challenges, respond to stakeholder expectations, and strive for sustainable and responsible business practices. The ongoing interplay between shareholder activism and corporate governance underscores the need for a balanced approach that aligns shareholder interests with the broader goals of sustainable value creation and stakeholder well-being. By nature, fairness Shareholder oversight is challenging because shareholders are not activist crusaders but rather fair-weather friends. If they don't like the management, they might vote with their feet, and even other

investors have a tendency to disregard measures that uphold the law. However, in light of current policy trends favoring good corporate governance, the institution of independent directors is helping to focus attention on the role of the board of directors. In addition, banks and other financial institutions can still play the role of conscience keepers. Proxy advisory firms and investor protection organizations both have a significant part to play in fostering a culture of shareholder activism for improved governance. Remember that rights to governance will always be "rights."

Suggestions

Here are some suggestions which could be used for effective and smooth shareholder activism in Indian corporate governance:

1. Enhance Transparency and Disclosure

Advocate for clearer and more comprehensive disclosures from companies on financial matters, executive compensation, board structures, and decision-making processes. Push for regular and detailed reporting that enables shareholders to make informed decisions.

2. Focus on Long-Term Value Creation

Encourage a shift away from short-term gains towards sustainable, long-term value creation. Promote strategies that prioritize environmental sustainability, ethical practices, and social responsibility, ensuring the company's viability in the long run.

3. Engage in Constructive Dialogue

Emphasize the importance of constructive engagement between shareholders and company management. Encourage regular communication channels that allow for meaningful discussions on strategic direction, performance metrics, and governance practices.

4. Push for Board Diversity and Independence

Advocate for diverse board compositions that reflect varied expertise, perspectives, and independence. Encourage the nomination of directors with diverse backgrounds to foster a more inclusive decision-making process.

5. Strengthen Governance Structures

Push for stronger governance structures, including independent audit committees, risk management frameworks, and robust internal control mechanisms. Ensure that the company adheres to the highest standards of corporate governance.

6. Prioritize Stakeholder Interests

Highlight the importance of considering the interests of all stakeholders, including employees, customers, and the community, alongside shareholder interests. Encourage policies that balance diverse stakeholder needs.

7. Use Voting Rights Responsibly

Encourage responsible use of voting rights by shareholders. Advocate for informed voting on key issues, resolutions, and appointments during shareholder meetings to reflect shareholder concerns accurately.

8. Promote Ethical and Sustainable Practices

Push for the adoption of ethical business practices and sustainable strategies. Advocate for companies to align their operations with environmental and social responsibilities. Collaborate for Collective Impact: Consider collaborating with other shareholders or investor groups to amplify influence. Joint efforts can often yield more significant impacts on governance practices.

Leverage Regulatory Support: Engage with regulatory bodies to advocate for policies that support shareholder rights, transparency, and fair governance practices within companies.

Effective shareholder activism in Indian corporate governance requires a strategic approach that balances short-term goals with long-term sustainability, promotes transparency, fosters dialogue, and encourages responsible business practices for the benefit of all stakeholders.

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