PRACTICAL EFFECTS OF SHAREHOLDER ACTIVISM IN INDIA

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"To the wrongs that need resistance, to the rights that need assistance, to the future in the distance, give yourselves."[1] If Carrie Catt was a shareholder in 2019 Instead of a woman in the 19th century, this quote would still make perfect sense and that says a lot about the state of shareholder rights and activism in India. Much like Universal Adult Franchise, Corporate Franchise has been traditionally reserved for those in power, but not anymore. As the State legislates more transparency rules, SEBI enforces more Corporate Governance mechanisms and as the Investors themselves become more informed, Corporate Suffrage becomes more and more prominent in India Inc. Gone are the days when Companies could get away with tactics such as choosing remote locations for AGMs to discourage Investor Participation[2], India is on its way to fight concentration of Corporate power socially, legally and academically. But with the creation of a new right, come a ton of ways to misuse it. Misuse so grave that its evils sometimes exceed the right's benevolence. Is shareholder activism taking us down the same path? Are we forgetting that the concept of Separate Entity means the Company's best interests must be forwarded, which include but are not limited to shareholder interests? What about employee rights or corporate social responsibility that is negatively affected by short termism of activists? This part of the paper focusses on the ground reality of shareholder activism in India by discussing case studies and statistical data while analysing the same to determine the effect of activism on Market Operations.

Call it the hangover of the feudal system or sheer want of economical capital accumulation, promoters are sceptical to go public with their companies and even when they do, they reserve majority stakes in 'their' company. This high stake in the company, matched with the promoter's powers to appoint directors or become one themselves, results in little distinction in the company's ownership and management. So, any check on the management needs to come from the non-promoter shareholders. This process of scrutiny started by mere objections to Board Proposals that went against the interests of Shareholders, then came the stage where investors came up with their own proposals and finally, Activism reached the stage where minority Shareholders seek representation on the Board to forward their interests. We will discuss through case studies, how each stage of activism (supported by the legal framework at that time) affected Profitability and Shareholder Value by studying its effect on Share Prices immediately following and preceding said activism.

I. COAL INDIA LTD. AND THE FIRST CLASS ACTION SUIT IN INDIA

With 90% of its stakes in the government's hands and no minority shareholder holding more than 1% individually, Coal India Ltd. was the poster child of India's concentration

[1] Catt, Carrie (1952)
[2] Krishnan A, "Who Still Attends AGMs?" The Hindu Business Line (August 16, 2015) <https://www.thehindubusinessline.com/opinion/columns/aarati-krishnan/who-still-attends-agms/article7547005.ece>

of power in 2010. That was until TCI entered the picture. It became the first public Shareholder holding more than 1% in Coal India in 2011 and thus started the battle which led to the first class action suit being filed in India. They had chosen the worst, most powerful opponent, the Government of India itself. With its majority stake, the Government had influenced directors of Coal India Ltd. to sell Coal at a discount of 70% to the International price which had cost the Company Rs 215,250 crore in pre-tax profits in the two years of its functioning[3]. Since, there was no provision equivalent to s. 111 of companies act, 2013 (power of minority shareholders to file resolutions) in the old Companies Act, 1956, TCI had to approach the court after its complaints to Directors fell on deaf ears. Had it succeeded; TCI could've opened floodgates of mass investor action against a ton of PSUs where minority shareholders are oppressed by the Government's exercise of its shareholding majority. However, after continuous failure in its actions, TCI realised that its efforts were misplaced and completely exited Coal India Ltd. Even though the activism failed, it provides us with a valuable case study.

ANALYSIS:

Why did TCI fail even after such apparent mismanagement of resources by the company? The answer lies in what is called a 'Red Herring Prospectus'. It is one of the most common ways to limit the Company's liability by mentioning in the prospectus that Promoter decisions might not be in minority shareholder's best interest. Hence, by applying the rule of 'Caveat Emptor', the company forgoes its liability towards minority shareholders.[4] The story of TCI seems like a story where Shareholder Activism failed to actualise results, but the Share prices and Return on equity tell a different story. Throughout the whole battle, CIL's return on Equity remained above 30%,[5] which shows Coal India's efforts to satisfy Shareholders. Additionally, TCI fought back on three occasions, March 2012, November 2012 and August 2013. Coal India's share prices increased immediately following these three initiatives but fell once again after the Board's response and/or the Courts inaction[6] which highlights the market enthusiasm and responsiveness to Shareholder Activism.

While the case of TCI was a decent baby step towards Shareholder Activism in India, the new Companies Act, 2013 opened new prospects for shareholder involvement and the SEBI regulations strengthened Shareholder presence even further. Provisions like S.151 of the Companies

[3] Singh S, "TCI Sues CIL Directors for Causing Rs 2.15 Lakh Crore Loss to the Company" (October 13, 2012) <https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/tci-sues-cil-directors-for-causing-rs-2-15-lakh-crore-loss-to-the-company/articleshow/16781529.cms?from=mdr>

[4] Shahu RK, "The Curious Case of Children Investment Fund vs Coal India" NDTV Profit (August 7, 2012) <https://www.ndtv.com/business/the-curious-case-of-children-s-investment-fund-vs-coal-india-308957>

[5] Mohan R, "CIL:TCI's Misplaced Zeal" The Economic Times (April 12, 2012) <https://economictimes.indiatimes.com/t-t-ram-mohan/cil-tcis-misplaced-zeal/articleshow/12630192.cms?from=mdr>

[6] Coal India Ltd. Stock Price, Share Price, Live BSE/NSE, Coal India Ltd. Moneycontrol.com - https://www.moneycontrol.com/india/stockpricequote/miningminerals/coalindia/CI11

ISSN 2456-9704

Act,2013 which warranted the appointment of small shareholder directors ensured protection of interests and S.108 and 110 introduced e-voting and postal ballots respectively, which put physical access issues to bed. As a result, the scope of Shareholder Activism expanded from its initial limited area of operational mismanagement to more policy and recruitment-based concerns. According to InGovern, one of the three Proxy Advisory Firms in India, "Directorial appointments and their remuneration were the most scrutinised proposals by investors in the 2017 proxy season, comprising 82% of the total resolutions with a higher percentage of dissenting votes by the Top 100 companies' investors."[7] Illustrative of this trend was the battle for the appointment of a small shareholder Director in the country's oldest Pharmaceutical entity, Alembic.

II. ALEMBIC LTD. AND THE INVOCATION OF S. 151, COMPANIES ACT, 2013

In 2017, Unifi Capital, a Portfolio Management Company with around 3% stake in Alembic Ltd. mobilised Small shareholders to move a resolution[8] appointing Murali Rajagopalachari as a Director on the Board of Alembic Ltd on their behalf under S. 151 of the Companies Act, 2013. The Board stalled the Postal Ballot for a long time before completely rejecting this proposal. Why? It was contended that there is a conflict of Interest due to Mr. Murali's close nexus with the Company Unifi Capital and the small shareholders who were also related to Unifi capital in their other dealings. Another concern was that a majority of the Shareholders signing the resolution had become members only 3 days prior to the said resolution.

ANALYSIS:

The use of the term 'may' in S.151 denoting an absence of obligation on the part of companies to process such requests, coupled with the subjectivity of requirements such as being a 'person of integrity', provide defensive mechanisms for companies to reject such applications. The fact that it took four long years to invoke this provision for the first time shows the sheer difficulty of mobilising 1000 people towards a common goal. These problems of mobilisation have only increased as e-voting becomes the standard way of voting. Corporate Franchise is not merely a right to vote but includes the right to use that vote as an expression of shareholder's informed decision[9]. What follows from this is an absolute right to enquiry, clarifications and debate before any decision can be put to vote. These inherent problems faced by Shareholders are only maximised by the Promoter culture that rejects any representation in the above-mentioned manner. An appropriate alternative would have been for the board to intimate their views to the small shareholders thus enabling them to make an informed decision, completely stripping them off their right to vote in a matter solely subject to their votes is a gross misuse of Board power.

[7] "India Proxy Season 2017" (Ingovern) <http://www.ingovern.com/wp-content/uploads/2017/11/India-Proxy-Season-2017.pdf>

[8] Rule 7(1) of the Companies (Appointment and Qualification of Directors) Rules, 2014

[9] "Voting through Electronic Means (Sec 108) – Part-1 "(icsi.edu) <https://www.icsi.edu/media/portals/86/Geeta_Saar_54_Voting_through_electronic_means-Part-1.pdf>

But there is an upside to this story as well. The share prices were up 11 points in the morning session following the small shareholder's notice to mobilise against the Directors in July 2017[10]. This piece of information seems even more impressive when you consider the fact that this happened when sensex was down by several points! The Best thing about the battle at Alembic was that shareholders started asking for action and change rather than merely responding to what has been proposed by the management. This sign of investors stirring and wanting to actively participate in managing the company rather than just affecting a few decisions shows that Shareholder Activism in India is on the right path.

III. OTHER INSTANCES OF SHAREHOLDER ACTIVISM AND ITS CRITICISM

In the same year (2017), 45 out of the Top 100 NSE Companies had at least one AGM proposal receiving 20% dissenting votes by either the institutional or non-institutional shareholders[11]. In one case, the promoters of the company banded against its management, which is quite refreshing. But what about short termism? Does shareholder activism promote a myopic viewing of profitability and market operations? A research on the long-term effects of Hedge fund activism conducted by Bebchuk, Brav and Jiang[12] gives a plausible answer to these concerns. It is found in the paper that operating performance improves immediately following episodes of activism and even during the third, fourth year following the intervention, performance tends to be better than it was before the activist episode. This resonates with the results found in this paper about share prices increasing with incidences of shareholder activism in a company. The two case studies discussed in this paper were both failed attempts in the specific endeavour but signalled a wider pattern of shareholder activism in India. There have been quite a few successful attempts of activism as well. For example, Fortis Healthcare underwent the removal of a director in 2018[13] owing to the pressure of activist institutional investors and Funds, thereby showing their ability to affect Board composition. Whistleblowers are also increasingly calling companies out on lapses or regulatory violations with about 1/3rd of Nifty 50 companies getting 3139 complaints in the year 2017. The awareness has been steadily increasing as the no. reached 3508 in the year 2018.[14]

10 Alembic Ltd. Stock Price, Share Price, Live BSE/NSE, Alembic Ltd. Moneycontrol.com - https://www.moneycontrol.com/india/stockpricequote/pharmaceuticals/alembic/A08

11 "Institutional Investors Voted against 45 Resolutions in 2018 "*The Economic Times* (February 14, 2019) <https://economictimes.indiatimes.com/markets/stocks/news/institutional-investors-voted-against-45-resolutions-in-2018/articleshow/67990956.cms?from=mdr>

12 Bebchuk L, Brav A and Jiang W, "THE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM" (Columbia.edu) <https://www8.gsb.columbia.edu/financialstudies/sites/financialstudies/files/files/Jiang_Long-term effects of hedge fund activisim.pdf>

13 Narayanan N, "The Shareholder Rights and Activism Review - Edition 3" (The Law reviewsSeptember 2018) <https://thelawreviews.co.uk/edition/the-shareholder-rights-and-activism-review-edition-3/1173615/india>

14 Somvanshi K, "Trend of Tighter Corporate Governance Expected to Continue into the New Year "*The Economic Times* (December 30, 2018) <https://economictimes.indiatimes.com/news/company/corporate-trends/trend-of-tighter-corporate-governance-expected-to-continue-into-the-new-year/articleshow/67314715.cms?from=mdr&utm_sou

It has been argued by opponents of Shareholder Activism that Funds and Institutional investors use this concept to forward group interests that do little to benefit the rest of the shareholders. Activism is sometimes used by investors to forward pro-union policies and advance one groups agenda over the others, thereby creating a minority of the minority. This criticism, while valid, is only a result of the limited reach of Shareholder activism in India. Rather than defeating the utility of Activism it highlights the need to make it more pervasive so that all groups of shareholders can resort to its benefits.

IV. BOARD INDEPENDENCE (?)

One aspect of Corporate Governance that still needs to be addressed is the position of Independent Directors on the Board. Their presence is meant to ensure a Third-Party check on operations but in reality, the Independent directors are chosen from the social circle of the other Directors. Additionally, the trend in India is that one Director holds Board membership in no. of holdings and subsidiaries. Hence, instead of independence, self-interest prevails with an added touch of diplomacy. Furthermore, in 2010, on an average, board members met 6.5 times during the year in India.[15] An analytical review of the Business or constructive regulatory overview is not possible in such a short time span. What Boards actually do is, depend on the Management reports and informal Management discussions to arrive at an 'informed decision' on critical issues. Third party reports and stakeholder concerns are used as tools only by 23% of the companies[16]. Shareholder activism gains even more importance in a market like this.

V. CONCLUSION

SEBI is constantly working on boosting shareholder activism to increase corporate governance in India. It has declared that investor rights groups fighting court battles will receive financial help from SEBI amounting to 75% of their legal fees. Funding will be considered on a case to case basis, the criteria being that at least a thousand investors are affected by said court battle.[17] These are the initiatives that create a hospitable market for investment. Creeping Acquisitions by Promoters, whereby only 5% additional stake is acquired by them every financial year and hence, they don't need to make a public announcement is just one example of how Legal provisions can be twisted by those in power to suit their interests. S. 211 of the Companies act, 2013 provides for the appointment of Serious Fraud Investigation Officer (SFIO) who has powers to investigate matters of Fraud and also reserves the power of arrest. We have Judicial Activism in the Courts and Shareholder Activism on the fields to fight such misuse and mismanagement. It is time that Activism now shifts from a state-led regulatory activism to a more Market-led

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15 "Guest Post: Performance of Indian Boards" (Corporate GovernanceJune 13, 2012) <https://www.corpgov.net/2012/06/performance-of-indian-boards/>

16 "Guest Post: Performance of Indian Boards" (Corporate GovernanceJune 13, 2012) <https://www.corpgov.net/2012/06/performance-of-indian-boards/>

17 McRitchies J, "India Funds Investor Activism" (Corporate GovernanceFebruary 22, 2009) <https://www.corpgov.net/2009/02/india-funds-investor-activism/>

informed one. The Proxy-Advisory firms bring us closer to this goal and their regulation, which is a one-of-a-kind development in India ensures their unbiased functioning. It is high time that Shareholders start regarding themselves as Nouns in the Financial Markets rather than being mere Adjectives to their Companies. Activism follows money and as the Asian Market grows into a powerhouse with India growing at a rate of 7.0 Percent, more and more investors are going to find their way into India's Financial Market and as they do, Shareholder Activism will expand and diversify the Corporate Governance system of India.

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