



IS SHAREHOLDER ACTIVISM - A TRUE MEANS TO CORPORATE GOVERNANCE?

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ABSTRACT

The term 'corporate governance' which was unheard till 1980's had predominantly occupied the landscape of corporate environment as a panacea to all the problems cropped out of the series of scandals occurred across the world. Essentially, the concept of 'corporate governance' evolved as a reformative measure to secure the interests of shareholders. Today's corporate economy is witnessing a transition in the role of shareholders i.e. from being as a passive equity holders oblivious of their rights to that of an activists, serving as custodians of corporate governance. However, the industrial growth in every nation had simultaneously perceived the existence of corporate raiders. The only difference between the previous era green mailers and today's activists is the objective behind their protests. Along with the demand of a transparent, accountable and efficient corporate environment, securing their monetary interests, today's shareholder activists are demanding the corporate executives to consider the needs of future generations emphasizing on socially responsible investments. To one side of the coin, presence of active shareholder community is resulting in the establishment of an accountable and efficient corporate sector resulting in the healthy economic development, to the other side these 'active shareholders' were perceived by many

directors as the intruders into their decision making process and red flags to the company's public relations. In the light of above raised issues, the researcher in this article would like to throw light on "whether shareholder sovereignty serves as a catalyst to corporate governance or not?" The researcher adopted **doctrinal methodology** to compile the data collected from primary & secondary sources.

Key words: Corporate governance, shareholder activism, socially responsible investments, shareholder sovereignty.

INTRODUCTION: The term 'corporate governance' which was unheard till, "1980s" had predominantly occupied the landscape of corporate environment as a panacea to all the problems cropped out of the series of scandals occurred across the world. Globally, the period of 1997-98 had experienced literally a financial contagion, initially due to the collapse of Thailand currency and then affected the economies of Indonesia and South Korea to a major extent and other countries like Singapore, Japan, China and Taiwan etc. to a lower extent. Indian economy during late twentieth century [period of 1991] highlighted by the process of globalization and privatization boosting the industrial development, had simultaneously witnessed the series of corporate scandals like starting from Harshad Mehta, Ketan Parekh, Bhansali, UTI to very recently Punjab National Bank scam, **DHFL and YES Bank** fraud that had taken away the confidence of all its investors. The decision of Reserve Bank of India in imposing a moratorium on operations and withdrawal limits of YES Bank, due to the bad loans it sanctioned and its inefficiency in raising new funds to cover its non-performing assets had



put many of its customer's in dismay. At this juncture, it is solely the governance reforms that serve as a reformative measure to secure the interests of shareholders, creditors, other stakeholders and help in instilling a sense of accountability among companies towards general public.

Today's corporate economy is witnessing a transition in the role of shareholders i.e. from being as a passive equity holders oblivious of their rights to that of activists, serving as custodians of corporate governance. However, the industrial growth in every nation had simultaneously perceived the existence of corporate raiders. The only difference between the previous era green mailers and today's activists is the objective behind their protests. Along with the demand of a transparent, accountable and efficient corporate environment, securing the interests of all its investors, today's shareholder activists are demanding the corporate executives to consider the needs of future generations emphasizing on socially responsible investments.

ACTIVE SHAREHOLDER COMMUNITY- A CATALYST TO GOVERNANCE?

In the above discussed context, the researcher felt the necessity of addressing two key issues. The primary issue here is "Despite tenacious efforts and sound legal framework, corporate governance had remained as a long-term goal to be achieved and as a subject matter for academic seminars & conferences", the other issue required for an introspection is, "Whether shareholder

activism is a roadway to corporate governance or an intrusion into the corporate affairs turning out to be an impediment in implementation of key decisions of the company?" Simultaneously, addressing these two issues, the researcher would like to provide a brief glance of evolution of corporate governance in India and the role of shareholders in democratic exercise of their rights and in pressurizing the corporate executives in complying with the governance norms.

The increasing role of institutional investors, hedge fund managers and other shareholder associations gave impetus to shareholder engagement in corporate affairs. The establishment of "**Securities and Exchange Board of India**"¹ on 12th April 1992², as a regulator of equities market had laid a strong legal foundation to secure the interests of investors from corporate executives oppression and mismanagement. Corporate governance reforms in India had its genesis under the recommendations of the committee under the chairmanship of **Shri Kumar Mangalam Birla**³], that came up with two types of recommendations i.e. voluntary and mandatory. The major objective advocated by this committee is "incorporation of best governance norms with primary focus on securing the interests of shareholders and other investors. "Few key recommendations suggested by this committee by way of amendments to the listing agreement, that

¹ Here in after referred as "SEBI."

² Initially it came into existence on 12th April, 1988, replacing "Controller of Capital Issues Department", and subsequently gained statutory recognition with SEBI Act in 1992.

³ "Corporate governance", SMDRP/POLICY/CIR-10/2000, Feb 21, 2000, available at <https://www.sebi.gov.in/legal/circulars/feb-2000/corporate-governance_17930.html>,[last visited on 11/27/2019].



resulted in alteration of legal framework i.e. [insertion of clause 49] are the following⁴:

- Composition of Board with both executive & non-executive directors out of which not less than fifty percent of them to be non-executive directors.
- Companies are mandated to constitute audit committee comprised of chairman and a minimum of three non-executive directors, where the chairman is obliged to interact with the shareholders during annual general meeting and resolve all their queries.
- This amendment gave sufficient attention to the interests of the shareholders by involving them in the process of director's appointment⁵ and provided for the setting up of a "*Shareholders/Investors grievance committee*" to redress issues like non-registration of transfer of shares, non-receipt of dividends declared so on. Very importantly, companies are mandated to include *a section on corporate governance in their annual reports* and in case of non-compliance of mandatory recommendations, they are supposed to explain the reasons for the same. Subsequent to this, to enhance the corporate standards, SEBI constituted two more committees.⁶

Right of access to whistle-blowers- A turning point: One of the key recommendations suggested by Narayana Murthy committee is, right to be sanctioned

⁴ Ibid.

⁵ In compliance with Clause 49 of the Listing agreement, shareholders are supposed to be provided with the personal details [like resume, no. of companies they worked as directors] of the directors intended to be appointed.

⁶ One was "Naresh Chandra committee and the other was Narayana Murthy committee in 2002 and 2003 respectively whose recommendations were parallel to suggestions of Kumar Mangalam Birla committee.

to whistle blowers to approach the audit committees, directly without informing to any of their immediate superiors about any suspicious unethical or illegal practice undertaken by the said corporate executives⁷

Corporate governance voluntary guidelines: [2009] Following this, again in the context of global recession and other governance failures like Satyam scandal, CII had constituted a task force under the chairmanship of Mr. Naresh Chandra in the year 2009 to review the existing practices of companies and accordingly to suggest the higher standards so as to comply with the corporate governance norms.

Companies Act, 2013- A historic Milestone: Statutory framework pertaining to the corporate environment had undergone radical changes with the passage of Companies (Amendment) Act, 2013. Few such major changes are:

- Provision for appointment of at least one-third of total number of directors as independent directors. [See, Section 149(4) read with Rule 4 of Companies (Appointment and Qualifications of Directors) Rules, 2014].
- All listed and non-listed companies⁸ are supposed to have at least one woman director in their board. [See, sec149(1) of the Companies Act, 2013]

⁷ Report of the CII Task Force on Corporate Governance, pg.no.5, "Corporate Governance Recommendation for Voluntary Adoption", November 2009, available at <https://www.mca.gov.in.>, [Last visited on 11/28/19]

⁸ Non-listed companies with a paid-up capital of Rs.100 crores or a turnover of Rs.300 crores comes within the ambit of this clause.



- Section 135(1) of Companies Act, 2013 provided for constitution of corporate social responsibility committee with at least one independent director to monitor the activities. However, with the recent statements made by our Hon'ble finance minister, Nirmala Sitharaman, the legal position of CSR had been changed. Now it's no more a criminal offence. It is treated as a civil wrong.

Along with this there were certain other provisions inserted relating to constitution of audit committees, mandatory disclosure of information relating to the related party transactions etc. in order to attain transparency, integrity and accountability in corporate transactions.

SEBI (Listing Obligations and Disclosure Requirement) (Amendment) Regulations, 2018:

“Incompliance with the powers conferred by sec.11, section 11A sub-section 2 and sec.30 of SEBI Act, 1992[15 of 1992] read with sec.31 of SC(R) Act, 1956[42 of 1956], SEBI had amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015⁹. Key features of this amendment are as follows:

- All the top most 500 and 1000 listed companies are mandated to constitute their board of directors with at least one independent woman director by 1st April, 2019 and 1st April 2020 respectively¹⁰
- No person who has attained the age of 75 years shall be either appointed or continued as a non-executive director by any listed

company. In case, if any company would like to appoint or continue any such person, a special resolution along with an explanatory note justifying their decision had to be passed to that effect.¹¹

- No person shall serve as a director for more than eight listed companies from 1st April 2019 and seven listed companies from 1st April 2020.¹²

A prior notice had to be served to the shareholders regarding the appointment/reappointment of statutory auditors. Companies are supposed to constitute committee to redress the grievances of security holders. Unfortunately, despite many efforts put forth by Ministry of corporate Affairs and SEBI altogether, corporate scandals could not be put to an end, resulting in huge monetary losses to the millions of investors.

SHAREHOLDER ACTIVISM- ROAD A

HEAD: Shareholder activism is a generic term used to describe the different strategies adopted by individual or institutional shareholders seeking to effect change within a company whose aim may be to address management issues like remuneration or demanding for an improvement in the performance of the business or to change the company's strategy.

Case Studies reflecting the Shareholder activism as a tool to corporate governance:

No doubt in the changing times, the role played by shareholder activists is acting as a

⁹ Refer, SEBI (Listing Obligations and Disclosure Requirement) (Amendment) Regulations, 2018, No. SEBI/LAD-NRO/GN/2018/10.

¹⁰ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Regulation 17, sub-regulation 1,

clause (a) had been amended through SEBI [Listing Obligations & Disclosure Requirement) (Amendment) Regulations, 2018.

¹¹ Ibid. [SEBI Regulation 17, sub-regulation (1) amended with insertion of sub-regulation (1A)].

¹² *Supra* note 10.



means to corporate governance. A brief overview of different episodes taken place in India and abroad would help us in understanding the same. In 2010, SEBI came up with a mandatory requirement for domestic mutual funds to disclose their voting policies as well as voting actions at their investee Companies, on an annual basis.

• **‘NO-TO EXCESS REMUNERATION TO EXECUTIVES OF TATA MOTORS’:**

The year 2014, marked the first instance of shareholder activism¹³ in India, when the minority shareholders of Tata Motors Ltd. had rejected its company’s proposal to pay remuneration to its managing director, Karl Slym, in excess of the permissible limits prescribed by companies Act, due to the inadequate performance of the company. However in the subsequent year, shareholders gave their acceptance to enhanced remuneration upon the proposal put to second voting. Tata group owned Indian Hotels had appointed Mr. Shapoor Mistry as an independent director. Proxy firms had raised an issue that he cannot be designated as independent director on account of his personal relationship with Cyrus Mistry. Acknowledging the same, the Company had derecognized him as an independent director¹⁴

• **REJECTION OF SALE PROPOSAL AT RAYMONDS:** The recent incident of

shareholders of Raymond Company¹⁵, rejecting a sale proposal of JK house to its promoters & family members at a price disproportionate to the market value stands as a reflection of the fact that “*shareholders are custodians of corporate governance.*”¹⁶

INSTITUTIONAL INVESTORS- HELPING HAND TO SMALL SHAREHOLDERS:

The gradual increase in awareness among minority shareholders about their rights can be accredited to the constant efforts of institutional shareholders and proxy advisory firms. The attempt of **Unifi Capital Pvt. Ltd.**, Chennai based portfolio fund manager in securing a board seat at **Sembic Pharmaceuticals Ltd.** in order to represent small shareholders¹⁷ replicates the increasing participation of institutional investors and portfolio fund managers in the matters of their respective companies in order to secure the interests of shareholders. However the proposal was rejected. “In the recent times, Asian companies had witnessed a significant growth in the activist campaigns with the involvement of foreign Institutional investors”¹⁸.

With a minute equity stake of 1%, the board room battle waged by children’s Investment fund against its Dutch bank ABN Amro opposing its merger proposal with a Royal Bank of Scotland as the transaction would drastically effect the share value resulting in

¹³ Pertaining to remuneration matters.

¹⁴ Shriram Subramanian, “Shareholder Activism in India”, pg.no.1,(2015) available at < www.ingovern.com> [last visited on 3/7/2020].

¹⁵ This incident had taken place in the year 2017.

¹⁶ Hima Bindu Kota, 2018 January 17, “Advent of shareholder activism”, retrieved from < <https://www.dailypioneer.com/2018/columnists/advent-of-shareholder-activism.html>>, [last visited on 3/7/2020].

¹⁷ “Small shareholders” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.[Sec.151 of companies Act,2013].

¹⁸ Harsha Basnayake, “Shareholder Activism in Asia, Can Asian companies thrive in this new era?”, commentary Issue 123, available at <https://thehedgefundjournal.com> [Last visited on 11/27/2019]



the monetary loss to the shareholders and the negotiations it had with the Atticus Capital, a hedge fund which held one percent of stake in Barclays Bank stands note worthy for mentioning about the efforts of institutional shareholders in preserving the share value and thereby protect the interests of its beneficiaries.¹⁹

- **BUY-OUT OF PANAYA BY INFOSYS:**

Amidst several whistle-blower complaints surrounding the India's largest software company in reference to the Panaya acquisition deal and other issues regarding high remunerations paid, the founder shareholder Narayana Murthy had finally involved and wrote a letter to the board seeking clarification on all these issues and asked the company to give explanations to the public about compliance with the corporate governance norms.²⁰ Later, there was a negotiation between the board members and Narayana Murthy consequent to which the company executives had tagged him as a well wisher but not as an activist. This clearly shows that companies are not feeling so comfortable with the presence of shareholder activists

Along with above mentioned case studies, the current corporate scandals so as mentioned in introductory lines like Sahara India Parivar Investor fraud, ICICI-Videocon loan transfer, Punjab National bank scam,²¹ Yes Bank

fraud had once again highlighted the need for corporate governance and shareholder empowerment. Aravind Gupta, who in his capacity as an individual investor and stakeholder in Videocon and ICICI bank, had unveiled this loan fraud at ICICI bank in 2016 which was a clear case of conflict of interest with the executive directors²². Post these issues brought to limelight; few other senior most banking officials like Sandeep Bakhshi, and K.V Kamath were being interrogated by C.B.I.

Ousting of Prannoy Roy and his wife Radhika Roy, the then directors of broadcasting channel, NDTV (New Delhi Television Ltd) for two years, and not to hold any key managerial position for non-disclosure of material and price sensitive information about loan agreements entered into with ICICI Bank and Vishvapradhan Commercial Pvt. Ltd (VCPL) based on a complaint given by NDTV shareholder Quantum securities in 2017, by SEBI, stands as another incident of activism and growing vigilance among shareholders.

Conclusion: The concept of shareholder activism is vast and there are many facets imbibed in it. It ranges from addressing monetary issues to that of non-monetary policies like adoption of environment friendly resolutions, disinvestment from particular companies not complying either

¹⁹ Iris H-Y Chiu, "Shareholder activism unveiled", Page 88 in "The Foundations and Anatomy of Shareholder Activism", [2010], published by Hart Publishing Ltd.

²⁰ N.Sundaresha Subramanian, (April 17th, 2018) 'Panaya: From gold to dust in three years', *The Economic Times*, available at <<https://economictimes.indiatimes.com/tech/ites/panaya-from-gold-to-dust-in-three->

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²¹ The legal aspects of these cases were put before the judicial scrutiny.

²² Bhasha Singh, "ICICI-Videocon: Arvind Gupta tells National Herald why he blew the whistle", published on 7th April, 2018, available at <<https://www.nationalheraldIndia.com>> [Last visited on 11/27/2019]



statutory or ethical norms so on. The fact that the research field of shareholder activism is relatively young and vibrant, coupled with the growing incidence of the phenomenon in our country and in fact across the world, as well as its potential benefits for society as a whole, renders future investigation into the topic necessary.

A clear understanding of the concept at the global level will help one understand how the activist approach had to be perceived by the companies in addressing the unrepresented interests of the small and minority shareholders. Corporate governance reforms had become the need of the day. In this context, the suppression of the activism or negative projection of this concept as a threat to the functioning of companies will shake the very confidence of the investors thus allowing the tyrannical approach of the companies in dealing with the state of affairs. Activist shareholders act as a bridge between internal governance by board of directors and external governance by the market for corporate control, especially during the takeover transactions.

Finally to sum up, whether activism is a true means to governance or not, the researcher perceives that shareholder activism is like a double edged sword with its own pros and cons. Where positive usage will ensure socio-economical benefits to the society, misuse of the same to meet the personal interests of few individuals would hamper the efficient functioning of companies. Hence reference about the drawbacks and misuse of shareholder activism will help in striking a balance between the interests of both shareholders and corporate's.

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