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RISING SHAREHOLDER ACTIVISM AND CORPORATE RESPONSE IN INDIA

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ABSTRACT

Conventionally businesses in our country have been set up around strong promoters. Retail investors had surrendered complete control to the promoters of the company. They just looked forward to earning dividends and capital appreciation on their investments. There was a lack of sufficient regulation which could give the investors an opportunity to voice their opinions. Due to these reasons investors did not take much initiative in the affairs of the company and thus were unable to protect their interests. Promoters also adhered to the minimum levels of disclosures. The investors of the company are not only becoming more and more aware of the actions of their investee company, but they also have access to opinions of experts. From the information and opinions gathered the minority and institutional shareholders define how these companies are run. This research paper attempts to explain the evolution of activism by the shareholders in the country. It recommends measures companies and board of directors can take so that no unfavourable actions are taken by the shareholders.

KEYWORDS: *Blockchain, Corporate Governance, Institutional Investors, PAFs, Shareholder Activism, Small Shareholder*

INTRODUCTION

“Activism” can be defined as an action in which actions are taken aggressively to bring about any change in the prevalent systems. When shareholders of a company realise that the management of the organisation is acting against their primary purpose of maximising the potential of the company to the fullest, they raise their voices against this act of management. This is called Shareholder Activism. Scholars like Bernard Black, Gillian Starks (1998) defined Shareholder Activism. It is defined 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 a proactive effort to change firms’ behaviour or governance rules.” An activist shareholder is one who implements activism through raising ‘voice’ without bringing about any variation in the control of the company.

Thus, shareholder activism is a set of all activities undertaken by the shareholders to force the management of the business enterprise into changing operations, governance parameters, etc. These actions are taken with a view to protect their own interests.

In India, in keeping with the right of the shareholders to protect their interest as they deem fit, they have been accorded with laws and rights to pursue shareholder activism. The laws that provide for shareholder activism are provided in the Companies Act 2013. In addition SEBI - the securities regulator provides measures to the minority investors of the companies listed on the stock exchanges.

Companies Act 2013 provides for shareholders' approval required for a range of decisions and this in itself directly empowers the shareholders. In addition, the Act also allows shareholders to file legal case(s) as a collective against their investee company, and / or the investee company's board for mismanagement & oppression of rights of minority shareholders, and can seek their exit from the membership of the company in certain specified circumstances.

SEBI has pushed the agenda of supporting shareholders' rights and encouraging activism in case they feel that their rights are getting violated, SEBI has framed regulations that provide additional rights to investors (of listed companies) to be heard by corporate managements. SEBI regulations mandate listed companies to form a SRC to give a preemptive system for redressal of investor grievances. SEBI has also mandated provision of electronic voting facilities to allow for remote shareholders to register their say in the matters of the running and governance of the company.

Proxy Advisory Firms (PAFs) are a recent phenomenon that actively advise shareholders on corporate matters and have kindled shareholder activism all over the world. Proxy Advisors are entities that advise shareholders and investors on how to enforce their rights in the investee company on non-financial matters through research and intelligence gathering. Their high influence in developed markets and growing influence in the Indian capital markets make them a valuable player in the times to come. And with a view to support their development - while keeping any potential for missteps in check - SEBI has deemed their regulation through SEBI (Research Analysts) Regulations 2014.

These recent developments in the laws and regulations in India have pushed higher the corporate governance standards and have supported the creation of new mechanisms for the protection of shareholders' rights and providing them remedial measures. With such measures, shareholders too have found a new voice and means to communicate, and resulted in increased shareholder activism.

Shareholder activism could be triggered to meet several objectives ranging from the intent to replace the board of directors to opposing any appointment or reappointment to raising environmental concerns or flagging governance red flags. The activist investors suggest amendments in the policies of the organisation or ask for transparency on non-mandatory matters that may be important to the shareholders - essentially forcing the board and / or management to take certain actions they were otherwise not taking. In extreme cases, shareholder activism has been known to target even the business format of the company.

The key objective is to force the company's management or its board to take some action which they would otherwise avoid. The execution is driven by two key criteria - the type of activist shareholder, and the type of action they seek to push for or to stop. So shareholder activism can take the shape of a proxy war at the AGM of the company or as a threat of litigation and actual litigation or as discussions with the management or the directors or even anti-management campaigns in the business or national media.

OBJECTIVES OF THE RESEARCH

"Shareholder activism" started in the USA several decades ago, even though it evolved in India at the beginning of the twenty first century. One of the several reasons for this paper is to explore the concept of "shareholder activism" in the Indian scenario in reference to the New Companies Act, 2013.

The main aim of the research study are:

- To discuss activism by shareholders as a tool to enhance corporate governance.
- To explore both legislative and regulatory processes that have enabled the growth of shareholder activism.
- Study the impact of shareholder activism on target managers.
- To suggest reforms that companies can incorporate so as to eventually discourage shareholder activism

RESEARCH METHODOLOGY

The study is based on the analysis of the existing literature. Both Indian and international literature has been considered for the purpose of understanding and analysis. Several case studies developed in recent times have been discussed in the relevant sections.

Background

Activism by the shareholder inclines towards matters that may deal with monetary or non-monetary aspects.

Monetary concerns vary from issues relating to the distribution of profits, reducing costs, remuneration of board of directors, enhancing shareholder value by reviewing the business model, and dealing with inefficient use of capital and other resources. By keeping a vigil on the above, the aware shareholders use their right to maximise the worth of their investments.

Non-monetary issues that may give rise to shareholder activism may require increased accountability and transparency in the businesses processes, ensuring adherence of best practices, reforms in the internal system of the enterprise, toxic work environment, non adherence to the ethical code of conduct, issues related to appointment / reappointment of board of directors. Shareholder activism can also help in handling unresponsive managers and pressurise them to respond to the matter in hand.

Activist shareholder makes it possible for the shareholders to get involved in the process of making decisions of the organisation. They also directly engage them with the management of the company.

Strategies Used by Shareholder Activists

Shareholders can adopt varied means to bring about the change desired by them in the functioning of the company. Out of the numerous forms of shareholder activism, it is completely up to the shareholder activist to choose the form of activism. The activists can choose on any strategies stated below:

Shareholder Resolution

The shareholders can submit a written proposal for a vote at the AGM of the company. The management generally does not prefer such submissions from the shareholders, but with the changing business environment they are not left with much choice but to accept. This method is extremely useful to attract the attention of more retail individual investors and the general public as well.

Proxy Conflicts

Conflicts between shareholders and corporate management may happen when a group of minority shareholders are dissatisfied with the management's actions and decisions. In this conflict, sometimes the enterprising shareholders tend to involve passive shareholders, using their proxy voting rights to pressurise the management.

A proxy fight or a proxy battle refers to the act of existing classes of shareholders coming together to accumulate enough shareholder proxy votes to win a corporate vote.

Media Campaigns

Activist investors may use any form of media - mass media or social media either in isolation or in combination to bring to the attention of the public at large an issue in a company. Such campaigns enable in putting required pressure on the company. Social media platforms such as Twitter are being used for running such campaigns.

Management or Company's Board Parley with Shareholders

The grievances of the aggrieved investors can be resolved by having a discussion with the management of the board of directors on a regular basis. This is the simplest method to reach a solution. It sometimes gets difficult to engage in negotiations with the concerned officials. Thus adopting other tools of shareholder activism becomes mandatory.

Litigation

Activist investors can pressurise to initiate or resort to take action in the court of law against the management to get the company to agree to their demands. This option is not preferred by the two parties as the outcome is a substantial loss of reputation. Loss of a company's goodwill is extremely unfavourable for both. This course of litigation is costly for everyone involved.

Measures Adopted by Regulators in Strengthening Non-promoter Investors.

After unveiling of the various financial scams in the Indian Capital Market and also across the globe it became essentially imperative to save the interests of retail individual investors and boost their trust in the capital market. Also with the opening of the economies it became essential to strengthen the capital markets in all respects. So it can be clearly analysed that in the previous two decades there have been consistent changes in the Indian capital market. These developments have been aimed to increase transparency in the functioning of the companies. Thereby enhancing investor confidence especially that of the retail individual investor.

In the present times it is relatively easier for the small investor to become an integral part of the corporation in which he has his stakes. With the initiation of new procedures, investors can put forward their opinions. Activism has been enabled by the combined efforts of the regulators and by the activist shareholders. The regulators have paved the way for participation of small shareholders in the process of making decisions.

E-Ballot

The top five hundred listed companies on the BSE and the NSE give the facility of voting electronically to the shareholders. The Companies Act 2013 (Section 108) has made it compulsory for all the listed businesses to enable electronic voting facilities. This initiative allows retail individual investors to put across their opinions on the agenda to be discussed. They don't have to travel to far away places anymore. Voting is just a click away.

Subjecting All Related Party Transactions to Minority Approvals

All the Related Party Transactions (RPTs) are to be agreed upon by the shareholders of the company by passing a special resolution. In 2004, Siemens India management intended to restructure its India business and took a decision to sell its Metals Tech Business to its German company. In this context the consent of small shareholders through a special resolution. was required as it was a related party transaction proposal. The minority shareholders did not approve of the offer price as it was extremely low. Resultantly the parent company increased the purchase price from 857.2 Cr. to 1,023.27 Cr. Retail shareholders of United Spirits disapproved nine related party transactions with the companies of Vijay Mallya.

Grievance Redressal Mechanisms

Any company which is listed on the stock exchange or has greater than thousand investors shareholders must certainly have a Stakeholders Relationship Committee.The aim of this Committee is to resolve the concerns of the investors. All these companies which are listed on the stock exchanges must be registered on the SEBI Complaints Redress System. It is a centralised online platform which facilitates investors to file complaints and then keep a track of their complaints.

Independent Director for Small Shareholders

A retail individual investor refers to an individual holding shares of nominal value not exceeding ₹ 20,000 or any other value as mentioned. Listing Agreement mandates at least one half of the members of the listed company's board be independent. It further states that at least one third of the Board comprises independent directors when the chairman is a non-executive director. In addition to these restrictions, Companies Act 2013 states that all listed companies appoint a minimum of one director who is directly selected by minority shareholders. The rationale behind the inclusion of this concept was to protect the interest of the minority shareholders.

Collective Legal Action

When the rights of any of the investors are violated by the company due to inept practices of the management then the Companies Act 2013 (Section 245) permits for collective action to be taken by that section of investors. These suits can be lodged by a minimum of hundred investors or five percent of the total number of investors.

Oppression and Mismanagement

Oppression refers to those acts of the management of the company when they do not follow the standards of fair dealing with shareholders of their company. There is violation of conditions with respect to rights of shareholders. Mismanagement refers to the practice of managing company operations of the company in a dishonest, biased or incompetent manner. In such a situation a minimum of ten percent of the total number of investors (whichever is less) or investors having a minimum of ten percent of the outstanding share capital of the company, can approach the NCLT to take an action against the said company for conducting operations in a biased manner.

Information to the Serious Fraud Investigation Office

After a special resolution is passed, the investors can inform the Central Government about their concerns with the company. On receiving such an application the respective government can instruct a Serious Fraud Investigation Officer to thoroughly probe into the operations of the said organisation.

Promoting Involvement of Indian Institutional Investors

The GOI and Securities Board of India together have made consistent appropriate endeavours to promote engagement of

MF in the decision making process of the companies. In the year 2010, a circular was issued by the SEBI requiring the MF to use their rights to vote in the company in which they had invested. The AMC of the MFs has to certainly reveal their annual reports, guidelines & procedures related to their votes on their websites.

Role of PAFs in Shareholder Activism

Until the year 2010, The domestic institutional investors till the year 2010 had been conventionally related with matters such as mergers and acquisitions, corporate restructurings of the companies in which they had invested their funds. Information was gathered on several frameworks such as routine business actions such as related party transactions; sale of assets of business, tenure of the directors, appointments / reappointments and remuneration of directors, duties of directors, nomination of auditors, raising of funds via debentures or equity shares.

Domestic Institutional Investors over the years felt the need for participating actively in keeping track of the decisions taken by the management. These Institutional Investors diligently take measures to protect their interest along with the interest of their own unit-holders. For this purpose the investors depend on PAF for support.

A Proxy Advisory Firm is a business that advises institutional investors on voting recommendations on resolutions to be discussed at meetings of shareholders of the companies in which they have invested. The origin of the concept of PAFs can be traced back to the United States when the SEC made it compulsory for institutional investors to vote on all the agenda mentioned in the statements, thereby setting the foundation stone for the PAFs. These firms then carry out research and give suggestions to their clients. Currently these firms are extremely powerful in America as institutional investors in the States depend on the suggestions given by the PAFs when voting. The PAFs should make recommendations in sync with the objective of maximisation of shareholder value, but their suggestions also reflect other considerations of other aspects.

The emergence of PAF’s has helped the Institutional shareholders to judiciously combine their interests and the rights of other shareholders. This would enable them to deal with the objectionable matters in the operations of the company. The institutional investors can also help the management in the governance of the company. This would serve a dual purpose.

To further protect minority interests, SEBI in 2010 made it mandatory for MFs to reveal their voting policies and actions in the companies in which they have invested. This propelled the genesis of PAF’s in India who saw an opportunity in offering their services to the MF's. Since then, while the impact of PAF's may not be very apparent, it is certainly progressing. While there is limited factual data to ascertain this impact, PAF's role can not be understated.

A negative recommendation by a PAF recently showed how impactful they can be. In 2015, the PAFs advised against Maruti Suzuki’s proposal to get automobile spare parts from its parent Suzuki, in place of manufacturing them in-house. Armed with a negative recommendation from the PAF's, Maruti Suzuki's institutional investors sought SEBI intervention to safeguard minority interests by stopping this related party transaction.

Maruti Suzuki's institutional investors owned nearly seven percent of the company and through their resistance, forced Maruti Suzuki to subsequently publish the rationale for their decision to go with the related party (Suzuki). While the Maruti Suzuki board ultimately voted in favour of the related party transaction with a big majority, it still goes to show the significant impact a negative recommendation from a PAF can have on a company's operations. So the companies are understanding the need to be more transparent and communicative with their shareholders.

Since 2010, India has seen the origin of various PAF's. InGovern Research Services, India's first PAF - started operations in June 2010. As of date, Institutional Investor Advisory Services India Limited (IiAS) is another significant PAF. Both these PAF's focus on independent research and data collection and analysis to offer their opinions to their clients.

Discussion and Findings

Shareholder Activism is a pertinent leap in the advancement of capital markets. It propagates more transparency and paves a new way for adding value to all the investors. Occurrence of such activism in the country and abroad have had a substantial impact on the attitudes of company's promoters, directors, and the company's managers along with institutional investors. Companies across the globe have started to understand that having shareholders run campaigns is unproductive. The negative impact of shareholder activism are as follows:

- The activist shareholders in extreme adverse situations can get the management replaced.
- This may put the company's management at significant risk of a hostile takeover.
- Shareholder activism involves huge litigation expenses.
- Propagation of adverse marketing campaigns can lead to substantial loss of goodwill to the company. In addition to a direct negative impact on sales of the company, it will also influence customer and supplier relations.
- Shareholder activism can disorient the company's management. The focus of the management shifts from the daily operations to managing the attacks of the activists.
- Shareholder activism may bring attention of various regulators to the operations of the company.
- Generally shareholder activism may result in a decrease in market capitalization temporarily. This results in difficulties in raising funds from the capital market.

While making strategic corporate decisions like allocation of capital, business operations, business ethics, environmental impact of business, the Boards of directors and Senior Managers are largely thinking like activists.

Influence on Corporate Governance

Impact of Shareholder Activism on governance of the companies has been extremely positive. These are

- Corporates are now emphasising on a comprehensive outlook rather than a profit oriented approach to a comprehensive approach. Corporates listed on stock exchanges are required to invest into projects which have a positive impact on society upliftment and environmental challenges.
- Management is now thinking unconventionally. This would help the company to know the plans of active shareholders in advance.
- Emphasis on effective and timely communication between the management of the company and shareholders.
- Changes in practices of the managers, working culture of the organisation would help the organisation in the long run.

Suggestions for Corporate Management and the Path Forward

Regulators and market forces (like Proxy Advisory Firms) enable strengthening Shareholder Activism. The management can enhance corporate governance by taking the following initiatives.

1. Creation of Minority Shareholder Forums

It is imperative for the shareholder to get involved with the company. For this third-party regulated forums that can be created for their shareholders. These platforms will facilitate the exchange of ideas amongst different shareholders and also with the company's management. These forums will be advantageous for both the shareholders and the management.

If the management is aware of the concerns of shareholders they can take an appropriate action to please the minority shareholders. There might be situations where it might not be possible for the company to incorporate the suggestions and concerns of the shareholder. In such situations the management can adopt the right kind of tools to make the investors aware. This would help to change the shareholders' opinions in advance, before they raise campaigns and harm the company's goodwill.

2. Use of Technology to Enhance Corporate Governance

There is a range of new technologies available these days looking for new use cases. Corporate Governance can provide an interesting backdrop for the use of these deep-tech use cases that support greater transparency and empower the shareholders.

Artificial Intelligence is one such technology that can be implemented to support the regulators and Proxy Advisory Firms to identify the cases that may require further diligence and activism.

Another technology is the Blockchain Technology that could offer decentralised ledgers of transactions that can not be controlled by the company. Because it is decentralised and immutable by invasive forces, blockchain technology support the shareholders with genuine and actionable information to make decisions about the future of their company.

While the implementation of these technologies will serve the shareholders, the companies too can use these technologies to signal the transparency of their governance standards by adopting these technologies and allowing shareholders to connect with each other. In addition, these technologies can also bring down the cost of implementation of corporate governance actions.

3. Investor Outreach Programs

Investor outreach program should be designed to develop and nurture relationships with the top institutional investors. This would pave way for a strong two-way communication to address their concerns

4. Proactively Address Gaps and issues that could vex investors into becoming activists. This could be done through appointing committees that report directly to the board of directors or get external auditors and/or consultants to provide an outsider's perspective on the business and preventing negative shareholder sentiment

5. Independent Review of Board Performance

Boards can assume greater oversight of themselves by establishing independent review of their own performance to be shared with the minority shareholders. Independent third parties can be Credit Rating Agencies like Fitch India, CRISIL, Brickworks or even PAFs themselves. Such a step would serve to enhance the credibility of the company. Thus preventing shareholder activism.

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