

Should Shareholder Activism in India Be A Mere Reality or Absolute Necessity?



What shareholder activism really means is, a revolutionary action for exercising their democratic right to effect social, environmental and corporate change and to build better, more sustainable business which in turn help the corporations become better governed business overall. There are numerous weapons in the activist armoury that empower the stakeholders to involve themselves in setting the situation right, whenever they are of the view that the company in which their financial and physical capital are invested is being managed in an unethical/inefficient/ irresponsible manner and that may endanger safety of their investment and risk their personal reputation and respect. Unlike in the western world, where there is strong shareholder activism, the concept that was enjoying its infancy for several decades, seems to be growing from baby steps to youthful strides in India. This article discusses different aspects of shareholder activism in India. Read on to know more...



CA. H. Ghosh

(The author is a member of the ICAI, working as Joint Director in the Institute. He can be reached as ghoshi@icai.org)

“The world is a dangerous place, not because of those who do evil, but because of those who look on and do nothing”- Albert Einstein

How Did the Concept Evolve?

With the growth of Indian economy at a decent pace, the issues relating to corporate governance and accountability are becoming increasingly important. Gone are the days when shareholders (minority in particular) were mostly content with receiving regular

In India, there are primarily four avenues which ensure that debt holders and equity holders can exercise exit or voice opinions to make company management accountable. These include the Companies Act 1956; the SEBI Act 1992, and various regulations prescribed by the SEBI; a market for corporate control and active participation by financial institutions and institutional investors.

return (interim/final dividend) on their investment and having convenient exit option of realising their capital along with comparable appreciation. Simply, with provision of those two facilities cum flexibilities, they seldom bothered about the FAT (Fairness, Accountability and Transparency) factors of corporate governance and were hardly interested to know how their company was functioning or controlled by whom and what pragmatic measures need to be adopted to safeguard their investment at least to ensure its consistent return and to protect the company from probable failures due to bad management.

Now, they are more concerned about investment security and corporate sustainability with special emphasis on certain fundamentals such as, safety and reliability of products that their company produces, profit (not how much but how such) maximisation and market capitalisation, social and environmental care, faster and better movement of their company to achieve global recognition, strategic management to reduce risk, broadening of brand value and image building, improving corporate culture and employee loyalty with respect to human rights and importantly enhancing effectiveness of enterprise governance.

In fact, with the aid of regulatory power provided by laws of the land, the shareholders, be it singly or collectively, can now assert their democratic right by challenging the board decision, demanding poll on a resolution or calling extraordinary general meetings to resolve issues whenever they come across irregularity or inconsistency in the functioning pattern of the company or the management falls short of their expectation. Exercise of such articulated action open to the shareholders, in short, refers to shareholder activism. Ideally such right should be exercised responsibly, putting aside their ego and bearing in mind the best interest of the shareholders, stakeholders, employees, environment and the community at large. At the heart of shareholder activism is the quest for

value, yet the empirical evidence suggests that effects of such activism are mixed.

How Far the Concept of Shareholder Activism is Organised in India?

Unlike in the western world, where there is strong shareholder activism, the concept that was enjoying its infancy for several decades, seems to be growing from baby steps to youthful strides in India. The proxy advisors, in those countries, offer proxy advisory and solicitation services that may enhance effectiveness of activist coalition's campaign. Active investors are clearly influenced by the recommendations issued by such advisors to vote for or against a proposal. In particular, their recommendations encourage passive shareholders to vote in favour of proposals put forward by an activist coalition. In that line, the (two) proxy advisory firms like In-Govern and Institutional Investors Advisory Services (IIAS) are aiding the development of the (shareholder activism) idea for improvement in corporate governance practices in India.

There are several instances of shareholder activism in India. In the wake of consistent strike at its Manesar Plant, the worried investors of Maruti Suzuki dared to take the step of talking directly to the representatives of workers' unions while its stock price slipped to 52 week low. At the behest of the minority shareholders, the Crompton Greaves had to give a commitment towards selling a ₹270 crore jet that it bought during the period of disappointing profit to an unlisted group company. While the state owned institutional investor, LIC, increased its investment up to ₹3,500 crore in various tobacco companies, an NGO, working for cancer patients, raised its voice and questioned over the ethics and irony of such acts and the investor was at the receiving end.

What is Share (Stake) holder Activism All About?

Shareholder activism (in fact, shareholder engagement), in short, refers to exerting articulated pressure by exercising democratic power provided to the shareholders as owner/monitors of the company to influence its behaviour. The active participation of shareholders in their company's operations can ensure better management, less frauds, superior performance and improved corporate governance. By virtue of corporate democratic rights provided to them, the shareholders can raise concerns over economic, environmental even social issues in the annual or other general meetings. Shareholder activists generally include public institutional funds, unions, religious

institutions, universities, foundations, environmental activists and human right groups. Shareholder activism can be exercised through proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management.

What are the Possible Ways to Make It Work Effectively?

With the support of legal and institutional framework, the enlightened shareholders have pursued a much expanded and increasingly sophisticated series of tactics in their effort to monitor the corporations, in which they have invested, including everything from public lobbying to quiet, rigorous, behind the scene negotiations. In fact, the traditional board centric model of corporate governance now seems insufficient and tends to gravitate toward a paradigm that includes an increased role for shareholders. Shareholders now have greater access to proxy voting process. They can nominate dissident board candidates along with the selected management nominees. Active investors may seek or avail services of proxy advisory professionals and can vote for or against a proposal. And they can communicate among themselves. In short, shareholders now have a greatly enhanced opportunity to involve themselves in company operations.

Regulatory Options for Stakeholders to Make Management Accountable?

The main objective of the Companies Act is to ensure that the interests of the creditors and shareholders are adequately protected and that the shareholders are adequately represented in the management of a company. Since the day to day business of a company is controlled by the board of directors, it is, therefore, important that corporate boards can influence how well a company is run and functions. Enlightened shareholders, supported by a legal or institutional framework, can provide the necessary bulwark against

discretionary behaviour of management. In India, there are primarily four avenues which ensure that debt holders and equity holders can exercise exit or voice opinions to make company management accountable. These are the Companies Act 1956; the SEBI Act 1992, and various regulations prescribed by the SEBI; a market for corporate control (in the post economic reform scenario, regulation for substantial acquisition of shares ensures transparency in operations, equity and disclosure of material information to parties concerned) and active participation by financial institutions and institutional investors. There are rules that allow minority shareholders to take certain remedial action if they believe that they are being oppressed by the majority shareholders, and the company is indulging in management of resources in a way that causes prejudice to the interest of the company and the public.

Is shareholder activism controversial?

Those who favour the concept argue that companies with active and engaged shareholders are more likely to be successful in the long term; yet many reformers who are uncomfortable with this decentralised, market driven change, argue that pluralistic change is divisive and disruptive to corporations, boards, and even investors. They propose instead a “peaceful” solution that imposes a rigid process, vests power in a few arbitrary hands, and shuts down the opportunity for debate, contention and argument. Though, no change at all is better than the wrong kind of change, we need to promote this decentralised, market driven approach and fight those who would replace democracy with bureaucracy.

How does Shareholder Activism work in France?

In general, Shareholder Activism in France is a multi-stage process, which only in certain circumstances is escalated to the most hostile stage. The stages are illustrated below.

- Target Selection: The first stage involves target selection from a portfolio of firms. The choice of a target could be driven by a number of considerations relating to underperformance, governance, social or environmental issues.
- Private Engagement: The second stage, known as “behind the scenes” or Private engagement activism consists of collaborative informal communication activities (e.g., Private meeting with CEO and the Chairman or meeting with board members.)
- Public Engagement: In contrast, the third stage becomes confrontational as a result of the refusal

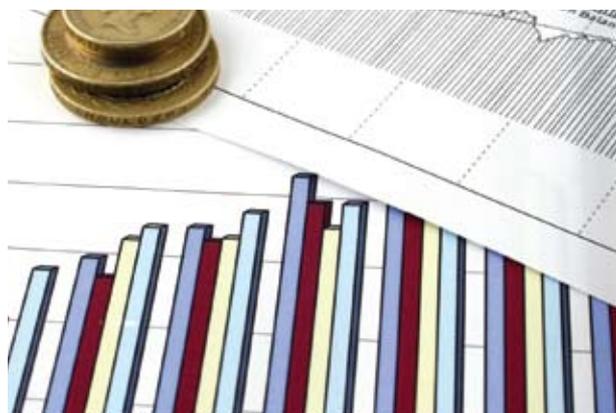
The market for shareholder activism in India is at a nascent stage. There are no large shareholders' associations that can monitor and exercise control over corporations. The central problem in Indian corporate governance is not a conflict between management and owners as in the US and the UK, but a conflict between the dominant shareholders and the minority shareholders.

by the target management to accommodate the changes sought by the activists. This stage refers to proxy voting process to support a shareholder proposal or to contest a management proposal at the shareholder meeting. It may also be characterised by activities such as media coverage, lobbying initiatives, and a proxy battle.

- **Hostility:** Finally, the fourth stage is characterised by the most hostile degree of activism and can take the form of a publicised exit by a dissatisfied shareholder, a takeover attempt, and/or a lawsuit. There are documented positive correlations between legal actions and calls for Extraordinary General Meetings (EGMs) of shareholders. In particular, when executive remuneration is the issue, shareholder activism appears to be most expressed through AGMs, through the courts or by filing a complaint with the authority appropriate.

A recent (TCI) case on shareholder activism related to CIL dispute may attract wider corporate governance issues and if not resolved deftly, may call for involvement of the UN Trade Commission

One of the partners at The Children's Investment Fund Management, TCI, remarked- *"We have a strong record of activism in many countries and just because no one has done this in India before doesn't mean it's not going to work"*. Importantly, TCI that holds nearly two percent of the Coal India Ltd. (CIL) share, largest holding after the Government of India, has commenced legal action after its repeated attempts to engage with CIL and the Government had failed. Certain concerns such as, Government involvement in the pricing of coal (CIL sells much of its coal under fuel supply agreements at up to 70% discount to market rates), contravention of two international agreements for the promotion and protection of investment, failure on the part of CIL Board to stand up for the interests of the



With a view to strengthening control mechanism, improving the governance standard and protecting the interest of investors and minority shareholders, in particular, the Companies bill prescribed a lot of new provisions. These include introduction of the concept of corporate social responsibility; proposal of provisions in respect of vigil mechanism (whistle blowing); introduction of the concept of independent directors, etc.

company and protecting the interest of the minority shareholders leading to breach of fiduciary duties, "lack of leadership" at CIL since IPO are the few to mention that TCI has alleged. That partner even went on saying- *"The implications are huge and potentially very detrimental to India if they don't follow through in a sensible fashion. If they choose to list a company they have to treat minority shareholders with respect"*. The instant impact of those allegations is that the independent directors of CIL opposed Fuel Supply Agreements (FSAs) with nearly 50 power units and perhaps the Coal Ministry of the Government has no better option than to suspend signing any such FSAs in March 2012.

Why Shareholder Activism in India is Not Gaining Popularity?

The market for shareholder activism in India is at a nascent stage. There are no large shareholders' associations that can monitor and exercise control over corporations. The central problem in Indian corporate governance is not a conflict between management and owners as in the US and the UK, but a conflict between the dominant shareholders and the minority shareholders. The board cannot even in theory resolve this conflict. But, how can one, even in theory, envisage a board that can discipline the dominant shareholders from whom the board derives all its powers? In reality, the problem of dominant shareholders arises in *three large categories* of Indian companies. First, are the Public Sector Undertakings (PSUs) where the Government is the dominant (in fact, majority) shareholders and the general public holds a minority stake (often as little as 20%). Second, are the Multi National Companies (MNCs) where the foreign parent is dominant (in most cases majority) shareholders. Third, are the Indian business group where the

promoters (together with their friends and relatives) are the dominant shareholders with large minority stakes, Government owned financial institutions hold a comparable stake and the balance is held by the general public.

That apart, there is a lack of active long term investors such as pension and hedge fund institutions; in comparison as in India, investors usually set sight on short term gains. The Indian market holds the history of limited institutional ownership with promoters including Government holding majority stakes followed by retail investors and institutions. Moreover, India suffers from a problem of too many regulations. Investors have little faith in the system as high litigation cost is involved; manipulative ways are adopted by the promoters sometimes, which makes it tough for activist shareholders to survive.

What are the Ways Forward?

With a view to strengthening control mechanism, improving the governance standard and protecting the interest of investors and minority shareholders, in particular, the Companies bill prescribed a lot of new provisions and a few are cited below.

- Concept of corporate social responsibility is being introduced
- Provisions in respect of vigil mechanism (whistle blowing) proposed
- Concept of independent directors introduced
- In addition to Audit Committee, various committees like Nomination and Remuneration Committee and CSR Committee have been prescribed
- Exit option to shareholders in case of dissent to change in object for which public issue was made
- Specific disclosure regarding effect of merger on creditors, key managerial personnel, promoters and non-promoter shareholders is provided
- The Tribunal is being empowered to provide for exit offer to dissenting shareholders in case of compromise or arrangement
- Valuation by registered valuers mandatory for certain actions like issue of shares to persons other than existing shareholders, acquisition/selling of assets on non-cash considerations to Directors/persons related to Directors, valuation at the time of merger/amalgamation, purchase of shares held by minority shareholders by majority shareholders



- Acceptance of deposits from public subject to a more stringent regime
- Central Government to have power to prescribe class or classes of companies which shall not be permitted to allow use of proxies
- Provisions that a person shall have proxies for such number of members/ such number of shares as may be prescribed
- Provision for class action suits to provide minimum number of persons who may apply for such suits and safeguards against misuse of these provisions
- Right of an investor to claim to continue even after transfer of the amount to Investor Education and Protection Fund (IEPF)
- Statutory status to Serious fraud Investigation Office proposed

Conclusion

The shareholder activism, in its softest form, should be of prescribing suggestions on strategic issues wherever really needed to ensure sustainable success of a publicly traded company. Since shareholder activism is a situation specific action, there cannot be "one size fits all" formula. In fact, there are numerous weapons in the activist armoury with diverse powers; its application therefore, should be invoked wisely to bring about the social and cultural change peacefully, leading to satisfaction of all stakeholders. Finally, let the share (stake) holders use that democratic power in right spirit for better governance of corporations. Let us conclude by remembering the words of wisdom of the Comptroller and Auditor General of India, Mr Vinod Rai, "No business can be sustainable unless based on probity and integrity.... do not succumb to the temptation of short term gains...nothing wrong will go unnoticed for long". ■