

# INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

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Volume 3 | Issue 5

2021

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# Shareholder Activism and Role of Proxy Advisory Firms in India

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## ABSTRACT

*Historically speaking companies in India have undermined the interests of shareholders over that of the promoters. Due to the impetus given by the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, shareholder activism gained some momentum in India. Moreover the advent of Proxy Advisory Firms (PAFs) have greatly contributed to shareholder activism. The author through this article has focused on the statutory provisions empowering the concept of shareholder activism in India as well as the role of PAFs.*

## I. INTRODUCTION

A shareholder is a part-owner of a company and the decisions taken by the Board of Directors have a direct impact on the rights of these shareholders. As seen in the past, increase in corruption and scams underpinned the value and power of shareholders and gave an edge to the promoters. However post the Satyam scandal, corporate governance structure witnessed a break-through in India. With the introduction of the Companies Act, 2013, shareholder activism has been on an upswing in India. Primarily, shareholder activism is seen as the efforts taken by the shareholders to influence the management or operations of the company in order to protect their interests over the promoters. From a multi-national perspective, India is at a nascent stage when it comes to shareholder activism however recent trends such as involvement of PAFs show

an upward movement affecting the major decisions of the company.

## II. LAWS TO BACK SHAREHOLDER ACTIVISM IN INDIA?

### Companies Act 2013

There does not exist any given law precisely with respect to shareholder activism in India. However, certain sections of the Companies Act, 2013 (“the Act”) empower shareholders to actively participate and take decisions for the working of a company.

#### 1. Appointment and removal of Directors

According to section 151 of the Act, small shareholders can seek the appointment of a minority shareholder representative as an independent director on the board of a listed company.<sup>2</sup> The presence of such an independent

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<sup>2</sup> The Companies Act 2013, s.151

director endows significant participation of minority shareholders. The very first instance of minority shareholder representation was observed through appointment of a small shareholder director by Unifi Capital on the board of Alembic.<sup>3</sup>

Similarly, the Act empowers shareholders to remove a director prior to the completion of his/her tenure by an ordinary shareholders' resolution which merely requires approval by a simple majority.<sup>4</sup> September 2020 will be remembered as a turning point in the history of shareholder activism. The minority shareholders of Lakshmi Vilas Bank created history at the AGM as they rejected 7 resolutions out of the proposed 10 resolutions regarding the appointment and re-appointment of Directors and Statutory Auditors.<sup>5</sup>

## 2. Class Action Suit

If the management or conduct of the affairs of a company are being conducted in a manner detrimental to the interests of company or its shareholders, then the shareholders are authorized to institute a class action suit against the company, its directors and third-party advisers.<sup>6</sup> However, to institute such an action, a requisite criteria needs to be followed as given under the Act. With the incorporation of this right, the Indian Corporate Law has taken a step

ahead from the restrictions laid down by the English court in *Foss v. Harbottle*.<sup>7</sup>

## 3. Requisite approval of shareholders

Although the management of the company is under the Board, but the Act restricts the power of the Board as certain matters require the prior approval of shareholders. In public companies, a special majority is required for matters pertaining to sale or lease<sup>8</sup>, mergers and amalgamations<sup>9</sup>, or related party transactions.<sup>10</sup> This right is critical as it can be exercised by shareholders to oppose major resolutions of the Board.

The recent case of UPL show that promoters carrying out abusive related party transactions and off-balance transactions take value away from companies and lead to low confidence in the companies.<sup>11</sup>

## 4. Voting method

An essential feature of shareholder activism is the right to vote which represents a democratic force of the company. Under the Act, every member of a company limited by shares and holding equity share capital have a right to vote on every resolution placed before the company.<sup>12</sup> 2018 saw a rise of shareholder activism where minority shareholders at HDFC, Apollo Tyres and Hindalco Industries blocked resolutions pushed by promoters.<sup>13</sup>

<sup>3</sup> InGovern, 'India Proxy Season 2017'

<sup>4</sup> The Companies Act 2013, s.169

<sup>5</sup> Stakeholders Empowerment Services, 'Lakshmi Vilas Bank – Silent majority must suffer', 2020

<sup>6</sup> The Companies Act 2013, s.245

<sup>7</sup> (1843) 2 Har 361

<sup>8</sup> The Companies Act 2013, s.180 (a)

<sup>9</sup> The Companies Act 2013, s.232

<sup>10</sup> The Companies Act 2013, s.188

<sup>11</sup> InGovern, 'India Proxy Season 2020'

<sup>12</sup> The Companies Act 2013, s.47

<sup>13</sup> Vijayanthi M C, 'Companies face hurdles as shareholder activism rises' *New Indian Express* (Mumbai 7 October 2018) <<https://www.newindianexpress.com/business/2018/oct/07/companies-face-hurdles-as-shareholder-activism-rises-1882037.html>> accessed 5<sup>th</sup> August 2021

Moreover, the Act permits shareholders holding at least one-tenth of voting paid-up share capital to notify the Board for requisition of an extraordinary general meeting (EGM)<sup>14</sup>, and if the Board fails to do so within 21 days of the requisition notice, the shareholders may themselves call the EGM.<sup>15</sup> The Board is required to reimburse any requisition-related expenses.<sup>16</sup>

### Listing Regulations

Another legislation that provides shield to shareholders of listed companies is the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("Listing Regulations"). The Listing Regulations authorizes and mandates every listed company to form a shareholders' relationship committee that will address the grievances and complaints of shareholders.

Furthermore, as per the Listing Regulations, every listed company is required to provide electronic voting facility to shareholders to increase their participation and compulsorily disclose the events pertaining to opinion of board of directors such as revision in ratings, resolutions of board meetings, corporate acquisitions, etc.

### III. ROLE OF PROXY ADVISORY FIRMS (PAFS)

As the name suggests, proxy advisory firms (PAFs) are intermediaries who advice

institutional investors and shareholders to exercise their rights for improving the standards of corporate governance. Although merely a decade old, PAFs in India have found a place in the Indian market microsystem as intermediaries strengthening shareholder activism. The Securities and Exchange Board of India (Research Analysts) Regulations, 2014 regulate both domestic and international PAFs. Unlike the PAFs globally, those in India do not have a proxy vote. This means that their advice is non-binding; making their role largely that of advocacy. However, the propositions given by PAFs have a significant effect on shareholders to collectively overcome a decision of the company and workout the decision in their favour.

PAFs have their voting policies available in the public domain well in advance of SEBI making it mandatory. Therefore, insurance companies, foreign institutional investors, mutual fund investors as well as retail investors can access the information rendering it easier for them to make well-informed decisions about a company.

In January 2020 InGovern, a domestic PAF, challenged the management of Sterling Wilson for the non-utilisation of funds as per the objects of its IPO and mandated that SEBI must force the promoters to provide an exit offer to the public minority shareholders.<sup>17</sup> On the recommendation of the PAFs, shareholders voted against the Tata

<sup>14</sup> The Companies Act 2013, s.100 (2) (a)

<sup>15</sup> The Companies Act 2013, s.100 (4)

<sup>16</sup> The Companies Act 2013, s.100 (6)

<sup>17</sup> InGovern Research Services, 'Sterling and Wilson Solar Limited: Solar Eclipse for Minority Public

Shareholders of a Solar EPC Company' (*InGovern*, 9 January 2020) <<http://www.ingovern.com/2020/01/sterling-and-wilson-solar-limited-solar-eclipse-for-minority-public-shareholders-of-a-solar-epc-company/>> accessed 3 August 2021

Motors executive remuneration resolutions.<sup>18</sup> Although relatively new, PAFs in India have played a role in influencing mergers & acquisitions transactions. Despite the Akzo-Nobel merger, more than 45% of minority shareholders raised their voice against the resolution on the recommendations of InGovern.<sup>19</sup>

The failure of Vedanta delisting shows that the rights of shareholders cannot be suppressed anymore. Based on the reports and research done by PAFs, public minority shareholders as well as LIC the institutional shareholder of Vedanta tendered their shares at high prices forcing the promoters to withdraw the offer.

#### IV. DEVELOPMENTS MADE BY SEBI TO REGULATE PAFs

PAFs were brought under the legal regime under the Securities and Exchange Board of India (Research Analysts) Regulations, 2014 that mandated registration with SEBI, disclosures of recommendations, formation of procedures and policies and maintenance of records. Later in May 2019, a 41-page report<sup>20</sup> was published by

the working group formed by SEBI in November 2018. The working group suggested improvements on several aspects of PAFs pertaining to conflict of interest between PAFs and companies, increase in disclosures, code of conduct, etc. Taking into account the report of the working group, SEBI introduced Procedural Guidelines<sup>21</sup> for Proxy Advisors and the Grievance Resolution<sup>22</sup> between listed entities and proxy advisors. The new guidelines directs PAFs to be more transparent and maintain a good standard of code of conduct. However, the enforcement of these guidelines was shifted to January 2021 on account of the COVID-19 pandemic.

#### V. THE WAY FORWARD

Despite the on-going COVID-19 pandemic and shift in paradigm from physical to virtual world, the participation by shareholders in carrying out the important operations of the company was not majorly affected. With virtual meetings, online webinars and conferences, engagement by shareholders and investors took on a different note. Aggressive voting with respect to the

<sup>18</sup> BS Reporter, 'Shareholders reject Tata Motors pay plan' *The Business Standard* (4 July 2014) <[https://www.business-standard.com/article/companies/shareholders-reject-tata-motors-pay-plan-114070400117\\_1.html](https://www.business-standard.com/article/companies/shareholders-reject-tata-motors-pay-plan-114070400117_1.html)> accessed 10 August 2021

<sup>19</sup> 'Minority investors lose as Akzo Nobel Coatings, Akzo Nobel Car Refinishes and Akzo Nobel Chemicals merger gets requisite majority' *Economic Times* (11 February 2012) <[http://articles.economictimes.indiatimes.com/2012-02-11/news/31050042\\_1\\_voting-shareholders-uti](http://articles.economictimes.indiatimes.com/2012-02-11/news/31050042_1_voting-shareholders-uti)> accessed 29 July 2021

<sup>20</sup> Security and Exchange Board of India, 'Report of Working Group on Issues Concerning Proxy Advisors-seeking public comments' (2019) SEBI Reports for Public Comments <<https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working->

[group-on-issues-concerning-proxy-advisors-seeking-public-comments\\_43710.html](https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html)> accessed 9 August 2021

<sup>21</sup> Security and Exchange Board of India, 'Procedural Guidelines for Proxy Advisors' (SEBI/HO/IMD/DF 1/CIR/P/2020/256, 31 December 2020) <[https://www.sebi.gov.in/legal/circulars/dec-2020/procedural-guidelines-for-proxy-advisors\\_48633.html](https://www.sebi.gov.in/legal/circulars/dec-2020/procedural-guidelines-for-proxy-advisors_48633.html)> accessed on 10 August 2021

<sup>22</sup> Security and Exchange Board of India, 'Grievance Resolution between listed entities and proxy advisers' (SEBI/HO/CFD/CMD1/CIR/P/2020/119, 4 August 2020) <[https://www.sebi.gov.in/legal/circulars/aug-2020/grievance-resolution-between-listed-entities-and-proxy-advisors\\_47252.html](https://www.sebi.gov.in/legal/circulars/aug-2020/grievance-resolution-between-listed-entities-and-proxy-advisors_47252.html)> accessed on 10 August 2021

appointments and removals of directors/auditors, resolutions and proposals of the companies has shown a sharp increment in the participation of shareholders as well as institutional investors. Moreover, the role of PAFs has been increasing tremendously in the recent years. This has helped shareholders to ascertain their rights and not get defrauded by promoters.

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