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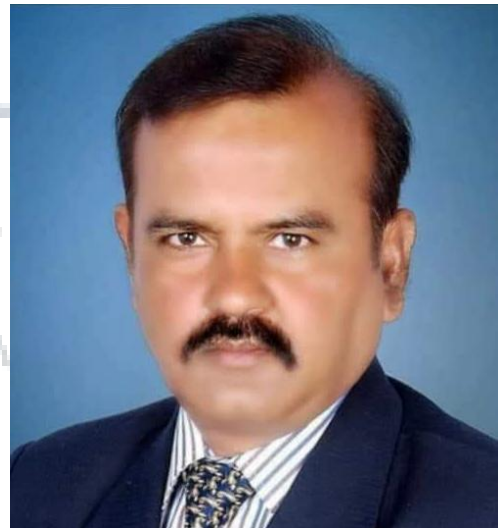


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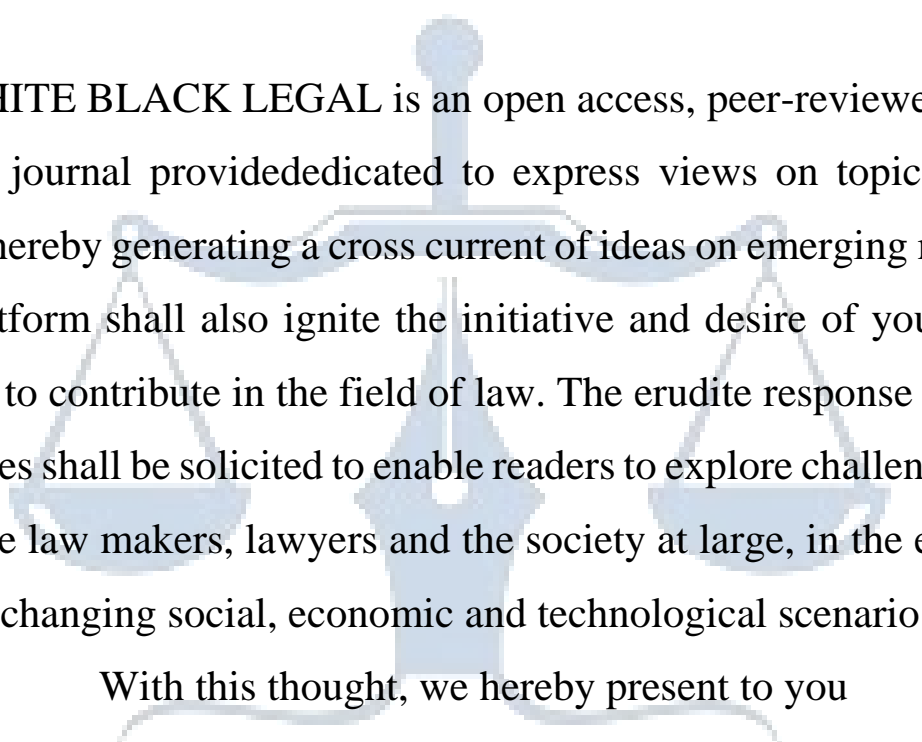


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With this thought, we hereby present to you

W H I T E B L A C K
L E G A L

SHAREHOLDER ACTIVISM AND PROXY ADVISORY FIRMS IN INDIA

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YASH PRATAP SINGH NARWARIA

ABSTRACT

Recently, India has witnessed a proliferation of entities and institutions like the Proxy Advisory Firms and regulations by the Securities Exchange Board of India that have helped investors to utilise their corporate franchise in an informed manner. This phenomenon has strengthened the foothold of shareholders in corporate decision-making benefiting corporate governance and paving the way for shareholder activism. However, this shift in the corporate governance structure needs to be fully understood keeping the focus on the phenomenon of Proxy Advisory Firm. For this purpose, the paper endeavours to probe origin, nature, impact and lacunes in the structure of corporate governance modelled around Proxy Advisory Firm. This paper suggests changes that can be placed to counter the lacunae that can help in shaping a robust corporate governance regime.

Keyword: Corporate Governance, Shareholder Activism, Proxy Advisory Firms, Research Analysts Regulation, Stewardship Code 2020.

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I. Introduction

As numerous news articles pronounce a paradigm shift in the corporate governance regime donning the rose-tinted glasses of shareholder activism for the India Inc., it has become important to measure the role of proxy advisory firms (hereinafter as “PAF”) acting as a spring board for shareholder activism from the yardstick of objectivity and pragmatism.

Recently, India has witnessed a proliferation of entities and institutions like the PAF and regulations by the Securities Exchange Board of India (hereinafter as “SEBI”) that have helped investors to utilise their corporate franchise in an informed manner. This phenomenon has strengthened the foothold of shareholders in corporate decision-making, thereby, raising the standards of corporate governance and paving the way for shareholder activism. SEBI as the primary corporate regulatory authority has also brought regulations to regulate PAFs to avoid any ill-motivate report that has the potential to hamper the right decision-making for the shareholder which could, subsequently, increase the changes of sceptical corporate milieu. Before the advent of PAF, the phenomenon of shareholder activism was dormant, but with the establishment PAF in India, this phenomenon has got vital traction and grown in leaps and bounds. Umakath Varotttil, a leading scholar on corporate law, has noted that prior to 2010, there were only handful of instances where shareholder rejected Board proposals.

It is an obvious case that PAFs have positively contributed in enhancing shareholder activism in the Indian corporate landscape. Despite such efforts, there is a need to find out potential corrective measures that may further facilitate shareholder activism and strengthen PAFs and decrease the tendency of Boardroom tyranny. Further, it is also necessary that regulatory bodies such as the SEBI ensure through concrete measures that a robust system and framework for the PAFs is create that imbibes the democratic principles of transparency and accountability. Therefore, in part III, this paper will consider the phenomena leading to the proliferation PAF. In Part IV, the paper examines how PAFs have aided in the creation informed shareholders and increased shareholder activism in India. Part V will evaluate existing loopholes and deficiencies in the present structure of PAFs that imperil shareholder activism. Part VI will provide, after considering the whole study, concluding remarks and suggestions.

II. The Problem

With the advent of shareholder activism in India, it has become indispensable to assess that what has led to this phenomenon. One of the major reasons for such development is clearly and closely associated with the proliferation of proxy advisory firms that are engaged in advising institutional investors, and publishing their opinions and reports for the general investors to devour

and exercise their corporate franchise in an informed manner. It is also essential to understand their impact and effect on corporate democracy and governance. Further, it is also important to examining the deficiencies in the present structure of PAF and its consequence over shareholder activism. Keeping this objective in mind, in the following the paper will be attempt to investigate the origins, impact, defects, and the changes required in the structure of PAF that have propelled shareholder activism in India. The strengthen of corporate governance will also be assessed.

III. The Proliferation of Proxy Advisory Firms

It is according to the Organisation of Economic Co- Operation and Development (hereinafter as “OCED”) that at the best watchdog for looking at the affairs of the company is the shareholder.¹ In other words, shareholder are the indispensable components of a corporate entities than can strengthen the observance of good corporate governance standard in a company. But the larger question that looms over is who empowers the shareholder. Majority of the shareholders are not experts in the field of finance, meaning, they are suffering from the handicap of analysing the annual financial reports of the company and cannot fathom the ramifications of all vital Board resolutions. This handicap eventually ends up for the Boardroom in deviating from the observance of good corporate governance norms. Further, it gives an upper hand to the Board of Director to manipulate and influence corporate decision-making by coaxing the shareholder to approve of their decision. The story of Mr. T.K. Mazumdar testified this scenario. Mr. Mazumdar has been an “active” investor in various companies across the country and an “active” participant in the yearly general meeting where he has been contesting the claims of the Board of Directors and Management of the company but to no avail.² He says many fellow shareholders are given exponential time to recite poetry but when it comes to unfolding the mismanagement within the company he is stopped even before the allotted time to speak and no attention is paid to his concerns by either, the management and shareholders.³

The above- mentioned anecdote was largely visible and accepted condition in all the corporation in India where shareholder held blind faith in the management of the company. But, corporate fraud in India where an eye- opener for the investors. Especially, the Satyam scam where the promoters of Satyam, who were also the promoters to other companies, sort to acquire other companies through Satyam and were also involved in cooking books and misrepresenting the financial health of the

¹ Organisation of Economic Co- Operation and Development, “OECD Principles of Corporate Governance Report,” (2004)

² Bhuma Srivastava, “Proxy advisory firms give a boost to shareholder activism,” The Mint, June 29, 2012.

³ *Ibid.*

company to all- stakeholders,⁴ made regulatory authorities like SEBI hang their necks in shame on the diminishing standards of corporate governance. The failure of SEBI, despite all the obligations of disclosures under Clause 49 of the Listing Agreement, acted as the ultimate catalyst and clincher that provided the PAFs with the perfect opportunity to enter the Indian commercial fray as analysts of annual reports, evaluators of the impact of management decision on shareholder rights and investments. Henceforth, the proliferation of PAFs began in India which was first noticed in the West.

Over the years, one of the essential functions of the PAFs were to disseminated important information regarding corporate decisions in public domain that aided in the creation of more informed investors. The first PAF established and the frontrunner of the movement is the In Govern Research Services (hereinafter as “IGRS”) founded by Shriram Subramaniam in 2010. Another major firm in this field is the Institutional Investor Advisory Services (hereinafter as “IIAS”) founded by Anil Singhvi and Amit Tandon in 2011. Both these firm have had a transformational and transcendental impact of the Indian corporate landscape whose rippling effect and firm grip over shareholder activism is still potently visible.⁵ These firms have also been instrumental in contriving a playing level field for the scattered minority shareholder, who, now have been able to come under a single unified umbrella and command considerable dominating position to protect their interests within a corporation.⁶

The impact of these firms can measure in terms of their effectiveness in altering the course of corporate decision- making. Mr. Mazumdar, whose has been discussed above, stance was vindicate in the 38th Annual General Meeting of Reliance Industries Limited. Prior to the 38th Annual General Meeting of Reliance Industries Limited, all Board proposals for re-appointment of Directors and Auditors were approved without protested. However, it is after red flag issued by IIAS that the thirty- five years of perpetual tenure of Reliance Auditors not only landed in hot soup and for the first time a Board resolution to re- appoint its auditor faced heat from the shareholders, but was ultimately reject.⁷ Similar instances that note the rising influence of PAF over corporate decision- making is enunciated in the next part of this paper.

IV. Proxy Advisory Firms: A Potent Game Changer

It is undoubtedly true that PAFs have forever changed the Indian Corporate regime. It has become the facilitator of information that has help shareholder to utilised their corporate franchise

⁴ HT Correspondent, “Satyam scam: All you need to know about India's biggest accounting fraud,” *Hindustan Times*, Arp. 09, 2015.

⁵ Naren Karunakaran, “Proxy Firms wade through proposed Resolutions,” *The Economic Times*, Nov. 29, 2011.

⁶ Umakanth Varottil, “The Advent of Shareholder Activism in India” 1 *Journal of Governance* 603 (2012).

⁷ *Supra* note 2.

in an informed manner and reinforced the diminishing principle of corporate democracy. Apart from this, they are enjoying an overwhelming influence over shareholder decision/activism to articulately participate in corporate affairs. Few instances are enunciated below.

The year 2012, in the corporate history of PAFs, can be called as the year of emergence. Apart from the RIL example, L&T's resolution on the modification of the usage of monetary fund received out of IPO were approved, merger of Vedanta to create Sesa- Starlite and merger of three entities into Escorts were voted against by their respective shareholder after showing confidence in the reports issued by the IAS.⁸

Further, in 2014, the Tata Motors failed to muster the confidence of its 75% minority shareholders when its Board proceeded to pay its late managing director, Karl Slym, along with two members of the Board, marking its first instance when remuneration proposals were stalled by shareholders on account of extravagant pays to individual at the top echelons of company affairs essentially because of underperformance.⁹ Similar phenomenon were also witnessed that same year in Panecea Biotec, where shareholders of the corporation stood against its Board resolution pertaining to related-party transaction with PanEra Biotec and in PTL Enterprise where even the resolution to introduce the selling off a larger proportion of the business to the promoters was promptly restrained by the shareholder through court decree.¹⁰ In 2017 and 2018, shareholders of Raymond Limited and HDFC, jolted their Board while rejecting its proposal to sell off undervalued property to a related party and turning down reappointments of directors devoid of independence, respectively.¹¹

Following the present events, it is detectable that the PAFs are playing a pro-active in bring the standards of good governance in India to a better position and strengthening the foothold of the shareholder within the ambit of corporate functioning. Take for example, the debt-ridden Suzlon Energies Ltd. proposal to re-appoint its promoters to the Board was recommended by IAS to be rejected citing its Board incompetence clear its debts.¹² Eveready's Aditya Khaitan re-appointment as the non-executive chairperson also witnessed the cautioned from the PAF over his choice of auditors and the lack of oversight on the company's working and setting of good governance.¹³ Similar scenario was further traceable when IGRS conveyed the shareholders of Sterling and Wilson Solar Ltd. its dissension to approve the re-appoint of Pallon Mistry as non-executive director

⁸ *Supra* note 2.

⁹ Shally Seth Mohile and Anirudh Laskar, "Tata Motors shareholders reject proposals executive pay", *The Mint*, July 14, 2014.

¹⁰ Khushboo Narayan, "The advent of shareholder activism in India", *The Mint*, Nov. 27, 2014

¹¹ Umakanth Varotill, *Shareholder Stewardship in India: The Desiderata*, available at <https://ssrn.com/abstract=3538037> (last visited on January 15, 2022)

¹² Rohit Jain, "Promoters of Four Firms Face Proxy Firm Veto", *BloombergQuint*, Sept. 21, 2020.

¹³ *Ibid.*

because of the Board's decision to use the IPO fund towards outstanding loans to promoter entity i.e. Sterling and Wilson Pvt. Ltd. materialized in a loss over 75% to value to on account of Covid-19 and its delay.¹⁴

All these instances above- mentioned singularly indicate towards the powerful influence of the PAF over shareholders. PAFs have literally rode the crest of shareholder activism in India. This event has also led to compelling companies to observe and maintain good governance standards in their functions that has resulted in effective in working of corporation. SEBI's role as a regulatory body is commendable but cannot match the potential of PAFs because it does not have such manpower or will to pursuing such endeavours as do PAFs. Without a shadow of doubt, PAFs have enhanced the value and interest of shareholding in the form of a potent game changer. Today, no giant corporation is beyond the radar of PAF and subsequently, the shareholder, who happen to the real owners of a company. In the era of information, PAF play a leading role in offering insightful details of the shareholder and paving the waying for shareholder activism. A much-warranted phenomena in India that cements the vision that a section of minority shareholder can also shape and charter a different path of a company.

Though, PAFs appear to have strengthened shareholders rights, still they are required to be regulated, and whether such regulation is sufficient or not is a matter under consideration in the next part of this paper.

V. Regulation and its Deficiencies

The single piece of regulation that regulates the functioning of the PAFs in India is the SEBI (Research Analysts) Regulation, 2014 (hereinafter as "RAR 2014").¹⁵ According to RAR 2014, the PAFs are defined as providers of information on exercise of corporate rights to investors of a company on IPOs and agendas included. Further, the RAR 2014 require the PAFs operating within India to make mandatory disclosure in order to provide the investor seeking advise from the PAF a cushioning safeguard against any ill motivate report. The RAR 2014 prescribes certification of the PAF,¹⁶ requires the PAFs to formulate inner policies and procedures,¹⁷ provides for limitation on trading practices of Research Analysts,¹⁸ expounds on disclosure obligations of the Research Analysts¹⁹ coupled with general responsibility to maintain arms- length relationship between its research activity and other activities.²⁰ Further, the RAR 2014 legally mandate the compliance of

¹⁴ *Ibid.*

¹⁵ Securities and Exchange Board of India (Research Analysts) Regulations, 2014. Available at <https://www.sebi.gov.in/sebi_data/commondocs/RESEARCHANALYSTS-regulations_p.pdf>

¹⁶ *Id.* at Regulation 7.

¹⁷ *Id.* at Regulation 15

¹⁸ *Id.* at Regulation 16.

¹⁹ *Id.* at Regulation 19.

²⁰ *Id.* at Regulation 26.

its regulation and conduction yearly audit for the same.²¹ These being the prominent features of the RAR 2014, let us now come to its lacunas with couple of examples.

In the recent events of things, Zee- Invesco controversy is grabbing headlines. Invesco that holds 17.88% in Zee Entertainment Enterprise Ltd., recently requested the Board of Directors for an EGM with an agenda to appoint six new members to the board along with the proposal to remove its MD, Punit Goenka.²² This request was called as the Board was undeterred by the majority shareholder concerns over the Sony merger. Therefore, through the EGM, Invesco sought leadership change. Seeing the Board not budge on its EGM request, Invesco approached the NCLT u/s 98(1) and 100 of the Act, while Zee sought injunction from the Bombay HC and was successful.²³

This infighting of Zee and Invesco can be attributed towards shareholder activism. However, it is the case but for the purpose of this study, we ought to look it from the perspective of PAF. Invesco is a foreign firm and is receiving advises from a foreign PAF. Here, lies the real danger for Indian companies who have foreign institutional investors. Invesco has is visibly acting on the advice of a foreign PAF that is not regulated by Indian laws. The RAR 2014 do not tend to regulate foreign advisory firms which is a clear lacuna and loophole in the law. It does not protect investors or companies against any ill motivate report that can catapult in combative shareholder activism that diminishes and obstructs the interests of other minority shareholders and the whole corporate entity at larger.²⁴ This phenomenon was self- evidently visible in the recent event in which HDFC Chairman Deepak Parekh escaped a near collapse in his position of non- executive directorship.²⁵ The precursor to such incidences occurs due to exponential rise in the foreign institutional investors in the India corporate landscape and their blind faith in the proposal of foreign PAFs. This a structural deficiency in the PAF regulation of SEBI and an alarming threat as it directly impacts corporate governance standards.

The above- mentioned situation demands a comprehensive stewardship code. The Stewardship Code implemented by SEBI w.e.f April 2020 (hereinafter as “Code”) patently a facsimile of the UK Stewardship Code (hereinafter as “UK Code”) that suffers from an inherent

²¹ *Id.* at Regulation 25(3).

²² Umakanth Varottil, “Bombay High Court Order in the Zee-Invesco Case: A Critical Analysis”, 27th Oct 21 available at <<https://indiacorplaw.in/2021/10/bombay-high-court-order-in-the-zee-invesco-case-a-critical-analysis.html>> last accessed 12 Jan 22; Umakanth Virottil, “Activists in the Boardroom”, The Indian Express, Nov. 1, 2021.

²³ Umakanth Varottil, “Bombay High Court Order in the Zee-Invesco Case: A Critical Analysis”, 27th Oct 21 Available at <<https://indiacorplaw.in/2021/10/bombay-high-court-order-in-the-zee-invesco-case-a-critical-analysis.html>> last accessed 12 Jan 22.

²⁴ Umakanth Varottil, “The Changing Face of Shareholders: Outsourced Governance”, BloomburyQuint, Aug. 14, 2018.

²⁵ *Ibid.*

defect on account of discounting the realities of the Indian corporate shareholding structure. Its cardinal objective being enhancing shareholder value is a clear deviance from the Indian peculiar approach of inclusivity of all the stakeholder and not just limited to ultimate beneficiaries.²⁶ Therefore, the role of a corporation is not only to maximum profit of shareholders but general welfare through CSR.²⁷ To put it succinctly, first, the code is a digression from the philosophy underpinning Indian corporate law, and second, the Code signifies a significant shift towards institutional shareholder's responsibility for to take stock of value enrichment of its beneficiaries.²⁸

VI. Conclusion

It is abundantly clear that the PAF have turned into a formidable machinery that has ushered in a new era of transparency, shareholder activism and adherence to good governance practices in the corporate landscape of India. They have successfully impeded the growing tendency among major corporation and its promoters to make take personal business risk on public money.

PAFs in India have acted as a spring board for the shareholder activism movement. They have also lessened the burden of institutional investor who would spend hefty amounts towards analysing financial reports, that too, with the exponential time and resource draining. This situation is nearly and largely averted with the coming of PAFs in the India Inc.

Whatsoever role the PAFs played to strengthen shareholder rights and ushering transparency regime, they still require corrective remedial measures. The RAR 2014 potent chasmic defects is its silence of the regulation of foreign PAFs. It needs to be corrected to keep any ill- motivated report that can trigger shareholder activism at bay. In the shadow of unregulated foreign advisory firms advising foreign institutional investor, the national economy can suffer unintended consequences that a may posed a threat of national sovereignty. Introduction of new laws modelled on the international framework that are able to regulated the tendency of domestic markets in India is the need of the hour and demands immediate attention for a promising future not only for corporate governance but for the national economy as a whole.

²⁶ *Supra* note 11.

²⁷ The Companies Act, 2013, s. 135.

²⁸ *Supra* note 11.