

# From Shareholder to Stakeholder: The Next Age of Activism



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“Activism” has become a pervasive and inescapable phenomenon for corporates in recent years, particularly in the wake of the global financial crisis. It is no longer restricted to raising voices against oppression of the minority shareholders, but has expanded to include voicing concerns in relation to business decisions, social and

environmental issues, strategic issues, brand value and reputation, etc. These developments are bringing about a paradigm shift in the corporate governance space.

Historically, minority shareholders in India were passive and rarely voted against a resolution proposed by the management. Since most companies in India, including the top listed companies, are governed and controlled by promoters and their families, public shareholders did not actively participate in the decision-making processes of the company, as the outcome of resolutions was a foregone conclusion. Previously, if a shareholder was not satisfied with the decision taken by the management or the controlling shareholders, he/she would simply exit the company by selling shares, or in rare cases, depending on the grievance, file a suit for oppression and mismanagement (if the criteria for filing such suit were met). However, the last decade which witnessed several financial frauds and scams, has also seen the rise of institutional and retail shareholders awakening and beginning to question promoters’/ management’s decisions. The increasing involvement of proxy advisory firms have also enhanced shareholder participation in corporate decision-making. Driven by the global phenomena, while mid and small-cap companies are more vulnerable to the rising instances of activism, larger companies are also not immune.

While the board of directors of a company has clear and distinct duties towards the company and shareholders, it also owes fiduciary duties towards its employees, the environment, and the community at large. The list of stakeholders and potential activists runs much longer, and include proxy advisors, regulators, whistleblowers, media, customers, clients, lenders, suppliers, distributors etc. The nascent stage of shareholder activism is now paving way for the age of stakeholder activism.

## **Growth of Activism**

The ownership structures of most listed Indian companies raising distinct corporate governance concerns is an age old saga. The development and sophistication of financial markets, financial crises and scams, reforms in the regulatory regime (such as mandatory e-voting and class action suits) and manner of exercising voting rights, has laid the foundation for far reaching shareholder activism. Shareholder activism, once restricted to powerful investment funds is now becoming a much larger phenomenon, due to increased participation by retail shareholders. India’s position as No. 7 of 190 on protection of minority interests in the World Bank’s Doing Business report, and 7th in Protecting Minority Investors’ as per a report issued by the World Bank.’ as against 39th in 2009 is a carefully curated outcome, arising from increased regulatory will to enforce rules to protect minority interests.

## **Expected Trends in Activism**

### *Increasing Impact of Proxy Advisory Firms*

The most notable instances of activism in India have either been led with the support of proxy advisory firms, or backed by proxy advisory firms, on the basis of their voting recommendations. Awareness amongst shareholders, particularly institutional and retail shareholders, serves as another layer of protection of shareholders’ interest, requiring companies to be more mindful of the decisions they make. Although shareholder awareness is in its nascent stage and there have not been many reported instances of shareholders engaging the services of proxy advisory firms to actively block resolutions, corporate India has been recently witnessing instances where minority shareholders have defeated resolutions for appointment/ reappointment of top management, executive compensation or M&A transactions.

Typically, large funds have arrangements with proxy advisory firms to get detailed advice and in-depth analysis, which tends to percolate down to the retail investors, once the recommendations are published, prompting minority shareholders to overcome collective action issues and shareholder apathy.

The role of proxy advisory firms and their influence in propagating shareholder activism in India is fast-evolving. There is varied empirical data on how their recommendations may have influenced decision-making in Indian companies - there are several instances where even though proxy advisory firms have advised against voting “no” on a proposal, the public shareholders have voted in favour of the same. Despite the same, there is no doubt that proxy advisory firms are significantly contributing in shaping public opinion on issues and concerns in relation to company management, which eventually play a significant role in building public opinion.

### *The Arrival of Class Action*

The securities class action regime in India has seen two recent game changing developments. The thresholds for determining a 'class' have been notified in May 2019. Further, it is reported that the Government is considering a proposal to extend financial support to minority shareholders who are seeking to pursue class action lawsuits. These changes may encourage class action enforcement and levy material liabilities in the form of damages payable by listed companies, directors and auditors.

The scope of a class action under Section 245 of the Companies Act, 2013 is fairly wide, and includes challenging the conduct of management that is prejudicial to the interests of the company or its shareholders.

In comparison to the era of Satyam (where the US investors filed a class action and received damages, and the Indian shareholders had no opportunity to file any such class action), investors now have rights of restitution that is bound to change the existing principal-agent relationship, as well as the power balance, between shareholders and management. It is expected that there will be a rise in activist arbitrage, that directors' and officers' insurance will become a much more sophisticated and sought after product in India, and that directors will shift their focus to governance matters and liability concerns.

### *Employee driven activism*

Governance activism is also being shaped by other stakeholders, including corporate employees, though often through the intervention of courts. For example, in California, a class-action lawsuit was filed by two employees of a leading multinational technology company, claiming discrimination on the basis of gender, race and political bias leading to termination of their employment. The suit was ruled in favour of the employees, allowing the employees and their legal team access to internal documents of the company to analyse employment-related documents, to determine whether employees were actually hired or fired on the basis of gender, race, or other discriminatory ground. Further, in another incident, in May, 2019, employees of a leading multinational e-commerce company used their company-issued stock options to introduce a shareholder resolution to adopt a more detailed, transparent strategy for acting on the climate crisis, at the company's annual shareholder meeting. Although the resolution was not passed by the requisite majority, it has prompted stakeholders to start scrutinizing the company's policies more closely. Further, reports indicate that the company subsequently started to look at more environment-friendly and sustainable long-term plans for the business of the company.

Such instances provide an opportunity to the company to take a closer look at its hiring practices, and also brings the company under the watchful eyes of investors.

### *Lender/ creditor driven activism*

The conceptualization and effectiveness of the Insolvency

and Bankruptcy Code (the "**Code**") in 2016 seeks to address the long due concerns with respect to the enforcement of lenders' rights. Under the Code, financial creditors, i.e., those creditors with whom the company's relationship is that of a pure financial contract and an amount has been provided to the debtor against the consideration of time value of money, are provided with a mechanism to initiate the insolvency process against a debtor company, individually or jointly with other financial creditors. In strengthening creditors' rights, the balance of power between equity holders and debt holders in a company is changing, and the rights and powers of creditors can no longer be overlooked in the corporate governance set-up. The Code has contributed to the recovery of non-performing assets and by virtue of shifting the bargaining power from creditors to debtors, has prompted companies to improve their internal standards on debt management.

### **Looking Ahead: How to strength the relationship with stakeholders**

Failure to follow best governance standards will raise concerns relating to inviting investments, attracting and retaining talented, competent and qualified management and attracting sufficient resources to compete on a large global scale. Companies have to build on their relationship with their stakeholders, to be sustainable in long term. This includes empowering and providing more responsibility to the Stakeholder Relationships Committee to ensure that all stakeholders have been provided an avenue to raise their concerns, and also providing additional roles and responsibility to the Risk Management Committee to identify and adopt strategy to deal with stakeholder complaints. Further, companies can significantly build on such relationship by way of appropriate and sufficient disclosures, be it through the explanatory statement shared with shareholders' meeting notice, the annual report or stock exchange intimations, which can provide sufficient information to all the stakeholders. While the Business Responsibility Report has been adopted in India by listed entities, globally, investors are asking and even funding integrated reporting initiatives as they provide investors and stakeholders with a more efficient and holistic corporate report on the company- these are ways of communicating internally and externally. In March, 2019, the Ministry of Corporate Affairs released the National Guidelines on Responsible Business Conduct (NGRBC) intending to set standards that are higher than compliance with the mandated legal regime, to be followed by all businesses in India (whether listed or unlisted), including MNCs, on a voluntary basis.

Ideally, given the global trends, boards and companies are better positioned if they are active rather than reactive. Boards can definitely start by adopting a standard operating procedure (SOP) for crisis situations, and ensure that the Board and management are adequately trained to operationalise it in a timely manner. As ultimately, the buck stops at the board!