

IMPACT OF SHAREHOLDERS'S ACTIVISM ON CORPORATE GOVERNANCE

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Abstract—This study examines the growing influence of shareholder activism on corporate governance practices globally and specifically in India. Shareholder activism involves equity holders leveraging their ownership rights to impact a company's operations. It has emerged as a crucial tool for promoting accountability, transparency, and alignment of management actions with the interests of shareholders. The research evaluates key forms of activism, such as proxy battles, public initiatives, and legal actions, and assesses their effects on board composition, executive compensation, ESG adherence, and overall financial outcomes.

This research explores the legal and regulatory framework surrounding activism, focusing on the Companies Act of 2013 and SEBI guidelines. It delves into the responsibilities of institutional investors, activist hedge funds, and minority shareholders. By critically assessing landmark cases and global best practices, the study highlights both the beneficial effects of activism, such as improved governance and increased company accountability, as well as the drawbacks, including a tendency towards short-term thinking and conflicts of interest. Ultimately, the paper asserts that, despite the challenges associated with shareholder activism, it remains an essential force in shaping corporate governance mechanisms in an evolving business landscape.

Regulatory bodies and legal structures play a crucial role in shaping the landscape of shareholder activism. The rules surrounding proxies, disclosure requirements, and shareholder rights significantly affect how activists can intervene and the outcomes of their actions. When disputes arise from shareholder activism, courts often find themselves acting as mediators, creating legal precedents that define the boundaries of shareholder influence. The impact of shareholder activism goes beyond individual companies, influencing market trends, investor attitudes, and corporate governance practices. It prompts businesses to reevaluate their governance frameworks and communication strategies with stakeholders, striving to achieve a balance between shareholder demands and broader corporate objectives. Understanding the intricacies of shareholder activism within corporate law is vital for all parties involved—companies, investors, regulators, and legal professionals—to effectively navigate the ever-evolving landscape of corporate governance, shareholder rights, and the interplay between activism and corporate decision-making.

I. Introduction

Shareholder activism has become a powerful influence in Indian corporate governance, transforming the dynamics between companies and their shareholders. This emerging trend reflects a proactive stance by investors aiming to shape corporate strategies, governance practices, and decision-making processes¹. In recent years, there has been a notable rise in shareholder activism in India, highlighting a growing emphasis on shareholder rights and accountability. Activism manifests in various ways, including engaging in dialogue with management, exercising voting rights at shareholder meetings, submitting resolutions, or even pursuing legal action, all aimed at instigating change within companies. Shareholders, including institutional investors, activist funds, and retail investors, often focus on issues such as improving corporate governance

¹ SEBI, Report of the Committee on Corporate Governance, October 2017.

standards, advocating for transparency, scrutinizing executive compensation, promoting environmental and social responsibility, and striving to enhance shareholder value.

The landscape of corporate governance in India has been significantly influenced by these activist efforts, with companies increasingly encouraged to adopt more transparent practices, strengthen their governance frameworks, and respond more effectively to investor concerns. Activist actions have also catalyzed regulatory reforms and changes to align corporate practices more closely with shareholder interests. The legal framework governing corporate governance and shareholder rights in India is crucial in defining the scope of shareholder activism. Regulations regarding shareholder meetings, voting rights, disclosure obligations, and board structures greatly impact the effectiveness of activism strategies². This, in turn, affects market dynamics, shapes investor sentiment, and contributes to the evolution of corporate best practices. As shareholders become more engaged and vocal, companies are prompted to reevaluate their governance structures and approaches to stakeholder engagement.

II. Literature Review

1. Large shareholder activism in corporate governance in developing countries: Evidence from India

Jayati Sarkar, Subrata Sarkar

International Review of Finance 1 (3), 161-194, 2000

Current research on the effectiveness of large shareholders in corporate governance has primarily focused on a select few developed nations, notably the UK, US, Germany, and Japan. This article explores the role of large shareholders in overseeing firm value within the context of India, a developing economy that blends the outsider-driven market systems of the UK and US with the insider-focused bank systems of Germany and Japan. Our case study of Indian corporations reveals a complex picture of large-shareholder oversight. While we find that directors with significant blockholdings can enhance company value to a certain extent, there is little evidence to suggest that institutional investors, particularly mutual funds, are actively involved in governance. Our research supports the effectiveness of the German/Japanese bank-based governance model, showing that lending institutions begin to effectively monitor firms once they acquire substantial equity stakes, with this oversight being further strengthened by their debt holdings. Additionally, we find that foreign equity ownership has a positive impact on company value. Overall, our findings align with the established view in developed country research that the identity of large shareholders is crucial for corporate governance.

2. Corporate governance on stakeholder issues: Shareholder activism as a guiding force

Nur Uysal, Katerina Tsetsura

Journal of Public Affairs 15 (2), 210-219, 2015

Publicly traded companies are increasingly under pressure from society to allocate resources in ways that enhance value for non-shareholding stakeholders. This research draws on management and public relations literature to propose a model of corporate social responsibility (CSR) that emphasizes the interaction between shareholders and stakeholders. It argues that engagement between shareholder activists and corporations regarding CSR can heighten corporate awareness of stakeholder issues by improving governance mechanisms that safeguard stakeholder interests and

² Shareholder activism and its influence on corporate governance practices in India by Raveena Nidhi Karn.

promote their well-being. Social shareholder activists, a distinct group of stakeholders, can effectively influence corporations to address shortcomings in these governance mechanisms.

Research Question

How does shareholder activism influence corporate governance practices in India, particularly regarding board accountability, transparency, and the formulation of long-term strategic decisions?

Statement of Problem

Despite the increasing engagement of shareholders in corporate decision-making, the actual influence of shareholder activism on corporate governance in India remains ambiguous. Although activism has led to improvements in board accountability, ESG adherence, and transparency, issues persist regarding short-term focus, managerial pushback, and the weakened power of minority shareholders. The challenge lies in determining whether shareholder activism genuinely strengthens governance frameworks or simply prioritizes immediate financial gains, occasionally undermining long-term sustainable growth.

Objectives of Study

- An exploration of the rise and various forms of shareholder activism both in India and globally, including proxy battles, public relations initiatives, and shareholder proposals.
- An examination of how this activism influences corporate governance aspects such as board structure, executive compensation, transparency, and ESG outcomes.
- A review of the legal frameworks and regulations, like the Companies Act and SEBI guidelines, that govern shareholder activism in India.
- An identification of key players in the activism landscape, such as institutional investors, activist hedge funds, and individual shareholders.
- An assessment of the benefits and drawbacks of activism on corporate strategy, stakeholder relations, and long-term viability. Suggestions for enhancing the role of shareholder activism as an effective tool for corporate governance in India.

III. EVOLUTION OF SHAREHOLDER ACTIVISM

Shareholder activism has transformed from a niche endeavor into a powerful force shaping corporate governance and strategy. Initially focused on financial outcomes, early activists aimed to boost profitability through tactics like proxy fights and hostile takeovers. Notable figures such as Carl Icahn and T. Boone Pickens gained recognition for their aggressive strategies, often targeting inefficiencies or advocating for asset divestitures to drive up stock prices. The late 1990s and early 2000s marked the rise of institutional investors, including pension and hedge funds, who began to assert their influence by questioning corporate management on financial results and governance standards, emphasizing the need for transparency and accountability. Hedge funds like Elliott Management and Pershing Square launched prominent campaigns to influence board decisions and strategic initiatives.

The 2010s marked a significant rise in activism, highlighting the importance of environmental, social, and governance (ESG) issues. Investors recognized that ESG factors could substantially influence long-term performance, leading to initiatives advocating for sustainable practices and social accountability. A notable example is Engine No. 1's 2021 campaign against ExxonMobil, which showcased how even small investors could create a significant impact by prioritizing climate risk. The rise of technology and social media has further democratized activism, allowing smaller investors to unite and amplify their voices. Platforms like

Reddit's WallStreetBets demonstrate how retail investors can influence markets, challenging traditional power dynamics³. Looking ahead, shareholder activism is expected to persist as a global trend, with an increasing emphasis on ESG issues and the role of technology. Companies will need to navigate these evolving pressures, balancing shareholder demands with broader stakeholder interests and long-term strategic goals.

IV. DRIVERS BEHIND SHAREHOLDER ACTIVISM

Shareholder activists enhance the value of their investments by asserting their rights. They act as positive catalysts for company growth. For instance, when a publicly traded subsidiary of a multinational corporation proposed selling one of its business units to its parent company, shareholder activists played a crucial role in adding value. This transaction required a special majority approval from both subsidiary and parent shareholders due to its nature as a related party deal. However, the initial low valuation led to the plan's rejection. A revised proposal with a higher valuation was then presented, benefiting the shareholders. Investors looking for long-term returns can hold onto the company's shares for many years, which is achievable if management prioritizes optimizing and balancing the long-term returns for these shareholders. Activist investors aim to boost their returns by improving the company's performance, which in turn fosters effective management and enhances the organization's long-term value. They often advocate for cost-cutting measures to increase profits through the responsible use of company resources. For example, a significant portion of shareholders in a financial conglomerate opposed the chairman's retention. A proxy advisory firm suggested that shareholders vote against reappointing the non-executive chairman, citing his directorship in eight other companies as a potential conflict of interest. In the case of a well-known automobile manufacturer in India, shareholders raised concerns multiple times about the company's purchases from a related party, leading to increased shareholder activism. As a result of strong pushback from activist shareholders, the company had to revise the agreement's terms to secure approval.

V. IMPORTANCE OF SHAREHOLDER ACTIVISM

In accordance with Indian law, directors possess the authority to manage the business and make decisions. This legal framework prevents third parties from holding the board and management accountable, thereby granting shareholders the ability to influence or interfere in a company's internal matters. Dissatisfied with the current sale process, two major shareholders of Fortis Healthcare Limited, who collectively own 12% of the company, appointed three new independent directors to the board in May 2018, replacing an existing director. SEBI has consistently emphasized the importance of management accountability to shareholders in listed companies. As partial owners, shareholders risk losing their investment value due to poor management decisions. Given India's history of corporate fraud, shareholder activism has become crucial for effective corporate governance, acting as a check on management's authority. This activism is bolstered by governance intermediaries, and reforms along with SEBI regulations enhance transparency and shareholder information. Without shareholder intervention, the company could continue to make detrimental managerial and operational choices, leading to a decline in share price. Shareholder activism plays a vital role in steering the company towards success by monitoring profitability and preventing actions that could devalue shareholders' investments. Furthermore, the company strives for complete transparency, recognizing that shareholder activists can initiate actions at any moment, which could adversely affect its reputation and positively influence market performance.

³ The Impact of Shareholder Activism on Corporate Decisions by directors institute on September 25, 2024.

VI. THE GROWTH OF SHAREHOLDER ACTIVISM IN INDIA

Shareholder activism has significantly evolved, driven by the rise of institutional investors, the proliferation of proxy advisory firms (PAFs) across the country, and a more informed shareholder base regarding their investments and rights. PAFs operate under the SEBI (Research Analysts) Regulations of 2014. These advisors guide institutional investors or company shareholders on effectively exercising their rights, such as making recommendations for public offerings or voting on key agenda items. Their insights have notably swayed shareholder voting behaviors, contributing to a surge in activism.

The expansion of legal remedies, powers, and rights for shareholders is a key factor behind this trend. In India, the Companies Act of 2013 serves as the primary legal framework, granting shareholders distinct rights and privileges that enable their involvement in company management. For instance, resolutions requiring shareholder approval can be passed by a simple or special majority, and shareholders also possess the right to appoint or dismiss directors.

VII. PROXY VOTING: INFLUENCING BOARD DECISIONS

Proxy voting stands out as a fundamental yet widely used tool for shareholder activism. It allows shareholders to participate in voting on company matters without needing to attend the annual general meeting (AGM) in person. Through proxy voting, shareholders can influence a variety of issues, including the election of directors, executive pay, mergers and acquisitions, and other significant corporate policies. Activists often utilize proxy voting to challenge the existing board of directors by proposing their own candidates in what is known as a 'proxy contest' or 'proxy fight.' This typically occurs when activists believe the current board is not acting in the shareholders' best interests or is resistant to necessary changes. By rallying other shareholders to support their chosen candidates, activists aim to gain control or sway the board, potentially steering the company in a new strategic direction.

A notable instance of a successful proxy contest occurred in 2008 when Carl Icahn targeted Yahoo. As a seasoned activist investor, Icahn sought to replace Yahoo's board after the company rejected a takeover bid from Microsoft. Although he did not manage to replace the entire board, his efforts resulted in a settlement that allowed him to nominate several directors, ultimately leading to significant shifts in Yahoo's strategy and management. Recently, proxy voting has expanded beyond financial concerns to encompass environmental, social, and governance (ESG) issues. Shareholders are increasingly using their votes to push for greater corporate responsibility on matters like climate change, diversity, and human rights. For example, in 2021, the small activist hedge fund Engine No. 1 achieved a groundbreaking victory in a proxy fight at ExxonMobil, securing three board seats by arguing that the company needed to take more decisive action against climate-related risks.⁴

VIII. PUBLIC CAMPAIGN- CHANNELLING MEDIA AND PUBLIC OPINION

Public campaigns serve as a powerful tool for shareholder activism. These initiatives typically involve activists taking their message to the public and the media to apply pressure on the targeted company. By generating public scrutiny and negative publicity, activists can compel a company to align with their demands, impacting its reputation, customer loyalty, and stock value. Such campaigns often kick off with the release of a comprehensive letter or report outlining the activist's concerns and proposals, which are made accessible to the public through press releases, social media, or dedicated websites. Activists

⁴ Voting power in the proxy process , Journal of Financial Economics - Volume 30, Issue 1, November 1991

frequently engage with financial news platforms, participate in industry conferences, and utilize social networks to amplify their message.

A notable instance of this is Third Point's 2013 campaign against Sotheby's, led by Daniel Loeb's hedge fund. Loeb publicly criticized Sotheby's management for what he perceived as inadequate financial performance and misguided leadership, even targeting the CEO for being disconnected from the global art market. His campaign garnered significant media coverage, placing pressure on Sotheby's to respond. Ultimately, this led to a settlement that allowed Loeb and his allies to gain representation on the board, prompting the company to rethink its strategy. Public campaigns are most effective when they resonate with broader social issues or when a company's reputation is at risk. For instance, activists focusing on ESG matters often employ public campaigns to highlight a company's environmental or social failings, rallying public support and advocacy groups to their cause.

IX. SHAREHOLDER PROPOSALS: CONFRONTING ISSUES

One significant tool for shareholder activism is the submission of shareholder proposals. These formal requests can be put forth by shareholders for consideration during the company's Annual General Meeting (AGM). Typically, these proposals address specific topics such as corporate governance, executive compensation, or environmental, social, and governance (ESG) initiatives, and they require a vote from all shareholders.

While these proposals are generally non-binding—meaning the company is not legally required to implement them even if they receive majority approval—they can still wield considerable influence. A proposal that garners substantial support from shareholders can convey a powerful message to the board and management about the concerns and priorities of investors. In some cases, companies may choose to adopt the proposal voluntarily, particularly if it draws significant public attention or if failing to act could lead to increased activist pressure.

For example, in recent years, there has been a notable rise in shareholder proposals focused on climate change, with investors urging companies to disclose their carbon emissions, set climate goals to reduce their environmental impact, and align their operations with the objectives of the Paris Agreement. In 2021, proposals related to climate issues received unprecedented support at companies like Chevron and ConocoPhillips, highlighting a growing consensus among investors that climate risk is a critical concern. The strategies of shareholder activism are diverse and evolving, reflecting the dynamic nature of the practice and the changing priorities of investors. Activists utilize various tools, including proxy voting, public campaigns, legal actions, private negotiations, and shareholder proposals, to influence corporate policies. As shareholder activism becomes more entrenched, these strategies are likely to become increasingly sophisticated, with activists continuously developing innovative ways to leverage their influence and drive change within the companies they target.

X. IMPACT ON CORPORATE GOVERNANCE

Shareholder activism significantly shapes corporate governance, altering the management and control of businesses. As shareholders increasingly pressure executives and boards, corporate governance evolves to reflect a more engaged and activist investor community. This influence permeates all facets of governance, affecting board composition, executive compensation, transparency, strategic choices, and

alignment of corporate policies with shareholder interests. Below is a detailed exploration of these key areas of impact⁵.

1 Board Composition and Accountability

One of the most significant and immediate impacts of shareholder activism on corporate governance is its influence on board composition. Activists often target boards they perceive as ineffective, complacent, or misaligned with shareholder interests. Through proxy fights and public campaigns, they can oust underperforming directors and replace them with individuals more likely to advocate for change and enhance shareholder value. The push for board reforms usually stems from concerns about the independence, diversity, and expertise of directors. Activists argue that boards dominated by long-tenured directors or insiders are less inclined to challenge management and more prone to groupthink. By advocating for independent directors, activists seek to create a board that is more objective and capable of holding executives accountable. A notable example occurred in 2018 when activist investor Trian Partners, led by Nelson Peltz, secured a board seat at Procter & Gamble (P&G) after a highly publicized proxy battle. Trian argued that P&G's board was too slow to adapt to changing market dynamics and that new perspectives were essential to rejuvenate the company's strategy. Peltz's appointment marked a significant shift in P&G's boardroom, signaling to other companies the importance of board renewal and the advantages of independent oversight. Additionally, shareholder activism has heightened the focus on board diversity in terms of gender, ethnicity, and professional backgrounds. Activists are increasingly advocating for a wider range of perspectives and expertise, which can lead to more robust decision-making, improved risk management, and overall better governance. Consequently, many companies are intensifying their efforts towards board diversity, driven not only by activist pressures but also by a proactive governance policy.

2 Improving Transparency and Disclosure

Transparency and accountability are crucial for effective corporate governance, with shareholder activism significantly influencing companies to improve in these areas. Activists advocate for enhanced transparency on key matters such as financial performance, risk management, ESG practices, and executive decision-making. By promoting transparency, they aim to bridge the information gap between shareholders and management, facilitating more informed investment choices. A notable area where transparency is vital is in ESG reporting. As shareholder activism increasingly focuses on sustainability and corporate responsibility, companies face mounting pressure to disclose comprehensive information about their environmental impact, social initiatives, and governance practices. This includes reporting on greenhouse gas emissions, labor practices, board diversity, and political contributions. The push for greater ESG disclosure was highlighted in the BP case, where activist investors, led by the Climate Action 100+ coalition, compelled the company to improve its climate-related disclosures. In response to this activism, BP committed to greater transparency in reporting its carbon footprint and clarifying how its business strategy aligns with the Paris Agreement's objectives. Such transparency not only helps shareholders assess the risks and opportunities associated with ESG factors but also holds the company accountable for its sustainability commitments. Additionally, activists often demand more transparent and comprehensive financial reporting, particularly in complex areas like accounting policies, tax strategies, and off-balance-sheet items. Enhanced financial transparency would allow shareholders to better understand a company's true financial health and risk profile, leading to improved valuations and investment decisions.

⁵ Shareholder Activism in India: Analysis of Shareholders' Exercise of Their Corporate Franchise in General Meetings – written by Heer Kamdar March 5th 2023

3 Aligning Corporate Policies with Shareholder Interests

Activists firmly believe that corporations should prioritize decisions that enhance shareholder value, advocating for corporate governance frameworks that ensure management is accountable to shareholders. They often push for changes in governance policies, such as implementing majority voting for director elections, abolishing staggered boards, and creating shareholder rights plans or 'poison pills' that protect shareholder interests without solidifying management's position. For instance, activists have successfully urged numerous companies to adopt majority voting, requiring directors to secure a majority of votes to be elected, contrasting with the traditional plurality voting system where a director could be elected despite majority opposition. This shift towards majority voting enhances board accountability, making it simpler for shareholders to remove underperforming directors. Additionally, activists frequently call for the separation of the CEO and chairman roles, arguing that distinct individuals should fill these positions to ensure effective oversight and mitigate conflicts of interest, thereby enabling the board to hold the CEO accountable more effectively. Shareholder proposals can cover a wide range of topics, from governance reforms to environmental and social concerns. While most proposals are advisory, their acceptance can reflect strong shareholder backing for particular changes, prompting boards to take action. The impact of shareholder activism on corporate governance is profound and far-reaching, as activists play a crucial role in influencing board composition, executive pay, transparency, strategic decisions, and overall corporate policies, thereby shaping how companies are governed and held accountable.

4 Impact on strategic decision making

Shareholder activism significantly influences corporate strategy, often leading companies to reassess and adjust their long-term plans. Activists typically focus on firms they view as underperforming or failing to capitalize on growth opportunities. Through their initiatives, they urge companies to adopt strategic actions that they believe will enhance shareholder value, such as divestitures, mergers and acquisitions, restructuring, or entering new markets. A common tactic among activists is advocating for the sale of non-core assets, as they argue that companies should focus on their primary operations and eliminate underperforming or unrelated divisions that may hinder overall performance. This was evident in the case of DuPont, where activist investor Nelson Peltz's Trian Partners pushed for the separation of DuPont's specialty chemicals division from its other businesses. This campaign ultimately led to the merger of DuPont with Dow Chemical and the subsequent division of the merged entity into three distinct companies, each aimed at different market segments. Furthermore, activists may also advocate for mergers or acquisitions if they believe such actions will create synergies and enhance shareholder value. For example, activist hedge fund Elliott Management played a crucial role in urging Sprint and T-Mobile to merge in 2019, claiming that the merger would strengthen the company's position in the wireless market. The successful merger highlighted the power of activist influence in shaping critical strategic choices. Additionally, activists can impact corporate strategy by pushing for increased capital returns to shareholders through share buybacks or special dividends. They may argue that a company is holding excessive cash or that its shares are undervalued, making buybacks a sensible approach to boost shareholder returns, even if this strategy may be unpopular as it diverts funds from reinvestment into the business.

Instance of shareholder activism in India

Recently, shareholders in India have engaged in activism for various goals, including restricting executive pay, appointing independent directors, and limiting related party transactions deemed harmful to the company and its shareholders..

Cases concerning the compensation offered to the company's senior management

In 2014, Tata Motors Ltd. sought the approval of its shareholders to increase the compensation for its top three executives, as their proposed pay exceeded the previously set limits. However, the motion was rejected because the Board could not secure the necessary 75% majority for the special resolution. When the same proposal was presented again in 2015, it received backing from investors, who felt the earlier rejection was due to the company's performance not justifying the pay hike. This marked one of the initial instances of shareholder activism.

The COVID-19 pandemic significantly impacted the revenue and profitability of Indian companies, leading to a notable rise in shareholder activism in 2020. Investors began to push back against management decisions, particularly regarding executive pay increases. For instance, in August 2021, Eicher Motor Ltd. failed to gather enough votes for a special resolution that would have granted a 10% salary increase to their managing director, Siddhartha Lal. Similarly, shareholders of Hero MotoCorp Ltd., Bajaj Auto Ltd., and Balkrishna Industries Ltd. also turned down proposals to raise their chairmen's salaries, although some proposals eventually passed despite lacking majority support.

XI. FUTURE OF SHAREHOLDER ACTIVISM

In the future, shareholder activism is set to prioritize long-term value creation alongside broader ESG concerns. As investors increasingly insist that companies tackle issues like climate change, diversity, and corporate responsibility, activism will inevitably incorporate these topics into its focus. Activists will advocate for more sustainable and responsible business practices, signaling a shift of ESG issues into the core of corporate governance. Furthermore, shareholder activism is likely to adopt a more collaborative approach. Instead of using confrontational tactics, activists may choose to partner with management and boards to pursue mutually beneficial outcomes. This cooperative strategy could mitigate some of the negative perceptions associated with aggressive activism and enhance communication between shareholders and companies. Ultimately, despite facing challenges and criticism, the shift of shareholder activism towards long-term value and ESG integration suggests a future where it plays a vital role in shaping responsible and sustainable corporate strategies

XII. Conclusion

Shareholder activism has evolved from a niche practice into a formidable force reshaping corporate governance and strategy. Initially aimed at enhancing financial performance, it has expanded to include significant focus on environmental, social, and governance (ESG) issues. With the rise of institutional investors and advancements in technology, even small shareholders can now drive substantial change. Looking ahead, activism is expected to increasingly prioritize ESG factors and leverage new technologies, compelling companies to balance shareholder interests with the needs of other stakeholders. Understanding this evolving landscape is crucial for navigating the complex dynamics of modern corporate governance and achieving sustainable success.