

CHAPTER6 -New Paradigm of Corporate Governance: Shareholder Activism, Institutional Investors and Class Action Suits

Traditionally, corporate governance was largely controlled by promoters, directors, and management, while shareholders played a passive role and had limited influence over corporate decisions. However, modern corporate governance recognizes that shareholders, as the owners of the company, should actively participate in ensuring accountability, transparency, and protection of their interests. This shift has given rise to three important governance mechanisms—**Shareholder Activism, Institutional Investors, and Class Action Suits**. Shareholder activism encourages investors to actively monitor and influence corporate decisions; institutional investors provide the voting power, expertise, and resources needed for effective activism; and class action suits offer a collective legal remedy against mismanagement or actions prejudicial to shareholders. Together, these mechanisms represent a **new paradigm of corporate governance**, characterized by greater shareholder participation and stronger oversight of management.

SHAREHOLDER ACTIVISM

Shareholder Activism refers to the active involvement of shareholders in influencing a company's policies, decisions, and management practices by using their ownership rights to ensure transparency and accountability.

FEATURES OF SHAREHOLDER ACTIVISM

- **Shareholder activism can be through different types of ownership positions** i.e. it can be undertaken by different shareholders-
 - ✓ Minority shareholders
 - ✓ Institutional investors (insurance companies, pension funds, mutual funds, development banks, private equity funds)
 - ✓ Labour unions (when they hold shares directly or indirectly through pension funds, employee shareholding schemes like ESOPs, or union investment funds)
- **Shareholder activism may range from financial reasons to non-financial reasons.**
 - ✓ Financial reasons could be like dissatisfaction with company results, disapproval of financing structure etc.
 - ✓ Non-financial reasons could be environmental issues, social concerns, board independence, corporate governance issues, ethical business practices etc,
- **Shareholder activism will be effective only if it has regulatory support.**
 - ✓ regulatory support converts shareholders' opinions into enforceable rights
 - ✓ gives shareholders the power to question management and protect them from retaliation
- **Shareholder activism can take various forms.**
 - ✓ Proxy battles, shareholder resolutions, litigation, public campaigns, media pressure etc.

ADVANTAGES OF SHAREHOLDER ACTIVISM

- 1. Reduces Agency Problem-**Shareholder activism results in shareholders closely monitoring the actions of management. Thus, managers become more accountable. The conflict between owners and managers is reduced.
- 2. Creates Shareholder Value-** When shareholders are actively involved, it pressures the management of underperforming companies to improve performance and create shareholder value.
- 3. Sharpens Corporate Strategy-**Shareholders, especially institutional investors, provide valuable insights and expert guidance to the company on policy matters thereby improving strategic decision-making.
- 4. Improves Corporate Governance-** When shareholders are active, they question the management decisions and actions. This alerts the management and reduces the chances of fraud and mismanagement thereby ensuring long-term sustainability.

DISADVANTAGES OF SHAREHOLDER ACTIVISM

- 1. Undermines Board Authority-** Excessive shareholder intervention may erode the Board's authority. When majority shareholders dominate, board's decision-making power gets weakened, and it may not be able to protect the interest of minority shareholders.
- 2. Information Asymmetry and Lack of Expertise-** Since shareholders often lack time, expertise and complete information on sensitive financial data, the solutions suggested by them may lack substance and practicality.
- 3. Encourages Short-Termism-**Some shareholders might push decisions that may result in short term gain but damage the long-term value of the corporation.
- 4. Ignores Other Stakeholders-** Shareholder activism enables the shareholders to protect their interests but the interest of other stake-holders like employees, customers, suppliers, and society may get overlooked.

WAYS OF PARTICIPATION IN SHAREHOLDER ACTIVISM IN INDIA

1. Interaction with the Board- Shareholders can regularly express their concerns by interacting with the Board either at AGMs or EGMs.

2. Requisitioning an EGM- Under Section 100 of the Companies Act, 2013, shareholders have a right to requisition the convening of an EGM to discuss specific matters or issues bothering them. *Example: Investors in Zee Entertainment sought an EGM regarding the appointment of Independent Directors.*

3. Using the Stakeholders Relationship Committee (SRC)- Listed companies and certain large companies must establish SRC to address the grievances and concerns of different stakeholders.

4. Making Public Announcements- When issues are not resolved privately, shareholders can express their concerns publicly, drawing media attention and thereby creating pressure on management to respond. *Example: Cyrus Mistry's public criticism of Tata Sons generated significant debate on governance practices.*

5. Approaching the NCLT- Shareholders can approach the National Company Law Tribunal (NCLT) in cases of oppression and mismanagement and thereby protect their interests. *Example: Fortis Healthcare shareholders approached NCLT regarding alleged fund diversion by promoters.*

6. Seeking Investigation by SFIO- If fraud or serious misconduct is suspected, shareholders can request government intervention. The government may direct the Serious Fraud Investigation Office (SFIO) to investigate. *Example: The IL&FS crisis led to an SFIO investigation into financial irregularities.*

7. Following Proxy Advisory Firms- Proxy advisory firms are independent organizations that based on their research, analyze company resolutions and provide shareholders, especially institutional investors, voting recommendations on board elections, executive compensation, mergers and acquisitions, related-party transactions and various governance issues. Shareholders can exercise activism by voting according to the recommendations of proxy advisory firms on important corporate resolutions. *Examples: Proxy firms -Institutional Investor Advisory Services (IIAS) and Institutional Shareholder Services (ISS) told shareholders of RIL to vote against the appointment of Anant Ambani, 28 years as non-executive director of the company as his age didn't match their voting guidelines while they endorsed appointments of his older siblings-Isha and Akash, both 31 years.*

SHAREHOLDER ACTIVISM IN INDIA

Shareholder activism is coming of age in India. Earlier, most shareholders in India were passive investors interested in just dividends. But now shareholders are becoming active owners by voting against management proposals, questioning executive compensation, opposing unfair related-party transactions, demanding better corporate governance, and filing class action suits when necessary. This has become possible because of Companies Act, 2013 and certain regulatory changes introduced by SEBI to promote shareholder activism.

Important Changes Introduced by Companies Act, 2013 to Promote Shareholder Activism

Initiative	Provision / Section	What it Means	How it Promotes Shareholder Activism
Mandatory E-Voting	Sec 108 of Companies Act, 2013	Eligible companies must provide electronic voting facilities to shareholders.	Enables participation of shareholders from any location, increasing voting by minority and retail investors.
Class Action Suits	Section 245	Shareholders and depositors can jointly file a suit against the company, directors, auditors, or experts for wrongful acts.	Gives minority investors a collective legal remedy and strengthens their bargaining power.
Approval of Related Party Transactions (RPTs)	Section 188	Interested promoters/directors cannot vote on resolutions approving related party transactions.	Shareholders can approve or disapprove a related party transaction by passing an ordinary resolution. They can decide whether transactions are fair, preventing promoter abuse.
Small Shareholders' Director	Section 151	Listed companies can have a director elected by small shareholders (holding shares of nominal value not exceeding ₹20,000).	Provides direct representation of small shareholders on the Board and protects their interests.

CLASS ACTION SUITS (SECTION 245, COMPANIES ACT, 2013)

A **Class Action Suit** is a lawsuit in which one or more persons file a case on behalf of a large group (the "class") who have suffered a similar wrong. It has the following features-

- **Common Injury** – Many persons are affected in the same manner.
- **Large Number of Victims** – Impractical for all affected persons to file separate case

Advantages of Class Action Suits	Explanation
1. Streamlines litigation	Many similar claims are combined into one case, avoiding multiple lawsuits.
2. Lowers cost	Legal and court expenses are shared among members. making litigation affordable.
3. Uniformity in decisions	All class members receive same judgment and compensation.
4. Stronger negotiating power	Companies may prefer settling class action rather than waiting for the court verdict. Because of collective bargaining power of shareholders, settlements tend to be larger than in individual lawsuits.
5. More media coverage	Attract more media coverage and public attention which increases awareness among shareholders about their rights.
6. Deters corporate misconduct	Large settlements impose financial costs, encouraging responsible behaviour.
7. Increases judicial efficiency	One case replaces hundreds of individual suits, reducing court workload.

Disadvantages of Class Action Suits	Explanation
1. Delay in resolution	Reaching consensus among many members and following procedures takes time.
2. Lack of individual control	Individual members have little say; representative parties make key decisions.
3. Limited compensation	Usually provides monetary compensation only; other remedies, like job re-instatement, not available.
4. Litigation financing issues	Funding such cases is difficult in India due to restrictions on contingency fees, success fee and third-party financing* .

*Term	Meaning	Example
Contingency Fee	Lawyer's fee depends on winning the case. If the client loses, the lawyer gets no fee.	Lawyer agrees: "If you win ₹10 lakh, I'll take 20% (₹2 lakh) as my fee."
Success Fee	Lawyer receives normal professional fees plus an additional bonus if the case is won.	Client pays ₹50,000 during the case. If successful, lawyer gets an extra ₹1 lakh as a success fee.
Third-Party Funding (TPF)	Someone, (who is neither defendant nor plaintiff) pays litigation expenses in return for a share of the compensation if the case succeeds.	A funding company pays all legal costs. If the plaintiff wins ₹1 crore, the funder receives an agreed share (say ₹30 lakh).

CLASS ACTION SUITS IN INDIA

Satyam Scam (2009)-Revealed lack of collective legal remedies for Indian investors. US investors filed class action suits against the company and auditors and got huge compensation. Highlighted the need for similar provisions in India.

First Class Action Case in India- Filed by the Department of Consumer Affairs against Nestlé Company under the Consumer Protection Act,1986.

Section 245, Companies Act, 2013-

- This section empowers members or depositors of a company to file class action suit against the company, directors, auditors and other parties such as experts, advisors or consultants if the affairs of the company are being conducted in a manner detrimental to their interests.
- Eligibility for filing class action suit- Class action suit can be filed only if agreed by sufficient number of persons such as-
 - ✓ Companies Having Share Capital- Lower of 100 members or 10% of total members are required
 - ✓ Unlisted Companies- Members holding at least 5% of issued share capital can file
 - ✓ Companies Without Share Capital-At least 1/5th (20%) of total members are required
- Class Action suit must be filed with the National Company Law Tribunal (NCLT) and the application must specify the grounds of complaint and relief sought. Upon admission, NCLT issues a public notice to all affected parties.
- If the NCLT finds the application to be frivolous, or vexatious, it may reject the application and order the applicant to pay costs to the opposite party, not exceeding Rs.100000.
- Expenses incurred by members or depositors on class action suits under Sections 37 and 245 and sanctioned by the NCLT may be reimbursed out of Investor Education and Protection Fund (IEPF).

INSTITUTIONAL INVESTORS

Institutional investors are organizations that pool large sums of money and invest it on behalf of their clients/members. These include mutual funds, insurance companies, pension funds, banks and financial institutions etc. Because they hold large shareholdings, they can significantly influence corporate governance. Institutional Investors could be domestic (DIIs) or foreign (FIIs).

Mechanisms/Methods of Institutional Investors' Participation

Mechanism	How It Works
Exercising voting rights on important matters	Vote on appointment/removal of directors, executive pay, mergers, acquisitions, and amendments to Articles of Association.
Engagement with Management to resolve governance issues privately and constructively.	Meetings with management, written communications, participation in investor conferences*. <i>Investor conference is a voluntary interaction event, in which a company's top management interacts with investors to discuss company's performance, strategy, and future plans. Investors ask questions, seek clarifications and express concerns. There is no voting and no binding decisions in these meetings.</i>
Public Statements, if private engagement does not work.	Press releases, media interviews, and disclosure of voting intentions to put public/market pressure on the company.
Collaborative Engagement i.e multiple institutional investors act together to have a stronger voice.	Working together through investor coalitions* and industry associations. <i>Investor coalitions are temporary coming together of several Institutional Investors for a common purpose to address a specific issue (by pooling voting power)</i>
Proxy Advisory Services	Relying on proxy advisory firms for research and voting recommendations. They shape investors behaviour.
Investment Decisions	Increasing/decreasing shareholding, exiting poorly governed firms, activist investing#. <i>Activist investment strategy refers to a strategy where Institutional Investors deliberately buy a large enough shareholding so that their voice matters. Then they demand strategic, operational or governance changes, use pressure tactics and exit loudly, if changes don't happen, often signalling loss of confidence and thereby hurting share prices of that co.</i>

ROLE OF INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE

(i) Improving Board Composition and Independence- Institutional investors influence board composition, CEO duality, diversity, ownership concentration etc. and thereby, play a significant role in shaping the governance structure of the company.

(ii) Influencing Executive Compensation- Institutional investors monitor executive pay particularly, when top management receives exorbitant remuneration while the returns to the shareholders are stagnant. They use “say on pay” votes and to influence executive pay structures and excessive management rent extraction. They support performance-linked compensation. *Example: In 2015, activist investor Trian Fund Management acquired a large stake in GE and demanded changes in executive compensation. This led to GE tying more of its executive pay to performance metrics and shareholders return.*

(iii) Protecting Shareholder Rights and Promoting Activism- Institutional investors lead ‘shareholder activism’ and use their significant voting rights to influence key decisions such as mergers and acquisitions. This involves -filing shareholder proposals, voting against recommendations of the Board and taking legal action against the company, when necessary. *Example: Maruti Suzuki Case-In 2014, institutional investors challenged Maruti Suzuki's proposal to allow Suzuki Motor Corporation to manufacture cars in Gujarat citing erosion of Maruti company's value on outsourcing of its core manufacturing activities and high royalty payments to Suzuki.*

(iv) Promoting Transparency and Accountability-Continuous monitoring, frequent corporate visits and active engagement with management lead to higher levels of information disclosure by the company reducing information asymmetry between company and investors.

(v) Promoting Sustainability (ESG)-Institutional investors insist on incorporating ESG (Environmental Social Governance) criteria in investment strategies. This way they contribute to sustainable corporate governance, and long -term value creation.

CHALLENGES FACED BY INSTITUTIONAL INVESTORS

Challenge	Explanation
Concentrated Ownership with promoters	Promoters often hold controlling stakes, limiting the influence of institutional investors' in corporate decisions.
Limited Voting Rights	Some institutional investors like FIIS do not have voting power equal to their shareholding. Regulatory caps restrict their voting power. <i>Eg. Incase of private sector banks, 74% FDI is allowed but voting rights are capped at 10%.</i>
Lack of Uniformity	Different institutions may have different priorities and they may not vote on governance issues in a unified manner. <i>Eg. HDFC faced a</i>

	<i>challenge when FIs opposed his appointment citing Parekh's multiple board positions while Indian proxy advisors supported it.</i>
Potential Conflict of Interest	Sometimes, institutional investors may have some business relationship with the company in which it has invested. Therefore, they not criticize or vote against the decisions of the management of the investee company. <i>Eg. a government owned financial institution invests in a PSU. Even if management is poor, the financial institution may hesitate to oppose it because both are govt-linked and opposing could be politically sensitive.</i>
Information Asymmetry	Investors may not always receive complete and timely information about company's operations and governance practices.

SEBI'S STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS (2019)

SEBI issued Stewardship Code for Institutional investors in 2019 and it applies to Mutual Funds + AIF (Alternative Investment Funds) investing in listed companies of India. As stewards of financial markets, the Institutional Investors are expected to protect the rights of investors and beneficiaries. The Code aims at increasing investors engagement, enhance transparency and improve corporate governance in the investee company. The major principles of this Code are-

- 1. Stewardship Policy-** Institutional investors should formulate a stewardship policy, disclose it and periodically update it.
- 2. Conflict of Interest Policy-** Institutional Investors should identify the potential conflicts of interest and disclose a policy on how it will manage them.
- 3. Monitoring Investee Companies-** Institutional Investors should continuously monitor the performance, strategy and risks, including ESG issues in the investee company.
- 4. Active Intervention-** Institutional Investors should actively intervene in the governance of the investee company to protect the rights of the shareholders. When necessary, investors should collaborate with other investors to strengthen their influence.
- 5. Disclosure of Voting Policy-** Institutional Investors should have a clear policy on voting and should publicly disclose their voting decisions- whether supporting, opposing or abstaining from voting, including the rationale behind their stand.
- 6. Periodic Reporting-** Institutional Investors should regularly provide report to their clients/beneficiaries on their stewardship activities, voting practices and engagement with investee companies.

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