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Corporate Democracy: A Leap from Authoritative to Democratic Culture

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ABSTRACT

Corporate democracy refers to the enjoyment of the rights and privileges available to the shareholders of a company at all times and in an unbiased manner. In a practical scenario, the dominant shareholders may marginalize the minority shareholders since the former can make decisions that are detrimental to the best interests of the minority shareholders. Hence, regardless of the share volume, the minority shareholders should be treated equally i.e. they must be permitted at liberty to participate in the meetings and influence the decisions made by the Board of Directors in the corporation. The management must carry out its activities by bearing in mind the welfare of the shareholders. Sound corporate governance is quintessential in developing added value to the stakeholders as it guarantees transparency which in turn ensures robust and stable economic development. It further safeguards the interests of all stakeholders including the rights of the minority shareholders. It ensures that every shareholder can exercise their rights subject to the legal provisions and that their rights are fully recognised by the corporation. Promotion and maintenance of corporate democracy retain the existing shareholders by gaining their confidence, trust and loyalty towards the company and attract more investments to the business that paves the way for the long survival of the company in the market with intact goodwill.

Keywords*: Corporate democracy, Dominant shareholders, Minority shareholders, Corporate governance, Goodwill.*

I. INTRODUCTION

To comprehend the term 'Corporate Democracy', it is essential to also grasp the underlying concept of 'Corporate Governance'. While the former accentuates the effective use of the shareholders' rights, the latter is the domain of the Board of Directors (BoD). Both have their tantamount importance. Running the business of a corporation with all the shareholders scattered nationwide or worldwide is practically not possible. Hence, the shareholders appoint

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the directors[3], who have been allotted the Director Identification Number[4], during annual general meetings (AGMs) to govern the corporate affairs by representing all the shareholders. The BoD is responsible for running the business of a company effectively and efficiently by procuring and allocating all the optimal resources by bearing in mind the interests of all the stakeholders.

The BoD is responsible for all the operational and strategic management of a corporation and the management team carries out the daily operational decisions and frames effective strategies for the effective management of the business. The Chief Executive Officer (CEO) holds the top-most priority in the management team and he directly reports to the BoD. While the BoD frames the internal regulatory policies, the management team executes such policies by managing the daily affairs of the company. The BoD is the core element of good corporate governance even during volatile economic conditions of the domestic and international countries. It should bear the interests of the stakeholders in mind while making any corporate decisions. Earlier the shareholder primacy[5] was given much weightage, whereas, in the current scenario, the stakeholder primacy[6] holds more weightage than the former.

Corporate Democracy is the foremost component of corporate governance without which the success of the latter is indisputably doubtful. With the best ethical practices and acting within the purview of the provisions of the relevant Acts and mandated and voluntary guidelines, the BoD must safeguard the rights of all the shareholders particularly the minority shareholders that are emphasized in and safeguarded through various provisions of the Companies Act, 2013 (hereinafter referred to as "the 2013 Act") and other laws. The concept of *'Majority Rule'* was established in *Foss v. Harbottle*[7] wherein the decision of the majority shareholders prevails concerning the affairs of the company, however, it is subjected to certain exceptions where the BoD is at default and safeguarding the rights of the minority shareholders is necessary.

In a way of ensuring corporate democracy, shareholder activism has also phenomenally increased in recent times and gets the limelight from the media, public, investors, companies,

[3] *vide, Section 152 of the Companies Act, 2013.*
[4] *ibid, Section 154.*
[5] Shareholders are the investors who hold the shares of a company and receive dividends and perquisites and may also be liable for the debts of the company during its liquidation process. In shareholder primacy, the interests of the shareholders are given much importance rather than all the stakeholders of a company. It is short-term goal-oriented where the shareholders focus mainly on the short-term goals, say the accomplishment of the quarterly targets.
[6] The term 'Stakeholders' includes all the shareholders, employees, creditors, dealers and others who are involved in the supply chain management and others who have an interest in the business of the company. In stakeholder primacy, the interests of all the stakeholders including shareholders are emphasised.
[7] *(1843) 67 ER 189*

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government, etc. through various campaigns. The supporters of shareholder activism claim that it is a tool that pushes corporations to promote and maintain sound corporate governance. On the flip side, the critics allege that it is mainly focused on short-window market returns at the cost of the long-term value. However, it is beneficial to the corporation and the shareholders if the BoD recognizes the expediency of shareholder activism to the company when it is wielded by shareholders with appropriate goals and in an appropriate manner. Thus, the BoD should aim at evolving the democratic culture in a company by encouraging the shareholders to actively engage in the affairs of the company rather than having the entire authoritative power with it.

This paper endeavours to understand the need and significance of corporate democracy for the welfare of the company and the stakeholders, particularly the shareholders. It mainly focuses on how corporate democracy builds the brand value of the corporations and mitigates the need for shareholder activism. Though the directors are empowered to manage and control the affairs of the corporation on behalf of all the shareholders, the shareholders also have the power to influence the corporate affairs through their voting rights. Hence, this research aims to seek the balancing mechanism between shareholder primacy and board primacy in the best interests of the company and its stakeholders. The foremost limitation of this paper is that it entirely relies on secondary sources of data to analyse shareholder democracy in line with the state of corporate governance particularly in India.

(A) Objectives of the study:

i. To comprehend the basic concept of corporate democracy.

ii. To analyse how far the rights of the shareholders are protected under the Companies Act, 2013.

iii. To analyse the factors supporting the growth of shareholder activism.

iv. To know the impact of shareholder activism on a corporation and its stakeholders.

v. To analyse the remedial measures for balancing shareholder primacy and board primacy.

(B) Review of literature:

Frank (1976) explored the extent of corporate democracy in the US and set forth certain proposals to further the concept of corporate democracy. The foundation of corporate democracy must be to allow the shareholders and even the management to nominate (a limited number of nominees is preferable), cast a vote either by themselves or through proxies without undue effort or cost and thereby, elect a director of a corporation. The cumulative voting in public companies has less significant representation of the minority shareholders since the

alternative candidates are not listed in the proxy statement or on the proxy card. However, the recommendation outlined in this paper would remedy that shortcoming. He, furthermore, suggested a pass-through vote by the institutions to their shareholders or other beneficial owners and to constitute a Committee on Shareholder Responsibility which should make a specific determination on how to vote for the stock held by the institution in any contested election and the institution would cast its vote in respect of the votes of the Committee members. The Committee vote must reasonably reflect the opinions of the shareholders though it is not a direct vote cast by them. It can also select an Advisory Group to make some recommendations to it. The author appealed that the legislations must be amended broadly to implement all the proposals made by him to ensure corporate democracy. In this regard, it must be noted that there are various amendments made in the US legislations to enhance corporate democracy.

Sprague and Lyttle (2010) stated that there is a fundamental flaw in the U.S Corporate Law's approach to corporate governance that prioritizes the business judgment rule which holds the directors of a company blameless when they fail to maximize the shareholders' wealth by setting aside the shareholder primacy which is the core principle in guiding corporate governance. They, thereby, concluded that this flaw in the corporate law could be curtailed by allowing shareholders to get access to the proxies to nominate alternative directors. This will make the directors realize their role in corporate governance and put effort into safeguarding and maximizing the wealth of the shareholders. Thus, it will be a breakthrough in corporate democracy.

Young (2017) in the first essay of his doctoral dissertation examined the history and outcomes of shareholder activism campaigns i.e. how investors and other informed capital market participants respond to shareholder activism campaigns. Following the intervention of the shareholder activists, there is a considerable improvement in the operational management of the targeted firms, analyst recommendations and long-term institutional investors' ownership and there are also significant short-window abnormal returns and declining short-selling. He examined five types of evidence i.e. market returns, analyst recommendations, short-selling, institutional trading, and accounting results and concluded that interventions by the shareholder activists increase long-term shareholder value. A consensus, therefore, exists among the three types of informed market participants (viz. financial analysts, short sellers, and institutional investors) which shows that shareholder activism adds to long-term shareholder value as well.

Sonule and Ronald (2017) argued that the concept of corporate democracy is given less importance in corporate governance. The BoD of a company aims at having the excessive power with it and only limited rights have been granted to the shareholders. It has been alleged that

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the Companies Act, 2013 predominantly aims at providing excessive authoritative power to the directors of the company by focusing more on corporate governance and less on corporate democracy. The authors claim that there would be no proper corporate governance without corporate democracy. Therefore, they suggest devising a *"checks and balances"* mechanism by the BoD so as to encourage the shareholders to actively participate in the process of decision-making and to ensure transparency in all the actions of the BoD. A proper legal foundation is obligatory to encourage corporate democracy in the company.

Fairfax (2019) argued that the shareholders of public companies, deviating from their conventional role of passivity, have become more active in recent times and exercise their rights effectively by virtue of their voting powers and thereby, have a strong influence over the governance of the corporation. Though the BoD is the domain of corporate governance, the shareholders can influence its decisions by voting against such decisions for the welfare of the company and the shareholders. The author acknowledged the shift away from shareholder apathy to shareholder activism. Enhanced Shareholder activism reflects a descriptive shift in the manner in which the voting powers of the shareholders are used to engage with the corporation. It asserts that shareholder activism is normatively appropriate, at least to a certain extent and for certain shareholders. It further argues that shareholder activism is the new corporate governance norm that should be acknowledged by all the stakeholders of a company and they must be accountable for that norm. It was concluded that the shareholder activism that toppled the shareholder apathy must be acknowledged at present though it may tend to lose its essence in the near future.

Cassim (2019) observed that proxy voting holds importance in the context of corporate democracy since most of the shareholders are not willing or unable to attend the meetings in a company. Having considered the importance of the shareholders' participation in the affairs of the company and its impact on corporate governance, the Companies Act, 2008 was enacted in South Africa and thereby, the rights of the shareholder proxies have been further fortified. The Act asserts that a proxy can be admitted at any time by the shareholder of a company before or even at the time of meeting[8]. Strate E-proxy voting facilitates the shareholders of the listed companies to cast their votes online via authorised login. By this means, the votes will get processed automatically and therefore, render real-time results to the listed companies. It,

[8] *Barry v. Clearwater Estates NPC (the Clearwater case), 2017 (3) SA 364 (SCA).* The practical impact of the Clearwater ruling is that despite any cut-off condition contained in a company's MOI or in its proxy forms, the proxy forms remain valid and effective. They may validly be lodged with the company at any time before the proxy exercises the rights of the shareholder at the meeting, and may be lodged even at the meeting itself.

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further, mitigates the errors or manipulation risks while counting the shareholder proxies.

Ahuja Dua (2021) in her paper underscored that the minimum requirements of being transparent to their institutional and minority shareholders may be prescribed by regulations at different times. Due to the effective role of mass media and social media, institutional investors and minority shareholders are gaining knowledge about the affairs of the company and updating themselves with the current scenario prevailing in the company. With easy access to information and opinions of experts, they become more inquisitive to comprehend how their investee companies run. As the regulators and market forces (like PAFs) help strengthen shareholder activism, there are steps that the current management can take to enhance corporate governance, and thereby pre-empt the need for shareholder activism. The BoD may pre-empt the further progression of shareholder activism by setting up third-party administered Minority Shareholder Forums to enhance their engagement; using decentralised blockchain technology that is immutable and free from manipulation or hacking in corporate governance; and Independent Third-Party Annual Review Report of the Performance of the Board.

II. CORPORATE DEMOCRACY: AN OVERVIEW

In general, the term "Democracy" means *'of the people, by the people and for the people'*. In a democratic country like India, the government is formed by the elected representatives of the people and the so-formed government is bound by the law, *'Lex Suprema'.* The Constitution of India is the Supreme Law of the land and the fundamental official written document that outlines the rights, duties and powers of the elected representatives and the citizens of the nation. It is the '*magna carta'* of a nation. Democracy ensures the effective participation of the people and creates a sense of trust and security. The elected representatives and the executives must function for the well-being of the people and in the event of any unlawful/illegal act or omission by them, an action could be brought against them before the Judiciary. Thus, there is a proper "*checks and balances*" mechanism. Similarly, democracy is essential in any corporation that functions *'of the shareholders, by the shareholders and for the shareholders'*.

Corporate democracy has been a burning topic in the boardroom in recent times. A corporation is a legal entity with perpetual succession. The shareholders of a company are a larger part of the stakeholders and they own a significant volume of stocks of a company that provides them certain legal rights in the corporate enterprise.

However, it is not possible to manage and control the whole corporate affairs by all the widely scattered shareholders. Hence, they elect the BoD to govern the affairs of the corporate entity. They discharge their duties with transparency and thereby, safeguard the interests of the

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investors. However, when the BoD acts against the welfare of the business and stakeholders and violates the laws, it will be held accountable for such acts. In such scenarios, even the minority shareholders have the right to question and they can further escalate the unsettled issue to the National Company Law Tribunal (NCLT) for the redressal of the grievances.

The concept of corporate democracy has evolved aiming at safeguarding the interests of the shareholders, particularly the minority. The shareholders can demand the information disclosure based on which the decisions are to be made and/or already executed in the meeting. Thus, they have the inherent right and power to question the BoD regarding their activities which may adversely affect the business and the interests of the shareholders. Nevertheless, there must be a proper *"checks and balances"* mechanism. They simply should not encroach upon the legally guaranteed rights and powers of the BoD. Therefore, there must be a clear demarcation between the rights and powers of the BoD and the shareholders. In short, the shareholders should not question the BoD when they carry out any lawful activity that enhances the value of the business unless the contrary occurs. They persuade the BoD to perform any function that promotes and enhances the corporate brand value and safeguards the interests of the stakeholders including shareholders. In other words, corporate democracy simply means gaining an insight into corporate affairs and voicing out their opinions either by directly participating in the meeting by the shareholders or via proxies.

Shareholders are the vital influencing element of a company in shaping the major operational and strategic decisions of a company. They are widely scattered within the nation and even abroad (say, foreign investors). FIIs[9] and DIIs[10] contribute much to the progress of a company and the economic development of a nation. Everyone is entitled to be treated equally and to wield their corporate rights democratically within the legal framework. The 2013 Act provides various rights to the shareholders. By exercising their voting rights, they can elect the directors to govern the corporation effectively and efficiently to safeguard the interests of the shareholders and look out for attractive opportunities in the market so as to survive in the competitive world and to ace up the firm. They can voice out their opinions in the meetings of a corporation and may also assist the BoD while making decisions. The opinions of the minority shareholders will also be taken into consideration. The Corporate Proxy facility is also made available for the convenience of the shareholders and ensures their indirect involvement. All

[9] Foreign Institutional Investors (FIIs) are the institutions established or incorporated beyond the boundaries of a nation that propose to make investments in the securities of a particular country. In the Indian market, they are registered as FIIs in accordance with *Section 2 (f) of the SEBI (FIIs) Regulation 1995*.

[10] Domestic Institutional Investors (DIIs) are the institutions established or incorporated within the boundaries of a nation that propose to make investments in the securities of its own country.

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the information regarding the decisions to be made and executed should be well-informed and properly disclosed to all the shareholders. They are free to transact the securities even in the secondary capital market.

The shareholders are left with only two options when the directors fail to accomplish one of the core objectives of corporate finance i.e. wealth maximization of the shareholders. The first option is to sell their shares[11] which is of little or no value if shareholders have already lost a substantial amount of their investment and the second option is to remove the directors[12] which is an arduous task to be carried out successfully in the practical scenario. However, granting shareholders some additional avenues to participate more actively in the selection of directors is the most practical option in order to protect their interests.

In order to adapt the values of democracy in the culture of a corporation, every eligible member should make dynamic or gritty efforts in the process of decision-making and the laws should be enacted by the legislature to keep in pace with the changing global scenario and implement the laws effectively.

(A) Practical Instances of Corporate Democracy in India:

Tata Motors (2014) – In 2014, the stakeholders including the institutional investors of Tata Motors refused to ratify the proposal of excess remuneration of about Rs. 20.28 crore to its executive directors due to the fact that the company may not have adequate profits for the financial year 2014 but in January 2015, voting was done again and the shareholders voted for the increase in the remuneration.

Raymond Ltd. (2017) – On 5th June 2017, the shareholders of Raymond Ltd. in the AGM by 97.67 per cent total votes rejected the resolution to sell the flats at JK House to its promoters and their extended family at a substantial discount below the market price. Proxy firm Institutional Investor Advisory Services (IiAS) also recommended to reject the proposal.

Fortis Healthcare Ltd. (2018) – The company's shares fell by more than 13% on 28th March 2018 after its minority shareholders criticised the potential merger and rejected the sale of its business to Manipal Health Enterprises Private Ltd. and TPG Capital Advisors LLC due to the undervaluation of the business.

(B) Members vs. Shareholders:

There are some differences between the members and shareholders of a corporation. By virtue

[11] This strategy is sometimes referred to as the "Wall Street Walk".
[12] Refer, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del. 1985) and Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984); DEL. CODE ANN. tit. 8, § 141(k) (2007).

of *Section 2 (55) of the 2013 Act*, a person can become a member of a company by -

(i) *subscribing to the Memorandum of Association (MoA) of a company*. On registration of the company, the name of the subscriber will be entered in the members' register. On account of his death in One Person Company (OPC), the name of the nominee shall be mentioned in the MoA so that the latter can become a member of OPC on the death of the actual subscriber[13].

(ii) *agreement in writing and entering of name in the entity's members' register*. It means that one can become an entity's member through the allotment of shares, transfer and transmission of shares and his name must be entered in the entity's members' register. If the allotment of shares and share certificate is signed and the allottee's name is also entered in the entity's members' register, then such an allottee will become a member of a company though he does not receive the shares[14].

(iii) *by holding shares of the company in a demat account and entering of name as a beneficial owner in the records of a depository*.

In all the above cases, entering the name of the person as a member in the entity's members' register is *sine qua non*. On requisition, the register of members can be modified[15] by the company.

In addition, the below-mentioned persons are also considered as the members of a corporation though not the shareholders.

(i) In the case of a company limited by guarantee having no share capital, there will be only members of the company but not the shareholders.

(ii) List B contributories liable for payment.

(iii) Any other person liable as a member by the court's order.

In a general sense, both the terms 'Members' and 'Shareholders' are interchangeable. However, in a legal sense, they could be differentiated. A shareholder is a person who holds or owns the shares of a company either as physical securities or in demat form whereas a member, though not a shareholder, is a person whose name is so entered in the register of members. In short, a member need not be a shareholder and vice versa. *"A member may be a shareholder but a shareholder may not be a member"*.[16]

[13] *Section 4 (1) (f) of the Companies 2013 Act.*
[14] *Herdilia Unimers Ltd. V. Renu Jain [1998] 92 COMP CAS 841 (RAJ).*
[15] *Section 59 of the Companies 2013 Act – Rectification of register of members.*
[16] *Kedarnath Agarwal v. Jay Engineering Works Ltd., Company Petition No. 96 of 1961.*

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III. RIGHTS AND POWERS OF THE SHAREHOLDERS

The shareholders are guaranteed certain minimal legal rights under the 2013 Act which are as follows:

1. Right to avail secure methods of ownership registration.[17]
2. Right to transfer and transmission of shares.[18]
3. Rights of the minority shareholders to be protected while reducing the share capital.[19]
4. Right to nominate any person to whom the securities of the individual shareholder or the joint holders will be transferred in the event of his death or the death of all the joint holders.[20]
5. Right of member to copies of audited financial statement.[21]
6. Right to participate in general meetings.[22]
7. Right to vote in the general meetings.[23]
8. Right to proxy representation.[24]

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[17] In India, the Depository System was started in 1996 by virtue of the Depositories Act, 1996. It was initiated by the Stock Holding Corporation of India Limited (SHCIL) in July, 1992. A depository is an organisation that must be registered with SEBI and holds the securities of the investors in an electronic form. It functions through an agent called a Depository Participant. Therefore, there is no direct link between the Depository and the Beneficial Owners. Currently, two depositories are functioning in India, say, the *'National Security Depository Limited (NSDL)'* and the *'Central Depository Services (India) Limited (CDSL)'.* These depositories ensure the safety of the shareholders' securities in an electronic format and assure the ownership of the shareholders over the holdings of such securities. While the concept of dematerialisation is blooming, the concept of rematerialisation is still in practice too. However, in this technological era, holding securities in Demat form is highly practised and appreciable.

[18] *ibid, Sections 56 - 59 of the Companies Act, 2013.*

[19] *ibid, Section 66*. Also *vide, Section 133* - NCLT should not entertain any application for reduction of share capital unless a certificate from the auditor and a declaration by a director of the company that the Company does not have any arrears of repayment of the deposit or the interest thereon and a certificate of the auditor that the Accounting Treatment proposed by the company for reduction of share capital is in conformity with the accounting standards.

[20] *ibid, Section 72.*

[21] *ibid, Section 136.*

[22] *ibid, Section 96 – Annual General Meeting (AGM); Section 100 – Extraordinary General Meeting (EGM)[generally referred to as Requisition Meeting]. By virtue of Section 97,* a member can also approach the NCLT to call or give directions for calling a general meeting if it is not done according to the statutory requirements. *By virtue of Section 98,* the member, being eligible to cast his vote at a meeting, can also apply to the NCLT to call or give directions for calling a meeting other than the AGM. *As per Section 101*, a proper notice has to be served to all the members at least twenty-one days before the meeting. To conduct a valid meeting, Quorum is also one of the essentials and it is elaborated on in *Section 103*. As per the AoA of a company, a Chairman will be appointed to conduct a meeting and if there is no such provision in the AoA, then the members may personally present at the meeting shall elect one of themselves as Chairman as mentioned in *Section 104*.

[23] *ibid, Sections 47, 43, 50(2), 188(1), 106 -110*. As per *Section 2(76),* a member shall not vote on such resolution in which he is considered as interested/related.

Also vide, Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 which says that the voting power in respect of shares with differential rights of the company shall not exceed seventy-four per cent (74%) of total voting power including voting power in respect of equity shares with differential rights issued at any point of time.

[24] *ibid, Section 105.*

9. Right to challenge the resolutions.[25]

10. Right to appoint the directors.[26]

11. Right to appoint the auditors.[27]

12. Right to be reported by the auditors in the general meeting on the books of accounts examined by him and on every financial statement.[28]

13. Right to remove the directors.[29]

14. Right to receive the (declared) dividend.[30]

15. Right to further issue of shares.[31]

16. Right to bonus shares.[32]

17. Right to vote to amend the Memorandum of Association and the Articles of Association.

18. Right to be informed about the liquidation process of the Company.

19. Right of small shareholders to appoint directors.[33]

20. Right to file class action suits.[34]

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[25] A single shareholder holding a *'minimum of ten percent of the company's paid-up share capital'* can file a petition before the NCLT challenging a resolution adopted by a general meeting on the grounds of oppression or mismanagement. A single shareholder, irrespective of his shareholding in the company, can also bring a derivative action challenging a resolution adopted by a general meeting, on behalf of the corporation, if that resolution is detrimental to the interests of the company. However, such an action by a shareholder is only maintainable if he has approached the court with "clean hands" The procedure for derivative action has been set out in *the Code of Civil Procedure 1908.*

[26] *ibid, Section 152.*

[27] *ibid, Section 139.*

[28] *ibid, Section 143(2).*

[29] *ibid, Section 169.*

[30] *ibid, Sections 123 - 127* deal with the declaration and payment of dividend. *Spencer v. Income Tax Officer, AIR 1957 MAD 133, AIR 1957 MADRAS 133* - the Dividend is payable only out of the distributable profits or out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government or from the free reserves of the company to the shareholders in a proportion equivalent to the number of shares held by him. It is not to be asked by the shareholders as a matter of right. *Kastur Chand Jain v. Gift Tax Officer, AIR 1961 CAL 649, 65 CWN 706, AIR 1961 CALCUTTA 649* - it is a discretion of the board to declare the dividend during the financial year by a resolution passed at the AGM. However, once it is declared by the board, then the shareholders have the right to claim it since it is to be considered as a debt payable to the shareholders.

[31] *ibid, Section 62 to be read with the Companies (Share Capital and debentures) Rules, 2014.* It is a "*pre-emptive right"* of the existing shareholders since they will be preferred to be offered by the company with the new shares in respect of their existing shareholdings rather than the outsiders. The shareholders can avail of such shares at a value of discount. There is no direct penalty provision in the 2013 Act for the failure to adhere to the provisions of Right Issue. Nevertheless, as per *Section 450 of the 2013 Act*, the company and every officer of the company who is in default as defined under *Section 2(60)* or such other person shall be punishable with a fine up to Rs.10,000/- and further fine up to Rs.1,000/- for every day after the first during which contravention continues.

[32] *ibid, Section 63.*

[33] *ibid, Section 151 to be read with Rule 7 of The Companies (Appointment and Qualification of Directors) Rules, 2014.*

[34] *ibid, Section 245*. Class action suits can be filed by a certain number of members, depositors or any class of them with common interests before the NCLT against the Company or its directors for the wrongful actions/decisions

21. Right to be protected during reconstruction and amalgamation.[35]

22. Right of piggy-backing.[36]

IV. MAJORITY RULE AND MINORITY PROTECTION

A company's AoA plays a prominent role by laying down the rules as to how the company should be governed. The BoD and the shareholders may exercise their voting rights at the AGMs and EGMs to voice out their opinions relating to the functioning of the corporation and to arrive at a decision for the welfare of the stakeholders. Generally, in such meetings, the decision of the majority prevails. Even if some shareholders in their capacity as shareholders want to bring an action against the directors for their wrongdoings which are against the best interests of the corporation, they do not have any such right to do so since it could be done only by the company after the decision of the majority shareholders. This is termed as the *'Majority Rule'* where the decision made by the majority of shareholders has a binding effect on the minority shareholders and therefore, the rights of the minority shareholders get suppressed. Nevertheless, certain laws restrict the power of the company, its directors, and the majority shareholders from undermining certain rights of minority shareholders. Thus, the rights guaranteed by the Statutes override the rules of the AoA. A minority shareholder is one who has less than 50% of voting rights in a corporation. Hence, a shareholder with more than 50% of voting rights has broad powers to appoint and remove directors and approve shareholder measures that only require more than 50% of the votes. However, the position of shareholders with less than 25% of the voting rights is more vulnerable than that of the minority shareholders.

In the words of Palimar, *"striking a balance between the rights of minority shareholders and majority shareholders is sine qua non for the smooth functioning of a business of a company."*

(A) Principle of Non-Interference:

The Principle of Non-Interference was recognized by the court in the notorious case of *Foss v. Harbottle*[37] and it held that the court cannot interfere even at the request of the shareholders in the internal corporate affairs while the directors and executives act within their powers

which are contrary to the AoA or MoA of the Company or likely to violate the provisions of the Companies Act. When the audit firm violates the regulatory requirements, then the audit firm will be held liable to pay the damages or subject to any other suitable action. On the flip side, if the audit firm is subject to any false accusations that tarnished its goodwill, then it can also sue the concerned parties seeking damages or any other suitable action. After deliberation, the order passed by the NCLT shall be binding on all the stakeholders including the company and all its members, depositors and auditors.

[35] *ibid, Section 235 & 236.*

[36] When majority shareholders decide to sell their shares, the minority shareholders have the right to be counted in the deal. This is called *'piggy-backing'*. It entails the party to take into account the acquisition of the business to sell 100% of the outstanding shares.

[37] *[1843] 67 ER 189*

conferred on them by the AoA and the MoA of the company and any other relevant Statutes. The concept of *'Majority Rule'* predominantly supports the idea that the directors and the executives are best suited to make business decisions and therefore, it prevails over the discontents of the minority shareholders if the decision is taken by the majority by passing a proper resolution at a meeting.

(B) Justifications of the principle:

The Principle laid down in the '*Foss v. Harbottle case'*[38] is justified and advantageous for the following reasons:

1. **Recognition of a Company as a separate legal entity:** The company is a separate legal entity i.e. *'it can sue and be sued in its own name'*. If there is any need for the redressal of the grievances, the company can directly file a suit in its own name to seek the remedies.
2. **Protection of the optimal decisions made by the majority shareholders:** It protects the rights of the majority shareholders who are more concerned about the corporate affairs and leads them to make the proper decisions for the welfare of the company and its stakeholders.
3. **Multiplicity of futile suits avoided:** There is a chance of multiplicity of suits that are trivial in nature if every individual member of a company is permitted to sue. Therefore, this principle turns out to be good for the company and even for the judiciary in piling up the list of trivial cases where the impact is substantially less and such cases could be avoided to save time and money.
4. **A suit filed by the minority is of no use if the majority does not wish it**: If the issue for which the suit is filed needs any subsequent ratification by the majority, then obviously it holds no value in filing such suits without the consensus of the majority in a meeting.
5. **Promotion of sound corporate governance:** This principle promotes the need for robust corporate governance that makes the directors and executives accountable to the shareholders for their decisions and addresses the grievances, if any, at the earliest without the intervention of the court.

(C) Exceptions to the Majority Rule:

The *'Majority Rule'*, however, does not succeed in every circumstance. For instance, in the case of *Brown v. British Abrasive Wheel Co Ltd*[39], the 98% majority of shareholders agreed to provide additional capital for the company on a prerequisite that the remaining 2% reluctant

[38] *ibid.*
[39] *[1919] 1 Ch 290*

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minority shareholders would sell their shares to them. Negotiations having failed, the Articles of the company were altered to insert a clause that forced a shareholder to transfer his shares to the other members at a fair value if requested to do so in writing. The court held that such alteration of Articles depriving the rights of the minorities without sufficient cause and not benefitting the company as a whole could not be allowed. In the circumstances where the majority acts against the best interests of the company, then a minority shareholder acting as a representative of the corporation can file a *'derivation action'*. It underscores the fact that the intervention of the court in the internal affairs of the company is justified when the majority shareholders violate the laws or are involved in any fraudulent activities or mismanagement.

The following are the exceptions to the majority supremacy underscored in *Foss v. Harbottle*[40]:

1. Ultra Vires Acts:

The court should not interfere in the internal corporate affairs since it considers that the company itself is the best judge of its own affairs. However, an individual shareholder, being a proper person in the eyes of the law[41], has a right to prevent the company and the officers from committing any ultra vires act that no majority of shareholders can sanction and therefore, he is entitled to file a suit against such default corporation and such default officers[42].

2. Fraud on the minority:

Where the conduct of the dominant shareholders amounted to fraud against the minority, then it can be impeached as a discriminatory action, and therefore, the shareholder is legally authorized to bring an action for such conduct.[43]

3. Acts requiring special majority:

Where a resolution necessitates a special majority but is approved by a simple majority or where a special resolution is not passed as per the legal provisions, then any shareholder is legally authorised to bring an action to invalidate such resolution.[44]

4. Wrongdoers in control:

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[40] *[1843] 67 ER 189*

[41] *vide, Nurcombe v. Nurcombe, (1985) 1 All ER 65 (CA)*. In this case, the wife, being a minority shareholder, brought an action against the wrongdoings of her husband, the director of a company, on which she gained knowledge during the matrimonial proceedings. It was held that she was not a proper plaintiff for a derivative action.

[42] *vide, Bharat Insurance Co Ltd v. Kanhaiya Lal, AIR 1935 Lah 792: 160 IC 24*.

[43] In *Menier v. Hooper's Telegraph Works (1874) LR 9 Ch App 350: (1874-80) All ER Rep Ext 2032*, the majority shareholders engaged in the financial transactions that favoured them and constituted fraud on the minority by not disclosing such transactions and therefore, the court held that the resolution that disregarded the interests of the minority shareholders was invalid.

[44] Refer *Nagappa Chettiar v. Madras Race Club (1949) 1 MLJ 662: ILR 1949 Mad 808.*

In order to safeguard the interests of the company, any individual shareholder can bring an action in the name of the company against the controlling shareholders who have committed any obvious wrong to the company and restraint any action to be brought against them.

When a company is controlled equally by the defendants and the plaintiffs, the plaintiffs can bring an action against the defendants who had fraudulently converted the company's assets for their personal benefits. When the directors breach a fiduciary duty, then the corporate veil should be lifted and the default directors should be held liable[45].

5. Individual membership rights:

Every shareholder has certain personal rights, arising from the provisions of the Act or the AoA of a corporation, against the company and the co-shareholders. Such rights are generally termed as the 'individual membership rights'. When such rights are infringed, the *'Majority Rule'* does not apply and therefore, the court can interfere to protect such rights. A shareholder is entitled to enforce his individual rights against the company which includes a voting right, a right to get his vote recorded, or a right to stand at an election for directorial positions[46].

6. Prevention of Oppression and Mismanagement[47]:

In *Kanika Mukherji v. Rameshwar Dayal Dubey*[48], the Calcutta High Court held that the principle of the Sections embodied in the Companies Act which provide for the prevention of oppression and mismanagement is an exception to the rule laid down in *Foss v. Harbottle*.

The term '*Oppression'*[49] means the conduct that deviates from the standards of integrity and fair dealing that a company is supposed to follow and on which every shareholder is relied upon.

Every member is entitled to apply to the NCLT when the BoD governs the corporate business in a way detrimental to the interests of the community or corporate or detrimental or oppressive to the interests of the member(s)[50].

The following members have the right to apply to NCLT seeking relief against the oppression

[45] *Glass v. Atkin (1967) 65 DLR (2d) 501 (Can).*
[46] Refer *Nagappa Chettiar v. Madras Race Club (1949) 1 MLJ 662: ILR 1949 Mad 808.*
[47] *Sections 241 to 246 under Chapter XVI of the Companies Act, 2013 deal with the prevention of Oppression and Mismanagement.*
[48] *(1966) 1 Comp LJ 65: 70 CWN 236.*
[49] The meaning of the term 'oppression' as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Western Ltd., (1952) Scottish Cases 49*, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in *Shanti Prasad v. Kalinga Tubes, (1965) 1 Comp. L.J. 193 at 204* is as under: *"The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely."*
[50] *Section, 241 (1) of the Companies 2013 Act.*

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and mismanagement[51]:

(a) in the case of a company having share capital, 100 or more members, or more than 10% of the total members, whichever is less, or any member or members holding more than 10% of the issued share capital of the company, on a condition that all calls and other sums due on his or their shares have been paid the applicant(s) can apply to the NCLT;

(b) in the case of a company not having a share capital, more than 20% of the total number of its members.

If found fit, the NCLT, being a quasi-judicial body, can pass any order, including an order directing the majority shareholders to buyout shares held by the oppressed minority shareholders.

In *Tata Consultancy Services Limited v. Cyrus Investments Pvt Ltd*[52], in January 2020, Tata Sons appealed to the Supreme Court (SC) against the order of the National Company Law Appellate Tribunal (NCLAT) to restore Mr. Cyrus Mistry ('the accused') as its executive chairperson on the ground that such restoration of the accused would undermine corporate democracy since he was properly removed by obtaining the majority votes in the board against him. The SC quashed the NCLAT order and held that Mr. Cyrus Mistry was removed from the directorship based on valid and justifiable reasons and therefore, it could not be termed as "oppressive or prejudicial in law".

V. SHAREHOLDER ACTIVISM

Shareholder activism is not a fresh concept, however, it is widely preferred by researchers in recent times to explore in the arena of corporate governance. With the ever-changing dimensions of the market and the regulatory frameworks, it tends to evolve simultaneously and so it requires constant research.

Shareholder activism is a practice adopted by the shareholders of a company by engaging themselves in a campaign to influence the actions of the corporation in their favour. It is a burning topic in corporate governance. While the supporters of shareholder activism are of the opinion that there is a positive impact in the capital markets due to the intervention of the activists, the critics severely criticise the *"myopic activists"* as *"opportunists"* who are with an objective of short-window market returns at the cost of long-term shareholder value.

The activists have the tendency to target companies with a recent history of stock-price

[51] *ibid, Section, 244.*
[52] *AIR ONLINE 2021 SC 179.*

underperformance and poor operating performance in the industry compared to the competitors and purchase shares of such companies, say between 6 and 10 per cent, sometimes supplemented with derivatives. They may compel such companies to repurchase stocks, initiate a cash dividend, grant them BoD representation, alter strategy, terminate a pending acquisition, or agree to a proposed merger. Mostly, the capital markets react positively due to the intervention of the activists i.e. the market share value of the companies will upsurge and provides good returns on investment to the shareholders in the short term.

In recent times, the index funds in the global market outperforms the mutual funds, especially in the US Stock Exchanges. The enhanced influence of the index funds has reduced entry barriers for activists and even influenced the kinds of campaigns that are more likely to be successful. Furthermore, due to modifications in the Securities and Exchange Commission (SEC) rules, changes in director sophistication and the adaptation of strategies based on preceding campaigns mean that the tactics activists employ and their upshots have changed over a decade or two ago.

Activists are also increasingly interweaving arguments involving Environmental, Social and Governance (ESG) factors into campaigns by pointing to an unsatisfactory ESG strategy or unaddressed exposure to ESG risks. Such strategies may emerge from a desire to appeal to institutional investors.

(A) Recent Trends in Shareholder Activism:

During the COVID-19 pandemic, shareholder activism slowed down considerably. However, it faced an upward trend afterwards[53].

1. For ages, mergers and acquisitions (M&A) have been one of the topmost objectives of shareholder activists. The activists could make a company sell its business wholly or partly or seek for favourable negotiation.
2. ESG matters remain a priority for institutional investors when engaging with their investee companies and climate change is at the uppermost of their agenda. Both traditional and modern activists focus on ESG matters. Many new firms have emerged particularly focusing on ESG factors. Some have even undertaken proxy fights to place their own directors on the board of the company.

[53] In the US, activists launched 34% fewer campaigns and targeted 25% fewer companies in 2020 than they had the previous year. But the fourth quarter of 2020 saw activity begin to rebound. During the first quarter of 2021, the number of campaigns launched increased 48% over the first quarter of the prior year. Activists initiated 37 campaigns, almost half of 2020's total activity.

3. The activists use Special Purpose Acquisition Companies (SPACs)[54], which have emerged as a popular alternative to an initial public offering (IPO) for some private companies, to raise the required capital for M&A.

(B) Tools Used by Shareholder Activists:

The shareholders make use of different tools to accomplish their desired goals. They choose the particular tool depending upon their nature and how radical a change they are pushing for.

The following are the most common tools used by shareholder activists:

1. Shareholder resolution:

As a thumb rule, any decision with respect to the affairs of a company must be taken via passing a resolution at a general meeting. The shareholders exercise their opinions by casting their votes either in favour of or against the resolution to be passed. Shareholder activists generally make use of this tool as a primary and effective weapon. They submit a proposal involving suggestions for managing the affairs of the company for a vote at the general meeting of the company. Though not binding in nature, it is an important investor tool typically used when a dialogue with the company on a certain issue stalls or is unproductive. It is an effective tool to engage the attention of other minority shareholders and the public in general. The BoD resists such submissions of shareholder resolutions.

2. Proxy Fights:

Proxy fights can be used to change the composition of the BoD of a company. When the shareholders are against the decisions to be made by the BoD, the activists may conduct a campaign to collect the proxy votes of the shareholders who are reluctant or unable to partake in the meeting and use such proxy votes against the BoD in order to bring out the desired changes.

3. Media Campaigns:

Modern media is effectively used by shareholder activists in order to gain the attention of the general public and even the regulators to a particular issue they are concerned about in a corporation. Such media campaigns are taken by the activists likely to pressurize the management in favour of the agenda of the activists. Media campaigns via social media like 'X' platform, Facebook, etc. have significant effects.

[54] By virtue of *Section 248 of the Companies Act*, SPAC cannot operate in India.

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4. Negotiations with the management or the BoD:

Even through a simple negotiation with the management or the BoD of a company, the activists can easily accomplish their goals. However, when the management or the BoD is reluctant to any negotiation at first instance, the activists will be left with no other option other than using a certain tool of shareholder activism.

5. Threats of Litigation or Actual Litigation:

As an ultimate weapon, a threat to institute a suit or an actual institution of a suit against the management and the BoD of a company is used by the activists to accomplish their goals. It is a relatively expensive tool. However, it is not generally preferable since it has a detrimental effect on the reputation of the company that brings out a significant loss to all the stakeholders including the activists.

(C) Role of Proxy Advisory Firms in Shareholder Activism:

In India, the institutional investors are more active in the securities market rather than the retail investors. At an early stage, they were more concerned about non-routine corporate actions such as mergers and acquisitions (M&A), restructuring/reconstruction of the company they invested in (i.e. the investee companies), etc. Over a period of time, they actively started concentrating on the functioning of the management of their investee companies in the ordinary course of business. In certain cases, they actively seek to take an action to protect their interests in their investee companies. They gradually started engaging themselves in shareholder activism.

In this scenario, the concept of Proxy Advisory Firms (PAFs)[55] has evolved in the US by the SEC. The SEC made it mandatory on the part of the institutional investors to cast their votes on all the items in their company's proxy statements. To assist the institutional investors, PAFs engage in market research and provide certain recommendations to the institutional investors on such proxy proposals. In a current scenario, PAFs hold high priority since institutional investors depend on their recommendations on proxy voting. They assist institutional investors to actively participate in shareholder activism in order to elevate the canons of corporate governance and to change the undesirable state of affairs in the corporate operations.

These firms analyse the major activities of the company and submit detailed reports to guide the shareholders to make decisions with a long-term perspective for safeguarding their interests in the company.

[55] A PAF is defined as a firm that offers voting recommendations to institutional investors (mutual funds, insurance companies, foreign institutional investors, private wealth management firms, etc.) on shareholder meeting resolutions of their investee companies.

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In 2010, the domestic mutual funds (institutional investors) were mandated by the Securities and Exchange Board of India (SEBI) to disclose their voting policies and voting actions at their respective investee companies. The PAFs, thus, originated in India. The role of PAFs in India is less effective than in the US, however, it has started evolving rapidly.

(D) Adverse Impact of Shareholder Activism on The Corporation:

Due to several campaigns by the shareholder activists and their success and negative impact on the corporation, there is a significant change in the perspective of the promoters, directors and executives of the corporation.

The following are some of the adverse impact of shareholder activism on the corporation:

1. By pointing out the inefficiency and unethical behaviours of the directors, the shareholder activists have the influential capacity even to reconstitute the entire BoD.
2. The directors would like to secure their positions and enjoy the power in the corporation. A threat to such position and power by hostile takeovers would make them stranded and eventually, it may even lead to an actual hostile takeover of the corporation.
3. When the initial negotiations with the BoD fail, the shareholder activists take their last powerful weapon in their hands and proceed to file a suit against the corporation that is more expensive.
4. Due to shareholder activism, the share value of the company in the stock market may plunge temporarily. However, it would later become an arduous task for the company to restore its share value.
5. When the activists indulge in adverse marketing campaigns, the market share value of the company may plummet and ironically, it may even result in the loss of goodwill of the company. When the goodwill is lost, everything the company earned since its inception will be at stake.
6. Due to the pressure created by the activists, even the executives of the company may face trouble in managing the firm's daily operations while dealing with the demands and mayhems created by the activists.
7. When the mass media get involved and broadcast the campaigns of the shareholder activists, an implicit invitation is offered to the government and regulators to look at the operations of the company.

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VI. CONCLUSION

(A) Findings and Suggestions:

- The majority shareholders, who may have the least interest in safeguarding the interests of minority shareholders, play a major role in appointing the independent directors. In a practical sense, independence may not be enjoyed by the independent directors. Hence, in the best interests of the shareholders, it is always preferable if the appointment process is carried out by the government or the regulators or other authorities authorised by them.
- In research conducted by Singla and Singh in 2018, it was found that the private companies are more active in incorporating the regulatory requirements related to corporate governance than the public companies. The Governments and the regulators established various Committees aimed at promoting and enhancing a good corporate governance in the public listed companies and thereby, passed laws and issued various policies and voluntary and mandatory guidelines. The Ministry of Corporate Affairs (MCA) and SEBI play a commendable role in protecting the interests of the shareholders. However, proper implementation of such provisions is the need of the hour to enhance good corporate governance and corporate democracy.
- Appointment of the independent directors in the BoD and various committees to make unprejudiced judgments is critically acclaimed. However, generally, such independent directors, being outsiders, are not encouraged to participate in the management of day-to-day affairs of the company and they may even tend to lose their motivation to work for the welfare of the company and shareholders. Hence, a sense of responsibility has to be instilled in their minds towards the betterment of the company and society as a whole. Active independent directors contribute to the positive outlook of the company and thereby, assist in increasing the value of the shares of the company.
- It is an incontestable fact that corporate democracy is profoundly dependent upon the voting strength of the shareholders either by themselves or through proxies. In a practical scenario, most of the shareholders are primarily concerned about their returns on investments (ROI) and least concerned about the functioning of the board and management and therefore, they are not actively participating in the general meetings to elect a BoD or to vote for or against the resolutions placed by the BoD.

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In this way, the powerful tool, i.e. the voting rights, handed over to the shareholders is not effectually used by them in order to achieve shareholder democracy at all levels and protect the interests of all the shareholders. Hence, the shareholders must realize this and take their time to attend the general meetings and exercise their voting power to ensure the safety of the interests of the corporation and the shareholders/stakeholders rather than risk losing their investments as a result of poor corporate governance.

- The above-mentioned factor i.e. only a few shareholders attend the meeting and elect the directors may have an adverse impact on corporate governance since such shareholders could have been influenced in many ways to vote in favour of a particular person who lacks adequate knowledge, skills, training and professional ethics. Therefore, the active participation of all the shareholders in the general meetings to elect a BoD is necessary to enhance good corporate governance and to achieve corporate democracy.
- Few shareholder activists are mainly focused on short-term ROIs rather than the long-term value creation. They must realize the fact that long-term shareholder value is weighed more than short-term returns and ensures their peaceful and settled life in terms of money. Even the tax levied by the government of India on long-term capital gains on equity shares (say, 10% on gains above Rs. 1 lakh) is considerably less than the short-term capital gains (say, 15%)[56]. Wealth maximization is of paramount importance to Profit maximization.
- When the initial negotiations with the BoD fail, the shareholders proceed to file a suit against the company which is more expensive to both the company and shareholder activists. Hence, the BoD should try to fix the issue once it comes to its notice. The activists should also accept the fact that they cannot achieve the success in all their endeavours and they should also heed the reasonable justifications put forth by the company.
- The Stakeholders Relationship Committee (SRC)[57] can be utilized in a more effective way to strengthen the relationship between the shareholders and the company. It should facilitate the shareholders in expressing their opinions more freely and address their concerns promptly and swiftly and if it cannot resolve such

[56] *vide, Sections 111A, 112 and 112A of the Income Tax Act, 1961.*
[57] *Section 178 of the Companies Act, 2013.*

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concerns or take into consideration the opinions of the shareholders due to some reasonable causes, then it should convince them according to its terms at the earliest before they get themselves engaged in shareholder activism.

- The BoD and management must be well-equipped with greater knowledge, skills, training and ethical standards to prevent impending attacks from the activists to safeguard the interests of the company and the stakeholders.
- Effective use of blockchain technology in corporate governance instils confidence in the minds of the shareholders that it acts transparently and therefore, there is no manipulation in decision-making. It ensures proper internal control and further assists in pre-empting the corporate frauds. It also increases the shareholders' participation in the meetings by enabling the direct and simple exercise of voting rights and thereby, it facilitates them to make decisions in the best interests of the company and the shareholders.

(B) Conclusion:

Good Corporate Governance must ensure an amicable relationship with all the stakeholders. Effective and timely communication between the BoD and the shareholders may avert many issues that are detrimental to the welfare of the entity and other stakeholders. Even the shareholder activists, particularly the institutional investors and PAFs, have paved the way for the reformation of corporate governance. In recent times, we have witnessed several successful campaigns by shareholder activists. On one hand, it strengthens the power of the shareholders in the corporation, however, on the other hand, it may have an awful effect on the goodwill of the corporation and even on the shareholders since such campaigns attract the attention of a large number of masses who may tend to develop a negative impression on the effective and efficient functioning of the corporation.

It is also noteworthy that, of late, many of the activists have shifted their focus from short-term profit-making to long-term shareholder value. Many Institutional Investors, being a large part of shareholders, focus on investing in projects that promote ESG factors.

To conclude, corporate democracy is all about the participation of the shareholders in the affairs of a corporation. The BoD must encourage the shareholders to effectively participate in the meetings and should consider their valuable opinions. It must ensure the viability of the firm and oversee the functioning of the management by incorporating an effective internal control framework. The BoD must realize the fact that retaining the shareholders for the long term is *sine qua non* in the development and survival of the company in the market. On the other hand,

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the shareholders rather than focusing on short-term returns should take into consideration the interest of the company as a whole, the long-term sustainability of which will enhance the wealth of the shareholders in the long run. To put it in a nutshell, a balanced approach between shareholder primacy and board primacy is significant in order to enhance good corporate governance.

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