

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 6 | Issue 6

2023

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Shareholder Activism: Does it Enhance Corporate Accountability or Cause Disruption?

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ABSTRACT

Shareholder Activism is a multifaceted phenomenon which has the potential to either enhance corporate accountability or be the cause of disruption within the corporations. This dichotomy arises from the diverse objectives, strategies and outcomes associated with shareholder's engagement with the company. It basically involves the efforts of the shareholders to bring about a desired change in operations the company ensuring they act in the best interest of the shareholders and encompasses a spectrum of activities ranging from advocating for greater transparency and pursuance of short-term financial gains. Consequently, the effect of shareholders activism on corporate accountability versus disruption are complex and is contingent upon various factors. On one hand, shareholder activism can bolster corporate accountability in several ways by enhancing transparency and increased disclosure. On the other hand, shareholder activism can be disruptive. Short term campaigns focused on immediate financial gains may divert corporate resources and attention from long term planning. This research paper aims to analyze the effects of shareholder activism based on their ability to either be constructive or disruptive. While the preliminary findings suggest that shareholder activism can enhance accountability, it also underscores the potential for disruption when short term gains are prioritized. Recognizing this complexity is essential and these findings will be further explored through an analysis offering valuable insights for the stakeholders, policymakers and corporate leaders as they navigate the evolving field of shareholder activism and its implications for corporate governance and accountability.

Keywords: Shareholder Activism, Short termism, Corporate Governance

I. INTRODUCTION

Shareholder activism is defined as engaging with the management of a company and influencing their behaviour, advocating for policy changes, and impacting their overall conduct. Adopting activist proposed strategies is expected to help shareholders maximize wealth. (Gillan and

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Starks 2000; Sjöström 2008).³

Shareholder activism has emerged as a powerful force reshaping the dynamics of corporate governance, as investors increasingly seek to influence the decision-making processes of the companies in which they hold stakes. This phenomenon reflects a shift from the traditional passive role of shareholders to one characterized by active engagement and intervention (BlackRock, 2019; Lipton & Lorsch, 1992)⁴. Activist shareholders, often institutional investors or specialized hedge funds, leverage their ownership positions to advocate for changes they believe will enhance shareholder value (Brav et al., 2008)⁵. This paper aims to explore the dual nature of shareholder activism—examining its potential to increase corporate accountability while also acknowledging the disruptions it can introduce into the corporate landscape.

In recent years, shareholder activism has gained prominence as a strategy to address deficiencies in corporate governance, inefficiencies in capital allocation, and lapses in ethical and responsible business practices. Activists employ various methods, including proxy contests, shareholder proposals, and direct engagement with management, to influence corporate decisions. The motivations behind shareholder activism are diverse, ranging from a focus on short-term financial gains to broader concerns about environmental sustainability, social responsibility, and corporate ethics⁶. The paper will proceed by examining the motivations driving shareholder activism, analysing the strategies employed by activists, and evaluating the impact of activism on corporate accountability. Additionally, it will explore instances where shareholder activism has led to disruptions within companies, weighing the short-term gains against potential long-term consequences. This research aims to contribute insights into the evolving area of shareholder activism and its implications for the corporate world.⁷

II. LEGAL POSITION OF SHAREHOLDERS IN INDIA

Though shareholder activism in India has been pulled back by systemic and institutional vulnerabilities for many years, some very encouraging green shoots have emerged lately in the form of institutional investors like mutual funds and other long-term investors, which have

³ Gillan, Stuart L., and Laura T. Starks. 2000. Corporate governance proposals and shareholder activism: The role of institutional investors. *Journal of Financial Economics* 57: 275–305.

⁴ Lipton, M. and Lorsch, J.W. (1992) A Modest Proposal for Improved Corporate Governance. *The Business Lawyer*, 48, 59-77.

⁵ Bebcuk, L. A., Brav, A., & Jiang, W. (2015). THE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM. *Columbia Law Review*, 115(5), 1085–1155. <http://www.jstor.org/stable/43582424>

⁶ Goranova, Maria & Ryan, Lori. (2013). Shareholder Activism: A Multidisciplinary Review. *Journal of Management*. 40. 10.1177/0149206313515519.

⁷ Harvard Law School Forum on Corporate Governance and Financial Regulation (Mary Ann Cloyd, PwC). (April 2015). Shareholder Activism: Who, What, When, and How? <https://corpgov.law.harvard.edu/2015/04/07/shareholder-activism-whowhat-when-and-how/>

ignited an increased level of engagement with the promoters. Similarly, in the last two decades, several legal and regulatory steps have been introduced to enhance the protection of shareholder interests. The Companies Act, 2013 (hereinafter “Act”) along with its recent amendments, Securities and Exchange Board of India (hereinafter “SEBI”) guidelines, primarily through the SEBI Act, 1991 along with SEBI (Issue of Capital and Disclosure Requirements), 2018 (hereinafter “SEBI ICDR Regulations”) and SEBI (Listing Obligations and Disclosure Requirements), 2015 and circulars for listed companies, Kotak Committee recommendations⁸ and the implementation thereof, the guidelines of the Insurance Regulatory and Development Authority of India concerning stewardship and expansion of proxy advisory firms, have been some path-breaking landmarks in the growth of shareholder activism in India.

Some of the individual rights available to shareholders are as follows:

(i) *Right to receive information*⁹: This includes a right to receive copies of the audited financial statement, including the balance sheet and profit and loss account, report of the Cost Auditor upon a direction given by the government, copies of the contracts regarding the appointment of managing director or manager of the company and disclosure of interest by directors¹⁰ and copies of the notices of general meetings of the company and documents annexed with such notice.¹¹

(ii) *Inspection rights*: These include a right to inspect statutory registers such as the register of charges¹², register of members and debenture holders¹³, shareholders’ minutes books¹⁴, and register of directors¹⁵, among others.

(iii) *Right to vote*, attend general meetings and other allied rights: Shareholders enjoy a right to receive notice of general meetings¹⁶, a right to participate in such meetings, as well as to vote at them personally or by proxy¹⁷. Equity shareholders have voting rights in proportion to their paid-up shares; they also have a right to receive share certificates¹⁸ and dividend as and when declared.¹⁹ They are entitled to rights shares and share in the company's surplus assets in the

⁸ Circular No.: SEBI/HO/CFD/CMD/CIR/P/2018/79

⁹ Section 136 of The Companies Act, 2013

¹⁰ Section 184 of The Companies Act, 2013

¹¹ Section 101 and 102 of The Companies Act, 2013

¹² Section 87 of The Companies Act, 2013

¹³ Section 94 of The Companies Act, 2013

¹⁴ Section 119 of The Companies Act, 2013

¹⁵ Section 170 of The Companies Act 2013

¹⁶ Section 101 of The Companies Act, 2013

¹⁷ Section 105 of The Companies Act, 2013

¹⁸ Section 46 and 56 of The Companies Act, 2013

¹⁹ Section 51 of The Companies Act, 2013

event of its winding up.

(iv) *Right to transfer shares*²⁰: The Act and the company's articles of association allow shareholders a right to transfer their shares. They may, however, contain certain conditions to be met by the shareholders before the transfer takes place.

III. HOW DOES IT ENHANCE ACCOUNTABILITY: ANALYSIS THROUGH CASE STUDIES

A. *Merger Case of HDFC Life and Max Life*

Leading life insurance providers in India, HDFC Standard Life Insurance Co. Ltd. and Max Life Insurance Co. Ltd., stated in August 2017 that they had cancelled their planned merger, for which lengthy discussions had been ongoing. If the merger had been completed, the result would have been an insurance behemoth with assets of INR 1.1 trillion and a market share that was second only to the dominant operator, Life Insurance Corporation of India²¹. Although the alliance's structure was found to violate §35 of the Insurance Act, 1938, which was the main reason why the merger was not approved by the competent authorities²², there was an unusual aspect to the issue that was related to another worry voiced by the shareholders. The agreement called for paying the Max Life group INR 850 crore in non-compete payments. Although the payment of "non-compete fees" as a structure has been widely used in merger and acquisition transactions involving private companies, this has been a divisive topic in the case of public corporations due to worries about the protection of minority shareholders.

B. *The McDonalds case*

The well-known case of *Vikram Bakshi v. Connaught Plaza Restaurants Limited*²³, which was heralded as the victory of Indian entrepreneurs over affluent investors, garnered a lot of attention because McDonald's had grown to be a popular brand among millennials. Mr. Vikram Bakshi filed an NCLT complaint alleging McDonald's oppression of him. Mr. Bakshi filed a petition in accordance with Sections 397–402 of the Companies Act of 1956²⁴. The case also involved the change in legislation from the Companies Act of 1956 to the Companies Act of 2013, which made §§ 241-245 of the Act and the NCLT's replacement of the Company Law Board applicable. The resolution that was passed in a meeting on August 5, 2013, resulted in the

²⁰ Section 44 of The Companies Act, 2013

²¹ <http://economictimes.indiatimes.com/markets/stocks/news/ birth-of-a-giant-hdfc-life-will-unite-with-max-life-to-becomeindias-biggest-listed-life-insurer-with-rs-50k-crore-market-cap/ articleshow/52803177.cms>

²² http://www.bseindia.com/corporates/anndet_new.aspx?newsid=e4fe0984-f741-4604-b177-b5a1b3e3d0b7

²³ *Vikram Bakshi and Ors. v. Connaught Plaza Restaurants Limited and Ors.* [2017] 140 CLA 142.

²⁴ <https://www.mondaq.com/india/shareholders/1087120/the-redefined-boundaries-of-section-397-after-the-mcdonald-case>

removal of Mr. Vikram Bakshi. It was claimed that Mr. Bakshi had broken important terms of his joint venture agreement with McDonald's India in addition to failing to carry out his responsibilities in a competent manner. In a groundbreaking ruling that deemed Mr. Bakshi's removal unlawful, the NCLT acknowledged Mr. Bakshi's genuine efforts in developing the joint venture business in India and the fact that McDonald's India had never filed a grievance against him during the previous 16 years as the joint venture business was being consolidated throughout India. Rather, there were times when Mr. Bakshi was given credit for his work. The NCLT noted that Mr. Bakshi had previously been contacted by McDonald's India to sell his shares, but he had turned them down. According to NCLT, Mr. Bakshi was removed in an oppressive act carried out with the intention of giving NCLT more power to compel Mr. Bakshi to sell his shares to McDonald's India for a pittance.²⁵

The key lesson from this case is that the NCLT expanded the application of the anti-discrimination provisions, taking into account the joint venture contract between the parties. It permitted individuals to seek relief on grounds of oppression other than those of shareholders or members, provided they can show that their shareholding or membership has been affected in the end.

C. Tata- Mistry case

The Supreme Court finally gave its judgment²⁶ on the unpleasant tussle between the Tata Group and the Mistry Group for the control of Tata Sons Company. After Cyrus Mistry was removed from his position as Executive Chairman of the Tata Sons in October 2016, a disagreement broke out between the two groups. Afterwards, he was removed from the board of directors of several Tata Group companies by their general bodies. Mistry's difficult situation did not end there. He was compelled to step down from the boards of several other Tata Group companies while plans were underway for extraordinary general meetings to remove him from those positions. The Mistry Group, incensed by these occurrences, had initially petitioned the National Company Law Tribunal (NCLT), which denied their request. However, Mr. Mistry's reinstatement was mandated by the National Company Law Appellate Tribunal (NCLAT) following an appeal. Several appeals against this NCLAT order are what led to the current Supreme Court ruling.²⁷ It is not enough for a shareholder to demonstrate that the company's operations are being run in a way that is oppressive or biased against her under the Companies Act of 2013. In order to receive relief, the shareholder must demonstrate that the discrimination

²⁵ India Corp Law, <https://indiacorplaw.in/2017/08/mcdonalds-case-nclt-decision-oppression.html>

²⁶ Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd., 2021 SCC OnLine SC 272.

²⁷ Cyrus Investments (P) Ltd. v. Tata Sons Ltd., 2019 SCC OnLine NCLAT 858

or oppression is severe enough to warrant winding up the business in a fair and just manner. In the event that the grounds are insufficient to support a winding-up order, the NCLT will not have the authority to compensate the oppressed shareholders. To put it briefly, Mistry Group set out to prove that there was a reason to close the venerable Tata Sons Company. Though opinions on whether the Mistry Group was treated fairly vary, it was inconceivable from the beginning that Cyrus Mistry's removal was a serious enough reason to justify the company's closure. The Court even lists the fact that two charitable trusts would receive a sizable portion of Tata Sons' dividend as one of the justifications for its conclusion that winding up is not warranted. The Court correctly concluded that the simple dismissal of an executive chairman or director does not constitute grounds for winding up. Naturally, no relief for oppression and mismanagement can be provided if there are no grounds for winding up. Relief cannot be given even if the removal of a director is not legal unless it is demonstrated to be oppressive or detrimental to the shareholders. Mr. Mistry's dismissal would not be considered an act that is oppressive or prejudicial to minority shareholders because he was not "representing" any shareholder on the Board.

There is strong evidence that a healthy market is created when minority shareholders' rights are better protected and upheld. The public will feel more comfortable participating in the market thanks to the protection. Restricting minority shareholders' ability to exercise their rights is likely to have the opposite effect. To put it briefly, the ruling emphasises how difficult it is for minority shareholders to obtain any kind of significant redress for discrimination, oppression, or poor corporate management. The case of *Tata v. Mistry* is an example of how minority shareholders' rights should be better protected.

IV. SHAREHOLDER ACTIVISM AND DISRUPTION OF CORPORATE PERFORMANCE

1. Short-Termism

It is undeniable that short termism is prevalent at the very core of financial systems in which the investors function. Companies deliver superior results when executives manage to create long-term value and resist pressure from short-term investors.²⁸ But in today's parlance the term 'shareholder activist' literally means investor seeking maximum financial gains in the short term. This has a negative effect and is at the expense of the company's policies which are focused on long term.

The primary evidence is hedge funds which seek to boost the short-term shares but at the

²⁸ <https://www.mckinsey.com/mgi/overview/in-the-news/the-case-against-corporate-short-termism#/>

expense of the performance in the long run.²⁹ A hedge fund basically promises the client to deliver higher returns in a timespan which is short.

The other instance is where shareholders hold stocks for shorter periods considering the fact, they have the flexibility to do so and subsequently shifting targets which damages the long-term proposition and sustainability. If the investors continue such practice, it is nothing but a sign that short termism will become the core of decision making.

2. *Narrow view*

The activists fail to take a holistic view of the corporate performance which places pressure on the long-term strategies. The main examples being reducing the investments in R&D which is basically the core of companies with long term values, increasing leverages etc. Well, the partial blame for this is to be put on the management as well as the long-term projects are not properly explained keeping in the mind that majority are short term activists. They are basically on the belief that investors do not value the long-term projects.³⁰

3. *Disruptive of cost and time*

The campaigns of the shareholder activists distract the company from its long-term goals. A campaign ending in a proxy fight has average costs of \$10.71 million.³¹

The most expensive activist campaign was of P&G in 2017 where the estimated cost was over \$100 million, which surpassed the previous proxy fights.³²

The campaigns also absorb considerable time spent on meetings and development of plans. These disrupt the focus of CEOs on long term strategies, rather they are seen dealing with the activists in dysfunctional meetings. The survey taken in 2016 stated that 87% of the KMPs feel they are pressurized to deliver strong financial performance within two years or even lesser.³³

Shareholder Activism V. Shareholder Adventurism:

Shareholder activism becomes shareholder adventurism when it crosses a threshold from being

²⁹ Cremers, Giambona, Sepe, Wang. (November 2015). Hedge Fund Activism and Long-term Firm Value. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231

³⁰ The Conference Board. (2015). Is short-term behavior jeopardizing the future prosperity of business at http://www.wlrk.com/docs/IsShortTermBehaviorJeopardizingTheFutureProsperityOfBusiness_CEOStrategicImplications.pdf

³¹ Nickolay Gantchev, The costs of shareholder activism: Evidence from a sequential decision model, *Journal of Financial Economics*, <https://doi.org/10.1016/j.jfineco.2012.09.007>.

³² Activist Insight and Schulte, Roths & Zabel. (2018). The Activist Investing Annual Review 2018. Available at <https://www.srz.com/images/content/1/5/v2/155375/The-Activist-Investing-Annual-Review-2018-HiRes.pdf>

³³ FCLT Global. (2016). Rising to the challenge of short-termism. Available at https://www.fcltglobal.org/docs/default-source/default-document-library/fclt-global-rising-to-the-challenge.pdf?sfvrsn=ed4e258c_0

a legitimate and constructive effort to influence corporate governance and performance to becoming aggressive, disruptive, or motivated primarily by personal gain or a short-term agenda. The line between activism and adventurism can be subjective and context-dependent, but several factors can help distinguish the two:

1. *Long-Term vs. Short-Term Focus:* Shareholder activism typically aims to enhance long-term shareholder value and corporate governance³⁴. When activism becomes primarily focused on quick financial gains without consideration for the company's long-term sustainability, it may be viewed as adventurism.
2. *Lack of Constructive Proposals:* Activists often propose specific changes to improve corporate performance, governance, or accountability³⁵. Shareholder adventurism, on the other hand, may lack well-defined, constructive proposals and instead involve disruptive actions or demands that do not serve the interests of the broader shareholder base.
3. *Lack of Transparency and Communication:* Activists typically engage in dialogue with the company's management and other shareholders to convey their concerns and proposals. Shareholder adventurism may involve secretive or uncommunicative actions that raise suspicions or create unnecessary disruptions.
4. *Undue Risk or Harm:* Shareholder activism seeks to bring about positive change without causing undue harm or risk to the company, its employees, or its stakeholders. Shareholder adventurism may involve actions that put the company at risk or create instability.
5. *Short-Term Profit Motive:* Shareholder activism can involve financial motivations, but shareholder adventurism often focuses on immediate financial gains, potentially at the expense of long-term value creation³⁶. The Luc Hoffmann Institute Report Shareholder Activism: Standing-up for sustainability? posited: “The term ‘shareholder activist’ or ‘activist investor’ has come to mean an investor who seeks, above all, economic and financial gains to maximise investments in the short term. This form of shareholder

³⁴ Hoss, N., & Eichner, K. (2023). Shareholder activism: Further evidence on the relationship between activists' demands and shareholder value creation. *Journal of Corporate Accounting & Finance*, 34, 157–173. <https://doi.org/10.1002/jcaf.22635>

³⁵ Shi, W., Connelly, B. L., Hoskisson, R. E., & Ketchen Jr, D. J. (2020). Portfolio spillover of institutional investor activism: An awareness–motivation–capability perspective. *Academy of Management Journal*, 63(6), 1865–1892.

³⁶ The Conference Board. (2015). Is short-term behaviour jeopardizing the future prosperity of business? Available at http://www.wlrk.com/docs/IsShortTermBehaviorJeopardizingTheFutureProsperityOfBusiness_CEOStrategicImplications.pdf

activism almost inherently weighs negatively on corporate sustainability policies which are focused on the longer-term.”³⁷

6. *Personal Agendas:* Activists often act in the interests of the broader shareholder base. Shareholder adventurism as compared prioritize the personal interests of the activist, such as quick profits or personal vendettas against corporate leadership.³⁸
7. *Legal or Ethical Boundaries:* Shareholder activism usually operates within the legal and ethical boundaries. Shareholder adventurism may involve actions that cross those boundaries, leading to legal consequences.

V. CONCLUSION

Financially motivated activists are strongly encouraged to prioritise actions that are expected to produce immediate results due to market forces. Such actions may have unfavourable effects on the sustainability of businesses. There is a lack of evidence to support this, indicating the need for a thorough investigation that specifically examines the sustainability performance of businesses that have been the target of shareholder activism. Furthermore, the focus should be on constructive engagement on issues to support long-term performance, given the impact on time and resources required to respond to shareholder activist campaigns. Shareholder activism, when conducted responsibly and with the long-term interests of the company and its stakeholders in mind, can play a constructive role in corporate governance.

³⁷ Cremers, Giambona, Sepe, Wang. (November 2015). Hedge Fund Activism and Long-term Firm Value. Available at [https:// papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2693231)

³⁸ DesJardine, M. R., Zhang, M., & Shi, W. (2023). How Shareholders Impact Stakeholder Interests: A Review and Map for Future Research. *Journal of Management*, 49(1), 400-429. <https://doi.org/10.1177/01492063221126707>