

II.

SHAREHOLDER ACTIVISM: AN ESG TOOL OR A FOUNDER'S CURSE?

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ABSTRACT: The need for appropriate shareholder activism has often been critically viewed as a proactive step towards managing the adverse functioning of a company to ensure corrective measures. The current study aimed at highlighting the good, the bad and the ugly of shareholder activism and its impact on companies from an environmental, social and governance perspective. However, before engaging in a comprehensive analysis of shareholder activism, it may be useful to explore what actually shareholder activism is, where is it coming from, and where it is going. The term is self-descriptive but only to a limited extent. In this study the authors have highlighted despite it having the potential to be misused, it remains desirable when it pushed the management of a company into achieving its ESG obligations.

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A. INTRODUCTION

An activist shareholder is one who uses its rights as a shareholder of a company to bring about changes within or for the company. In recent years, there has been a rise in the number of institutional investors and the influence exerted by them on companies as activist shareholders.³ Institutional investors, especially larger public hedge funds, have increasingly used their rights as shareholders of a company to effect changes within the company.⁴

Unlike investors of yesteryears, today's investors are not looking to exit companies at the first sign of distress. Today's investors are eager to play a more proactive role and do not shy away from calling out the blunders of the management.⁵ If required, they are also willing to ensure that corrective measures are taken in a timely manner to steer the company from any adverse consequences. However, while shareholder activism is often an effective means of disciplining the management, it has the capability to be misused and can become a nuisance to founders and the management. It may also act as a weapon in the hands of a motivated investor trying to protect short-term interests.⁶

In this article, we discuss the good, the bad and the ugly of shareholder activism and its impact on companies from an environmental, social and governance (“ESG”) perspective. In Part II, we discuss the background and rise of shareholder activism as well as the objectives it seeks to achieve. In Part III, we examine the types of demands that activist investors raise and the tools available to them under Indian law to bring about changes within companies. In Part IV, we discuss the importance of communication between shareholders and companies to ensure that objectives of shareholder activism are realized without such activism becoming a nuisance to founders and the management. Lastly, we conclude by finding that shareholder activism remains desirable, despite its potential to be misused, when it pushes the management of a company into achieving their ESG obligations.

³ Assaf Hamdani and Sharon Hannes, *The Future of Shareholder Activism*, BOSTON UNIVERSITY LAW REVIEW, 99(3), 971, 971 (2019).

⁴ *Id.*

⁵ Iman Anabtawi and Lynn Stout, *Fiduciary Duties of Activist Shareholders*, STANFORD LAW REVIEW, 60(5), 1255, 1258 (2008).

⁶ Virginia Harper Ho, *“Enlightened Shareholder Value”: Corporate Governance Beyond the Shareholder-Stakeholder Divide*, JOURNAL OF CORPORATION LAW, 36(1), 59, 61 (2010).

B. THE RISE AND OBJECTIVES OF SHAREHOLDER ACTIVISM

Shareholder activism has grown multifold in the last few years due to multiple factors such as the increase of institutional investors, increase of informed investors, tightening of the corporate governance regime and better access to information.⁷ In fact, investors' growing preoccupation with ESG standards across the world is also giving rise to significant shareholder activism.⁸ A recent and prominent example of this includes the activism demonstrated by Engine No. 1, a small hedge-fund investor of Exxon, which was successful in mobilizing the support of other institutional investors and installing three directors on the board of Exxon, with the aim of pushing Exxon into reducing its carbon footprint.⁹

Shareholders are increasingly engaging with the company management to influence their behaviour, push for policy changes and influence overall conduct. There have, typically, been two streams of shareholder activism.¹⁰ First, financial activism which focuses on maximizing the shareholder value and governance issues. Second, social activism which focuses on the influence of the company on larger outcomes, such as company's overall environmental impact, social standing etc. Many a times, the activist investors raise both financial as well as social issues.¹¹ The type of investor often determines the nature of the issues that the investor is likely to raise.¹² For instance, venture capital funds, private equity funds and mutual funds may be more interested in making changes from a financial and governance standpoint. On the other hand, investors who are environmentally or socially more conscious may be more interested in bringing changes from a social standpoint. Having said that, when an issue is raised, each investor will attempt to mobilize support from others in aid of their view.

C. ACTIVIST DEMANDS AND TOOLS UNDER INDIAN LAW

⁷ Assaf Hamdani and Sharon Hanes, *supra* note 2 at 971.

⁸ Anna Christie, *The Agency Costs of Sustainable Capitalism*, UC DAVIS LAW REVIEW, 55(2), 875-954 (2021).

⁹ *Id.*; Anna Christie, *Battle for the Board: Climate Rebellion at Exxon Marks a New Era of Shareholder Activism*, OXFORD BUS. L. BLOG (Jul. 12, 2021) <https://law.ox.ac.uk/business-law-blog/blog/2021/07/battleboard-climate-rebellion-exxon-marks-new-era-shareholder>.

¹⁰ Virginia Harper Ho, *supra* note 5, at 67.

¹¹ *Id.* at 67.

¹² *Id.* at 60.

To achieve these goals, an activist investor may raise multiple and a varied set of demands from a company. For example, in public companies that are valued at less than the sum of their parts (i.e., the amount they could generate if they were liquidated), the investors can push the management to break up and sell off parts of the business,¹³ issue generous dividend,¹⁴ divest and simplify the corporate structure and conduct asset sales, with the proceeds intended for share repurchases and the repayment of debt.¹⁵

In other cases, the activists typically make demands such as requiring the management to voluntarily disclose climate change risks,¹⁶ sell prior acquisitions and split operations (e.g., design and manufacturing), revamp human resource policies and be more disciplined with capital allocation. From a governance standpoint, the activist investors may require the company to increase or decrease the number of directors, add more independent directors, overhaul management compensation, rationalize CXO pay, put in place better internal control mechanisms, and change the management.

Indian law provides several tools for shareholder activists to hold a company accountable. In particular, the shareholders can exercise the following rights under law to influence the behaviour of the company:

- a. **Right to receive information:** The Indian Companies Act, 2013 (“**Companies Act**”) entitles the shareholders to receive information / document such as annual return

¹³ Walter Frick, *The Case for Activist Investors*, HARVARD BUSINESS LAW REVIEW (March 2016), <https://hbr.org/2016/03/the-case-for-activist-investors>.

¹⁴ *Id.*

¹⁵ In fact, a recent study by Reuters suggests that nearly half of all activist investor campaigns in 2019 in the United States involved a demand for asset spin-off and sales. Svea Herbst-Bayliss, *Activist hedge funds stepped up calls for asset sales and spin-offs in 2019: Data*, REUTERS (Jan. 15, 2020) <https://reuters.com/article/us-hedgefunds-activism-idUSKBN1ZE1TT>.

¹⁶ Caroline Flammer, Michael W. Toffel, and Kala Viswanathan, *Shareholders Are Pressing for Climate Risk Disclosures. That's Good for Everyone*, HARVARD BUSINESS REVIEW (Apr. 22, 2021) https://hbr.org/2021/04/shareholders-are-pressing-for-climate-risk-disclosures-thats-good-for-everyone?utm_medium=email&utm_source=newsletter_daily&utm_campaign=dailyalert_actsubs&utm_content=signinnudge&deliveryName=DM129167.

extracts,¹⁷ audited financial statements along with auditor's report,¹⁸ and statutory registers (such as register of members, debenture-holders etc.¹⁹)

- b. **Right to vote on critical matters:** Under the Companies Act, certain critical matters require consent of the shareholders and cannot be carried out by the board. While some matters can be passed by a simple majority, certain matters require approval by special majority. Matters such as removal of directors,²⁰ remuneration of directors,²¹ acceptance of deposits from the public,²² etc. can be passed with simple majority. Whereas matters such as alteration of memorandum of association,²³ alteration of articles of association,²⁴ change in the registered office of the company,²⁵ issue of sweat equity shares,²⁶ reduction of share capital,²⁷ etc. require special majority approval.
- c. **Right to appoint auditor:** Shareholders have the right to appoint the auditors of the company in an annual general meeting.²⁸
- d. **Right to requisition shareholders meeting:** Shareholders holding 10% of the shares with voting rights can require the board of directors to call for an extraordinary general meeting.²⁹ In the event the board of directors fails to requisition the meeting, the requisitionist shareholder can call the meeting on its own.

¹⁷ Companies Act, No. 18 of 2013, § 94 (Ind.).

¹⁸ Companies Act, No. 18 of 2013, § 136 (Ind.).

¹⁹ Companies Act, No. 18 of 2013, § 94 (Ind.).

²⁰ Companies Act, No. 18 of 2013, §169 (Ind.).

²¹ Companies Act, No. 18 of 2013, § 197 (Ind.).

²² Companies Act, No. 18 of 2013, § 73 (Ind.).

²³ Companies Act, No. 18 of 2013, § 13 (Ind.).

²⁴ Companies Act, No. 18 of 2013, § 14 (Ind.).

²⁵ Companies Act, No. 18 of 2013, § 12(5) (Ind.).

²⁶ Companies Act, No. 18 of 2013, § 54 (Ind.).

²⁷ Companies Act, No. 18 of 2013, § 66 (Ind.).

²⁸ Companies Act, No. 18 of 2013, § 139 (Ind.).

²⁹ Companies Act, No. 18 of 2013, § 100 (Ind.).

- e. **Grievance redressal mechanism:** A listed company or a company with more than 1000 shareholders, debenture-holders, deposit holders or any other security holders, must have a stakeholder relationship committee to resolve grievances.³⁰ In this regard, a web-based grievance redressal mechanism called the SEBI Complaints Redress System (SCORES) has been set up by SEBI, which enables investors to lodge and track their complaints through the platform.
- f. **Related Party Transactions:** Shareholders can withhold their consent for any related party transaction being undertaken by a company.³¹
- g. **Protection of interest of the minority shareholders:** The Companies Act also accounts for the interests of minority shareholders by providing that at least one director of a company should be appointed by small shareholders.³²
- h. **Class Action Suits:** Certain category of shareholders can bring a class action suit against the company, its directors and third-party advisers if the rights of any of the members are infringed or the conduct of the management is prejudicial to the interest of the company or its shareholders.³³
- i. **Derivative Action:** A single shareholder, irrespective of his/her shareholding in the company, can also bring a derivative suit on behalf of the company challenging a board resolution if it was detrimental to the interest of the company. The derivative action procedure is set out in the Code of Civil Procedure 1908.³⁴
- j. **Serious Fraud Investigations Office (SFIO):** Shareholders by passing a special resolution can intimate the Central Government that the affairs of the company are required to be investigated. The Central Government, on receiving such a request, can order the SFIO to investigate the affairs of the company.³⁵

³⁰ SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Gazette of India, pt. III sec. 4, Reg 4(2)(a)(vii) read with Reg 13 and Reg 20(4) (Sept. 2, 2015).

³¹ Companies Act, No. 18 of 2013, § 188 (Ind.).

³² Companies Act, No. 18 of 2013, § 151 (Ind.).

³³ Companies Act, No. 18 of 2013, § 254 (Ind.).

³⁴ Code of Civil Procedure, No. 5 of 1908, Order I Rule 8 (Ind.).

³⁵ Companies Act, No. 18 of 2013, § 212 (Ind.).

Further, Section 241 of the Companies Act allows shareholders to file an application in the National Company Law Tribunal against the company if it believes that the company is operating in a manner which is against the public interest or is oppressive and prejudicial to the shareholders. Shareholders also have the right to remove directors by passing an ordinary resolution under Section 169 of the Companies Act.

It is important that activists understand and exercise their rights in accordance with law.

The demands by investors can and usually do end up becoming contentious. To that end, the manner in which such issues are raised and the manner in which solutions are discussed require that constant communication through dialogue remain constant. Should dialogue not take place, the matter will probably end up before the courts, which will prejudice all stakeholders.

D. IMPACT OF ACTIVISM ON THE COMPANY

Most cases of activism are a well-intentioned attempt at addressing any issues that may be found in the company. Shareholders' role as "watchdog" therefore, can provide effective oversight of the management and board. It also ensures effective acknowledgement and implementation of improved ESG standards in the company, with more transparency and accountability.

However, shareholder activism has also gained disrepute as it can sometimes cause more interference than necessary in the management of the companies.³⁶ Many a times, increased involvement of shareholders, howsoever well-intentioned, has resulted in greater disputes between the management of the companies with the activist shareholders. One need not look further than the *BharatPe*³⁷ controversy or the more recent *Trell*³⁸ and *Zilingo*³⁹ controversies, to understand these clashes between founders and investors. These controversies are unsurprising in start-ups wherein investors, taking on immense risks at the early stages of a

³⁶ Virginia Harper Ho, *supra* note 5, at 61.

³⁷ *BharatPe redefined India's payment ecosystem. The unicorn now wants to challenge India's banks*, THE FORBES (Sept. 9, 2021) <https://forbesindia.com/article/take-one-big-story-of-the-day/bharatpe-redefined-indias-payment-ecosystem-the-unicorn-now-wants-to-challenge-indias-banks/70299/1>.

³⁸ *Trell is the new BharatPe; Boat Plans Acquisition Spree*, ECONOMIC TIMES (Mar. 17, 2022) <https://economictimes.indiatimes.com/tech/newsletters/morning-dispatch/trell-is-the-new-bharatpe-boat-plans-acquisition-spree/articleshow/90277139.cms?from=mdr>.

³⁹ *Salman SH, Zilingo CEO Ankiti Bose exploring buyback option ahead of board meeting*, FINANCIAL EXPRESS (Apr. 26, 2022) <https://financialexpress.com/industry/sme/cafesme/zilingo-ceo-ankiti-bose-exploring-buyback-option-ahead-of-board-meeting/2503439/>.

company, consider themselves justified in taking a more active role in the management of such companies, especially as the companies grow exponentially. We see this happening not only in Indian companies such as *Flipkart*⁴⁰ and *Housing.com*⁴¹, but also globally through the examples of *Apple*, *WeWork*, *Uber* and *Twitter* amongst others.⁴²

E. IMPORTANCE OF EFFECTIVE COMMUNICATION

While investor activism is a double-edged sword, it becomes important to understand whether the sword is being used as a weapon of attack, or defense. To that end, understanding the motive and the proposed solution is key.

In the case of Maruti, India's largest carmaker and subsidiary of the Japanese Suzuki corporation, a situation unfolded where the parent, Suzuki Motor Corporation acting through a separate subsidiary, proposed leasing a plot of land from its own subsidiary, Maruti, and setting up a plant which would manufacture Maruti cars and engine components and sell them to Maruti. It did not take long for activist investors to question the decision to house the manufacturing in a separate subsidiary and on land which was already owned by Maruti.⁴³ It was argued by IAS that Suzuki Motor Corporation was parking a profitable business in a 100% subsidiary.⁴⁴ Extremely vocal shareholder activism led to this proposal being scrapped and Maruti setting up the Gujarat plant directly thus ensuring that the benefit was passed on to all its stakeholders. In its true sense, the company was able to derive full value from its own business and future growth.

⁴⁰ Saritha Rai and Matthew Boyle, *Revealed: How Walmart Decided to Oust Flipkart Co-founder Binny Bansal*, BUSINESS STANDARD (Nov. 15, 2018) https://business-standard.com/article/companies/revealed-how-walmart-decided-to-oust-flipkart-co-founder-binny-bansal-118111500702_1.html.

⁴¹ Deepti Chaudhary, *Housing.com shows the door to Rahul Yadav*, THE FORBES (Jul. 1, 2015) <https://forbesindia.com/article/special/housing.com-shows-the-door-to-rahul-yadav/40597/1>.

⁴² Tom CW Lin, *The Corporate Governance of Iconic Executives*, NOTRE DAME LAW REVIEW, 87(1), 351, 359 (2011). Also see David Gelles, Michael J. de la Merced, Peter Eavis and Andrew Ross Sorkin, *WeWork C.E.O. Adam Neumann Steps Down Under Pressure*, THE NEW YORK TIMES (Sept. 24, 2019) <https://nytimes.com/2019/09/24/business/dealbook/wework-ceo-adam-neumann.html>; Seth Fiegerman, *Uber's first investors open up about their wild ride*, CNN BUSINESS (May 10, 2019), <https://edition.cnn.com/2019/05/08/tech/uber-first-investors/index.html>; Greg Roumeliotis and Sheila Dang, *Twitter CEO Jack Dorsey Hands Reins to Technology Chief Agrawal*, REUTERS (Nov. 30, 2021) <https://reuters.com/business/media-telecom/twitter-ceo-jack-dorsey-expected-step-down-cnbc-2021-11-29/>.

⁴³ Himank Sharma and Aradhana Aravindan, *Big Funds Challenge Maruti over Gujarat Suzuki plant*, REUTERS (Feb. 24, 2014) <https://reuters.com/article/india-maruti-investors-gujarat-plant-idINDEEA1N0FU20140224>.

⁴⁴ *Maruti Investors See Red over Suzuki Plan to set up Gujarat Plant*, THE FINANCIAL EXPRESS (Jan. 30, 2014) <https://financialexpress.com/archive/maruti-investors-see-red-over-suzuki-plan-to-set-up-gujarat-plant/1221432/>.

Accordingly, it is important to maintain clear channels of communication between the investors and the company. This would not only ensure that the motives of activist investors are clearly understood by companies, but it would also ensure that shareholders are better aware of a company's decisions. The reasons for a proposed decision form the bedrock on which investor opinion is based. We live in a world of extreme transparency where each aspect of a decision can and usually is dissected by each and every stakeholder. The opaqueness with which entities operated previously is a thing of the past. To that end, a company's decision-making process, if well communicated and articulated, will reduce the chances of activism in its ranks. Where the moral compass is unquestionable and the communication is well-thought-out and reasonable, it will usually ensure that the stakeholders of a company will have faith in the proposals that come before them.

F. CONCLUSION

With the increase of institutional investment in Indian companies, more and more incidents of activism are being seen whereby activists are attempting to control or influence the day-to-day activities of the company. This is only going to increase. Shareholders are slowly but surely taking on an active role to the extent that they begin to make their voice heard within the decision-making within a company. While overreach by shareholders may arguably have an adverse effect, it does not mean that the management of a company should be free to run the company without any monitoring.

As the Companies Act also requires, directors of a company should act in the best interests of the company, shareholders and the community.⁴⁵ Shareholder activism, when it rightfully seeks to push the management of the company into achieving such obligations, continues to remain desirable and will be required in the larger scheme of implementing and monitoring ESG goals.

⁴⁵ Companies Act, No. 18 of 2013, § 166 (Ind.).