

Growing role of Proxy Advisory Firms as Stewards

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INTRODUCTION

The shareholders are the investors of the company and hence are concerned about the return on their investment. The company also aims to maximise shareholders' wealth. Section 47 of The Companies Act, 2013 provides shareholders the voting rights to allow them to participate in the functioning of the company.

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UNDERSTANDING THE CONCEPT OF SHAREHOLDERS ACTIVISM

Companies are increasingly facing critical scrutiny from shareholders, including institutional investors, thereby giving rise to shareholders activism.

Earlier, the shareholders played a passive role as the members of the company with the lack of interest in taking informed decisions and holding a more concentrated and exclusive shareholding while influencing and taking decisions regarding the conduct of the business behind the close doors. Whereas now, they have reversed the cycle by playing an active role and taking control of the business while making informed decisions about the matters that have significant influence on the business. The intent is to maintain corporate

governance and adhering to the laws, rules and regulations while maximising shareholders' wealth.

The concept of shareholders activism involves the efforts put in by the shareholders to influence corporate policies and practices. In other words, the shareholders activism is the course of action taken by the shareholders of the company so as to influence corporate governance by utilizing their ownership privilege. The areas where the shareholders raise their concerns cover everything affecting the business, the society and the environment as a whole, ranging from governance to profit distribution and internal culture of the Organization.

THE EMERGENCE OF THE CONCEPT OF SHAREHOLDERS ACTIVISM

Since shareholders were allowed to vote under The Companies Act, 2013 as well as in the erstwhile Companies Act, 1956, it can be said that the concept of shareholders activism is not a new one. It has always been in existence ever since the shareholders had the voting rights in the companies where they hold shares.

The reason it has gained so much eyeballs is due to the fact that they have now shifted from being a passive participant to becoming an active member of the company. Further, owing to the technological development, the shareholders have easier access to public documents with regard to the companies and thus, are in a better position to take informed decisions and form an opinion to vote based on such information and updated knowledge. It gives a chance to the shareholders to raise their concern in areas where they are dissatisfied with the company's status quo and seek to change company's policies and practices.

Shareholders activism plays a multi-faceted role, thereby contributing towards the overall growth of the company. As such, it aims to serve the following purposes:

1. To help shareholders in addressing their concerns and questioning the working of management of the company.
2. To keep the management accountable and disallowing their dictatorship in crucial business matters.
3. To take on the ownership and touch uncomfortable business spots such as financial issues, ESG reporting, adherence to corporate governance norms, etc.
4. To utilize company's resources optimally through methodical governance.
5. To take informed decisions and thereby forces the management to take informed decisions as well.
6. To take on a leadership role and mentoring the management so as to reach newer heights of success- both financial and non-financial.

7. To unlock company's value, thus ensuring greater return on their investments.
8. To promote effective engagement between shareholders and management of the company.
9. To encourage a trustworthy and prosperous business environment.
10. To improve company's overall profitability and performance and enhancing shareholders' value in the long run.

REGULATORY REFORMS AFFECTING SHAREHOLDERS ACTIVISM

The Ministry of Corporate Affairs (MCA) and the Securities and Exchange Board of India (SEBI) come up with various regulatory reforms from time to time so as to meet the changing needs of the business. As such, they have introduced several critical amendments in the Companies Act, 2013 and the SEBI regulations respectively so as to encourage greater level of participation by the shareholders and empower them to play an active role in the conduct of the business.

Some reforms were introduced by the regulatory authorities to promote shareholders participation :

1. **Electronic Voting-** MCA and SEBI specifically provides for the facility of electronic voting (e-voting). Section 108 of the Companies Act, 2013 states that a Central Government may prescribe the class or classes of companies and the manner in which a member may exercise his right to vote by the electronic means. Regulation 44 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 [SEBI (LODR) Regulations, 2015] mandates the listing entities to provide remote e-voting facility to its shareholders, in respect of all shareholders' resolutions. However, SEBI observed negligible participation by the public non-institutional shareholders/retail shareholders.

At present, there are multiple e-voting service providers (ESPs) providing e-voting facility to listed entities in India thereby mandating registration on various ESPs and maintenance of multiple user IDs and passwords by the shareholders. Thus, in order to increase the efficiency of the voting process, pursuant to a public consultation, SEBI, vide circular no. SEBI/HO/CFD/CMD/CIR/P/2020/242, decided to enable e-voting to all the demat account holders by way of a single login credential through their demat accounts/websites of Depositories/Depository Participants. This allows the demat account holders to be able to cast their vote without having to register again with the ESPs, thereby, not only facilitating seamless authentication but also enhancing ease and convenience of participating in e-voting process.

The introduction of E-voting by the regulators has made it possible for the shareholders to participate in the general meetings of the company and put forth their opinion by participating in the voting process, thereby playing a crucial role in the decision making of the company without being required to travel physically to the registered office of the company.

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2. **Shareholders Class Action Suit-** Sub-section (1) of section 245 of the Companies Act, 2013 empowers the member(s), depositor(s) or any class of them to file an application before the Tribunal on behalf of the member(s) or depositor(s), if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors. Further, sub-section (2) of section 245 states that where the member(s) or depositor(s) seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement in the audit report or who acted in a fraudulent, unlawful or wrongful manner.
3. **Participation of Institutional Investors-** In order to encourage participation of mutual funds in corporate decision making, both the Government as well as the regulator viz. SEBI have made significant efforts. With intent to direct the mutual funds to play an important role in exercising their voting rights in the investee company in a responsible manner, SEBI passed a circular which states that the asset management companies of the mutual funds shall disclose, on their websites, their annual reports and their general policies regarding the exercise of their votes in the listed companies.
4. **Mismanagement and oppression-** Sub-section (1) of section 241 of Companies Act 2013 empowers the member of a Company (including minority shareholders) to file an application before the Tribunal if the affairs of the Company are being conducted in oppressive and prejudicial manner. Further, as per sub-section (2) of section 241, the Central Government may itself apply to the Tribunal for an order if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest.
5. **Appointment of director elected by small shareholders-** Section 151 of the Companies Act 2013 states that a listed company may have one director elected by small shareholders in such manner and with such terms and conditions as may be prescribed by the Central Government. The explanation to this section further clarifies the meaning of the term 'small shareholders' to include a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.



UNDERSTANDING THE ROLE OF PROXY ADVISORY FIRMS AS STEWARDS

As discussed earlier, shareholders activism calls for active action by the shareholders of the company who raise their concerns and legally compel the management to take necessary corrective action for any wrong being done by the management that may adversely affect the business. However, to actually make a positive impact in the business with regard to shareholders activism, the fundamental requirement is that the shareholders are updated and are in a position to take informed decisions. For this purpose, shareholders need proper research-based resources with all the relevant information so as to make an informed decision. And here comes the role of proxy advisory firms as Stewards.

MEANING OF THE TERM 'PROXY ADVISOR' AND 'PROXY ADVISORY FIRMS'

According to Regulation 2(1)(p) of the SEBI (Research Analysts) Regulations, 2014, the term 'proxy advisor' means any person who provide advice, through any means, to institutional investor or shareholder of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items.

Further, the proxy advisory firms are the independent consulting firms that provide research on corporate governance practices of the firms and voting recommendations on governance issues brought before investors at the shareholder meetings [Larcker McCall and Tayan (2013)].

The shareholders' rights are available to both retail investors as well as the institutional investors. The institutional investors usually invest in thousands of shares across various companies and look up for authentic resources to help them vote knowledgeably. Proxy advisory firms guide them on how to vote on various matters due to be discussed in the shareholders' meeting of a company.

THE BIRTH OF THE PROXY ADVISORY INDUSTRY IN INDIA

In India, the listed companies were largely controlled by promoters and the shareholding pattern was not widespread. Although SEBI introduced Clause 49 of the Listing Agreement which deals with Corporate Governance, yet the institutional investors remain passive and as such the proxy advisors did not even exist in India.

The huge corporate scandal of 'Satyam Computer Services Ltd', one of the prominent software services firm in India, shook India's financial market. To prevent such scandals in future, SEBI took several serious measures, one such measure was passing of the Securities and Exchange Board Of India (Mutual Funds) (Amendment) Regulations, 2010 in July 2010. The regulation requires the Indian mutual funds to establish greater transparency in voting in the resolutions of shareholders of their investee companies. The regulation mandates the mutual funds to-

1. disclose the general policies and procedures to determine the manner in which voting rights could be exercised on the shares held by them; and
2. disclose on their website the details regarding the manner in which they exercised their votes on resolutions in shareholder meetings.

SEBI, in February 2010, introduced the Mutual Funds Voting Disclosure Requirements and this marks the entry of proxy advisory firms in India just like their entry in USA when The U.S. Securities and Exchange Commission (SEC) introduced regulation which mandates the mutual funds to disclose their voting records.

EMERGENCE OF PROXY ADVISORY FIRMS IN INDIA

The proxy advisors, as a concept, was first introduced in India in the year 2010 and within a span of 2 years, India witnessed the establishment of three proxy advisory firms. The 'InGovern Research Services', India's very first proxy advisory firm was established in the year 2010 followed by establishment of the 'Institutional Investor Advisory Services India' (IIISA) and the 'Stakeholders' Empowerment Services'. These firms have already published several recommendations with regard to the corporate proposals relating to various listing companies in India including the proposals relating to appointment of directors (especially independent directors), the appointment of auditors and major corporate transactions such as mergers and takeovers.

CRITICAL ANALYSIS OF THE IMPACT OF PROXY ADVISORY FIRMS

The Indian proxy advisory industry showed tremendous potential for growth with emphasis by the FIIs on shareholders' activism, entry of pension funds in equity market and the improved corporate governance practices resulting in an increase in cases of hostile takeovers. The proxy advisory industry in India faces several challenges like indifferent attitude of investors towards corporate governance, resistance from corporates and regulators, increased competition and requirement for human resources.

RESEARCHES IN INDIAN PROXY ADVISORY INDUSTRY

The corporate governance system in India faces a major problem of lack of awareness among the investors. The investors are unaware about the problems related to corporate governance in the firms in which they have invested. Awareness among investors will result in major improvement in reducing

the indifferent attitude towards corporate governance by the companies and domestic financial institutions, in particular.

To judge whether Proxy advisory firms can be called as Stewards in the year 2022, let us compare and check if the situation has improved since the emergence of proxy advisory firms in the year 2010. Some of the ways to do so are discussed below:

1. **Event study methodology-** Empirical analysis of the reaction of the voting recommendation of a proxy advisory firm to vote against the management's resolutions in the shareholder meeting on the stock prices of that firm by adopting the event study methodology. A strong negative reaction in the share price on the day when the proxy firm made a negative recommendation would indicate seriousness of the shareholder on the issue.
2. **Adherence by the Institutional Investors-** The extent to which the institutional investors adhere to the negative voting recommendations of the proxy advisory firms is another way to test the effect. This can be done by obtaining the actual voting patterns and comparing the same with the voting recommendations. This can give us an idea of how much the voting recommendations of proxy firms are impacting the decisions of institutional investors.
3. **Survey on Shareholders Activism-** Conducting a survey to gather an understanding about the level of awareness among the institutional investors with regard to shareholder activism can also help us in having an understanding regarding the impact of recommendations made by the proxy advisors.
4. **Efforts of Other Stakeholders-** Other stakeholders like employees/ customers/suppliers also create awareness about the shareholder activism and the effectiveness can be tested by implementing simple techniques as discussed above.
5. **Economic stream-** Traditionally, the proxy advisory service industry has worked in a monopolistic manner. However, in India, many proxy advisory firms have already been established and are operating while having different ownership pattern. This enables the availability of an excellent platform to conceptually analyze the competition in the proxy advisory industry from economic perspective and to study the right ownership structure for the firms in this industry.

RECOMMENDATIONS BY PROXY ADVISORY FIRMS SHOWING THE WAY AS STEWARDS

Investors now have access to recommendations of the proxy advisory firm (IIAS) and these recommendations enable the investors to take an informed decision while voting in favour of or against such resolutions.

This highlights the role of the proxy advisory firms as Stewards, they help in facilitating meaningful shareholder engagement at general body meetings of listed companies. There are many proxy advisory firms in India and IiAS is amongst the leading proxy advisory firms in India. IiAS's voting recommendations have impacted the shareholders' decision-making during the time of voting in General meetings of the company in many cases in the years 2021 and 2022. Reliance of the shareholders on the recommendations of proxy advisory firms is slowly and steadily growing.

Some examples of the voting recommendations by proxy advisory firms in regard to the resolutions to be discussed in the upcoming AGMs of such companies:

1. **NHPC Limited** - The AGM of NHPC Limited was scheduled to be held on the 25th August, 2022. The company had listed 9 resolutions in total, out of which 5 were ordinary resolutions and 4 were special resolutions. Among these 9 resolutions, the voting recommendations as per IIAS were in favour of all 5 ordinary resolutions. However, the proxy firm recommended against the 3 special resolutions pertaining to appointment of three independent directors.
2. **Balaji Telefilms Limited** - The Balaji Telefilms Limited's AGM for the year 2022 was on 18th August, 2022. Out of the listed 5 resolutions in total, IIAS's voting recommendations was against 2 resolutions- 1 ordinary resolution pertaining to appointment of Ms. Priyanka Chaudha as a Non-Executive Non-Independent Director from 20 May 2022 till the FY22 AGM and 1 special resolution with regard to approval of grant of stock options exceeding 1.0% of the paid-up capital to Abhishek Kumar, Group CEO.
3. **Ultratech Cement Limited – The AGM of Ultratech Cement Ltd.** Was held on 17th August, 2022. Out of the 3 special resolutions listed by the company, one resolution regarding the approval for extension of UltraTech Cement Limited Employee Stock options and Performance Stock Unit Scheme 2022 to group companies, including holding, subsidiary, and associate companies, had more shareholders voting against the resolution as compared to the rest of the resolutions. IIAS's recommendations were against this particular resolution. This is a signal that many shareholders are relying of the recommendations made by the proxy advisory firms.

CONCLUSION

The analysis of the history of proxy advisory industry in India indicates that it owes its growth to the increasing shareholding of institutional investors in equity market and the regulatory requirements imposed on them. The pattern of emergence of proxy advisory industry in USA is being repeated in India, with the arrival of three plus proxy advisory firms. However, the growth of proxy advisory industry in India may not be similar to that of USA as ownership pattern of listed corporate entities in India are different from that of USA. This provides its own unique research questions for the proxy advisory industry in India.

Keeping in view the recommendations being made and the role played by the Proxy advisory industry in Shareholders Activism, we can conclude that Proxy Advisory Industry is emerging as a Steward for the investor community in India.

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