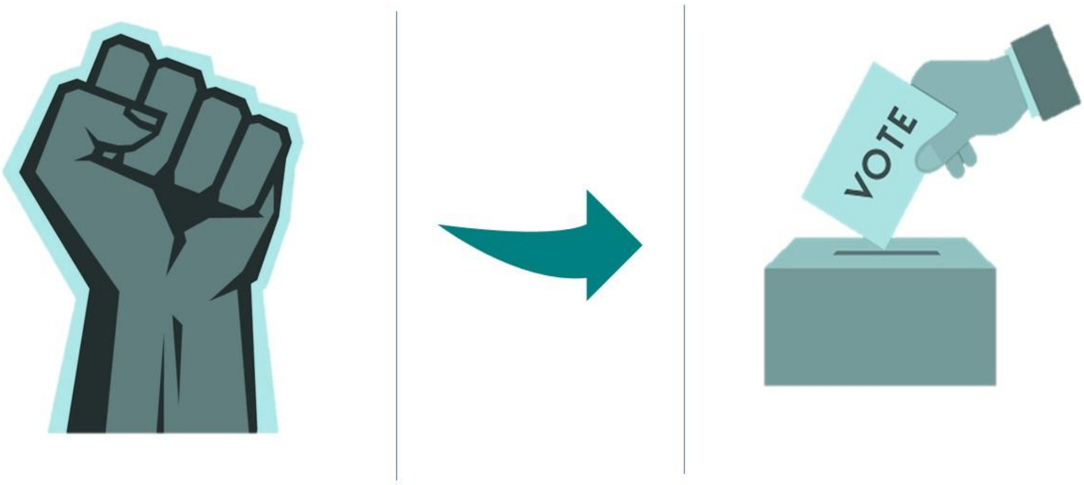
Shareholder Activism: What India Inc can expect

The global and our markets shift, from active selection and passive ownership to passive selection and active ownership means investors in India are set to adopt a different tone on activism.



Those hoping to witness fireworks this proxy season from 1 July to 30 September will no doubt be disappointed by the absence of any notable skirmishes. True, 35 shareholder resolutions were defeated this season, but this was in line with the 34 defeated last year and just ahead of the 28 resolutions in 2020. But none of these can be described as a brawl. The shareholding pattern where even today an average 55 per cent of the NSE-500 company shares are held by promoters, serves as a bulwark against full-throttled activism. If the ownership structure was to change to one dominated by 'institutionally-owned and professionally-managed companies', will we see different outcomes? What does reading the tea leaves tell us?

Shareholder activism refers to shareholders influencing corporate behaviour by flexing their rights as partial owners. The US has the longest and best-documented history of activism. It had concentrated equity ownership till the middle of the last century - much like India does today. So, investors needed to persuade and politely cajole corporations to change. This gave way to diffused individual ownership of equities, very quickly paving the way to institutional ownership, as we know it today and the most celebrated period for activism. Better described as the junk bond era, during this phase, and at the risk of generalising, the activists used their own money to obtain a large block of the company's shares and engage in a proxy contest for control of the board, and frequently sought the breakup of the company — hence their frequent characterisation as "corporate raiders". Its defining feature was the vast infusion of money that Mike Milken directly gave to the raiders.

The excesses of this period are accurately portrayed in the 1987 movie *Wall Street* which immortalised the phrase "greed is good", and faithfully retold in the 1989 book, *Barbarians at the gate* by Bryan Burrough and John Helyar, about the take-over battle for RJR Nabisco.

Things began to change after many of the activists themselves became targets of activism! The new set of funds that took over raised outside capital. And if they were unable to raise sufficient capital, they still went ahead and embarrassed the company. Mary Ann Cloyd, writing in the Harvard Law Bog, described them as using minority board representation with one or two board seats — rather than a board majority, to influence capital allocation decisions and thereby company strategy. While a company breakup was still on the table, most asked for new executive management, operational efficiencies, or financial restructuring.

Jeff Gramm, a fund manager and author of *Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism* contends that "The game of shareholder activism is a lot more a game of persuasion now. You as an activist are trying to convince the institutional shareholders that you have the right ideas and perhaps that the current management doesn't." The strategy focus is on behind the scenes persuasion. As a consequence, "the big institutions are the arbiters in a lot of these disputes."

Gramm contrasts activism in the 1980s with what we see today, stating "when Carl Icahn surfaced as a large shareholder of Philips Petroleum in early 1985, he was sued in a matter of days. Nowadays his targets will often greet him with board seats."

The other big change is the shift in focus to climate, sustainability and all matters environmental, social, and corporate governance (ESG). The governance and proxy voting literature has been dominated by investor concerns on climate and

ESG where the focus is on climate-related disclosures but rarely on director appointments. The ExxonMobil proxy fight last year showed that things have changed. Engine No. 1, a relatively small activist hedge fund, holding just 0.02 per cent of the equity, won three of 12 board seats at ExxonMobil's board, signalling that ESG has to be high on every board's agenda.

The Indian market has seen a few instances of investor campaigns, but these have been limited to companies where "promoter" ownership is low. These and the count of resolutions that have been defeated do not capture the undercurrents, which are reflected in the increased tally of resolutions that investors are engaging in with companies. Still, Investors in India are set to adopt a different tone. This is because our markets are changing as we transition from active selection and passive ownership to passive selection and active ownership. This as Gramm points out, is also what is currently underway in the US. The broad implication for India Inc. is that investors will no longer wait till a company is broken to agitate to fix it but communicate their ideas – be it on board composition or capital allocation or concerns on ESG, more regularly. And that the pitch of the activists will not rise to the level seen in the US. But this will be so only if boards have their ears to the ground and act on feedback they receive.

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