CHAPTER- V
SHAREHOLDERS

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"Shareholders behave like Victorian Children, i.e., mostly seen but rarely heard".\(^1\)

5.1 INTRODUCTION

This chapter presents the role of shareholders in the corporate governance mechanism. The chapter attempts to evaluate the rights and responsibilities of the shareholders. The intention of the corporate law in India is to empower the shareholders to select the board according to their wishes and replace them whenever they are not satisfied with the performance of the board. In short, corporate democracy is the intended way of managing the company. The chapter attempts to evaluate to what extent the corporate democracy is alive and the reasons for the prevailing situation. Two types of shareholders are in existence, viz., individual shareholders and institutional shareholders. Their roles in the corporate governance is evaluated. An attempt is made to highlight the extent to which the shareholders can monitor the board and the extent to which they are actually monitoring the performance. Reasons for the gap between the expected level and actual level of monitoring is also attempted to be highlighted.

5.2 OWNERS OF THE COMPANY

Who will govern the company internally is a central issue facing the business. There is no easy answer to the question: "who is in charge of the affairs of a company?" A number of key groups are involved. Managerial personnel occupy a strategic position owing to their professional skill and knowledge influencing day-to-day decision-making. The Board of Directors exercises formal legal authority over company policy. Shareholders, as owners of the company, have a vital stake in the company. Employees and workers, particularly those represented by Unions can affect some policies and influence

\(^1\) Anonymous
the economic prosperity of the business. The strict vigilance over corporate activities and corrective measures over erring companies by the government and its regulatory agencies, through laws and regulations, also affect the corporate governance. During the last ten years the efforts to improve the status and standing of shareholders have mainly focussed on providing more and better information, assuring greater participation in company meetings, giving easier access to the courts when abused.

The corporate governance model followed in the Indian sub-continent is Anglo-American model where the right of constituting the board is given to the shareholders only. Though the Directive Principles of Indian Constitution suggests for workers participation, the right of forming the executive organ is entrusted to the shareholders only. They have the right to hire and fire both the executive organ, viz., Board of Directors as well as auditors. They are the supreme authority in the Indian context. In the words of Birla Committee Report on corporate Governance “the committee’s recommendations have looked at corporate governance from the point of view of the stakeholders and in particular that of the shareholders and investors, because they are the raison de etre for corporate governance and also the prime constituency of SEBI. The control and reporting functions of boards, the roles of the various committees of the board, the role of the management, all assume special significance when viewed from this perspective”.

It is also just and equitable to adopt the Anglo-American model. In the event of bankruptcy or winding up of a company, a comprehensive ranking of claims determines their pecking order. Clearly, the equity shareholder is last in the line and fully qualifies as the residual claimant. It is not, therefore, unreasonable for such shareholders to expect that the overall accountability of the business managers and the board of directors should be to them. This argument is further strengthened by the fact that the claims of at least some of
the stakeholders may not be mutually congruent and may be in conflict. A clear line of accountability to shareholders, to the exclusion of other stakeholders with such conflicting demands is, therefore, in full accord with the canons of natural justice. As such, shareholders do justify their claim, legally and morally, to be the owners of the business with important control rights.

Conceptually, this derives from the principles of private property and the risks and rights attached to its ownership. In essence, equity shareholders pool their monies to run a business, not very unlike several partners getting together for the same purpose. The difference, however, arises because of the size and complexities involved. The shareholders, unlike the analogous partners, cannot manage the business but let a group of executives to manage the show under the surveillance of a representative board of directors.

The main objectives of the reform in company law of India, immediately after the independence was primarily to safeguard the interests of shareholders. The shareholders lacked sufficient time, money and experience to make full use of their rights. In many cases they are numerous and too widely dispersed, to be able to organise themselves. The Bhabha Committee appointed to review the earlier Companies Act, paid sufficient attention to the rights of shareholders. One of the terms of reference of its enquiry was to consider and report the necessary amendments with particular reference to the powers of management vis-à-vis shareholders, and the relations between them. The Committee also considered the desirability of adequately safeguarding the interests of investors and the public. In order to install the shareholders in their right positions, the Companies Act of 1913 (as amended in 1936) was completely changed by introducing numerous new provisions in the Act of 1956. The Act of 1956 went one step further than its counter-part, the English Companies Act 1948, in giving rights to shareholders. The new Act was framed, after taking into account the then prevailing environment. Low standard of business knowledge, experience

\[ ^2 \text{Kumar Mangalam Birla Committee Report on Corporate Governance.} \]
of the average investors and other factors peculiar to India were considered while framing the Companies Act, 1956. The factors which are peculiar and considered for reviewing the then Companies Act are the absence of any well-informed, reliable and free financial press, the vast territory of the country, apathy of shareholders, the dominance of managing agents over the company’s management, and investment trust companies. While enacting the Companies Act, 1956, the Legislature became the custodian of the welfare of the public and it took care that the business families did not grow at the expense of the investor community and the public at large.

The shareholders are the real owners of the company. As owners they cannot run the show. Again companies cannot be managed by shareholders referendum also. It is practically infeasible to expect shareholders to assume the responsibility for the management of corporate affairs. A company’s management must be able to take business decisions rapidly. The shareholders have therefore to delegate many of their powers as owners of the company to some representatives. The result is one of the organs of the corporate governance mechanism, viz., Board of Directors. Though the shareholders have constituted the Board of Directors, they cannot absolve themselves from their responsibilities. It is an accepted principle in the science of management that authority can be delegated but not the responsibility. Therefore shareholders have the responsibility of constituting an effective functioning board and review its functioning also. The matter ends there only. In the absence of any one of this, viz., constitution of an effective functioning board or review of the functions of the board, the shareholders have failed in their duty. The system is bound to fail.

Voting right is the corner stone for both of the above mentioned functions viz., constitution of the board as well as the review of the functioning of the board. Review results in rewarding the board through extension of the directors who have contributed to the cause of the companies and rewarding them duly.
Similarly, if the board fails to deliver the results, the board should be shuffled or the managing director should be changed. Thus the voting rights is both an asset as well as a responsibility. It is the responsibility on the part of the shareholders to exercise their voting right and see to that the constituted board functions in such a way to enhance the shareholders wealth and realising the mission of the company for which it is established. This alone ensures the highest standards of corporate governance.

This relationship therefore brings in the accountability of the boards to the shareholders of the company. A good corporate framework is one that provides adequate avenues to the shareholders for effective contribution in the governance of the company while insisting on a high standard of corporate behaviour without getting involved in the day to day functioning of the company.\(^3\)

With the growth and development of technical and management education and industries, the country has come of age but the people have not. The people do not have idea about the concept of the company, i.e., the divorce between the ownership and the management. This phenomenon is acting as a great constraint between the giver of capital (shareholders) and the recipient of capital (the company). Although, an effort to remove this constraint was made by enacting the Act of 1956, the follow up work is far from satisfactory from the angle of the achievements. Till now neither the government nor the great industrial tycoons have seriously attempted in this direction. The result has been that the objectives envisaged by the Act of 1956 have remained by and large unfulfilled. It is only in paper. Even after twenty-four years from the enactment of the Act of 1956, the Sacher Committee very rightly concluded that “In the changed development of the structure of the corporation, a wide gap has arisen between control and ownership on the one hand and management and

\(^3\) Kumar Mangalam Birla Committee Report on Corporate Governance.
ownership on the other. Although some or a group of shareholders, in recent times, can be viewed, more often than not, as an investor rather than as one who is interested in control. The aim of each Committee, whether in India or in England, appointed to revise and simplify company law has been to devise means of making it easier for shareholders to exercise more effective general control over the management of their companies.

5.3 IMPORTANCE OF SHAREHOLDERS

It is an accepted fact that the shareholders are the owners of the company. The major functions of shareholders are: (1) to provide a regular supply of capital through purchase of company shares, and (2) to ensure the installation of governance mechanism. The shareholders expect to be rewarded for their investments through business profits. Management, on the other hand, is charged with the responsibility of operating the business and ensuring its survival. Questions of how and for whose benefit a company should be operated, and what is the purpose of the business enterprise, have often led to conflict between shareholders and the management (Board of directors) because their points of view are sometimes different. Usually, lacking the managerial skills and busy with their regular work, shareholders depend upon management to employ the funds provided by them in a productive and profitable manner. The management, too, depends upon the shareholders for a continuous supply of capital necessary to operate and expand the business and it expects the company's shareholders to support major decisions and policies taken and framed by the elected directors. Legally, too, there is a close bond between the management and shareholders, because the management of a company is acting as the lawful agent of the company. The practices and policies carried out by the management are supposed to reflect the corporate mission, for which the

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shareholders have given their tacit approval. Thus the shareholders occupy a predominant position in the corporate governance model.

5.4 RIGHTS OF SHAREHOLDERS

A shareholder by virtue of his membership in a company enjoys two types of rights viz., corporate membership rights and individual membership rights. The rights of shareholders can also be viewed from another angle viz., the source of their rights. Such rights can be classified into three broad divisions. They are: (i) statutory rights, (ii) rights given by virtue of memorandum or articles of association or terms of issue, and (iii) common law rights attached to shares. The rights of the shareholders discussed below follows the first classification viz., corporate membership rights and individual membership rights.

5.4.1 Individual membership rights

Many steps have been taken since the enactment of the Companies Act of 1956 to strengthen shareholders and to help them to play an active role and be an actor in the business-play financed by them. Shareholders enjoys a set of rights in accordance with the provisions of the Companies Act. The Memorandum of Association and Articles of Association bestows a shareholders to enjoy a number of rights in addition to the rights enjoyed by virtue of Companies Act, as far as it is not inconsistent with the Companies Act. As soon as a person becomes a shareholder of a company, he binds himself to observe all the provisions of the Memorandum and of Articles. Most of the rights of shareholders are given, governed and regulated by these two documents, in addition to the Companies Act, 1956.

Some of the more important individual rights of members, as contained in the Companies Act, 1956, which are relevant in the corporate governance mechanism are taken for discussion in the following paragraphs:
1. He has the right to receive notices of, attend and vote in the general meetings of the company and also the meetings of the class of shareholders to which he belongs to [Section 165, 166, 169 to 173, 177].

2. He has the right to appoint proxies for meetings and to exercise his voting right through the proxy [Sec.176].

3. He has the right to get copies of memorandum and articles of association, resolutions of general meetings and certain other documents [Sec.39].

4. He is entitled to receive share certificate as title of his share-holding [Secs.84 & 113].

5. He has a right to transfer his shares [Sec.82 & 108].

The first contact between a company and a shareholder arises on account of this right. A person who acquires shares in a company will contact the company for getting the shares transferred in his name and getting his name included in the Register of Members. The researcher has come to know from the secretaries of the company that the majority of the interaction between shareholders and the company is only with reference to the transfer of shares. In many cases, the only occasion a shareholder contacts a company is with reference to share transfer. Prior to the economic reformation in early nineties, the chances for such interaction are minimum. The present researcher comes to know from the secretaries that the shareholders transfer is a routine business. Normally it may not be entertained only when the incumbent management feels that the shares are purchased with some ulterior motive. However, with the launch of economic reforms, the population of shareholders have taken an exponentially grown. As a result the volume of work to the secretarial department increased. This created delay in executing the transfer. Hence in the post-reformation period, the communication between the shareholders and the company increased on account of this factor alone. Apart from the delay on account of clerical work, many management illicitly utilised the scrips
surrendered for transfer. Many times shareholders have to go, even to the court of law to get back the shares lodged with the company for share transfer.

6. He has a right to appeal to the Company Law Board against the refusal of the company to register transfer of shares [Sec.111].

As mentioned earlier, the Board of Directors will refuse to transfer the shares, if the board feels that the shares were acquired with some ulterior motive. One such occasion where the board refuses to transfer is when it is lodged by a predator who have acquired the shares with the object of taking over the control.

7. He has a right to apply to the Company Law Board for rectification of the Register of Members [Sec.111].

8. He has the right to have the first option to subscribe to rights shares and of renouncing the same in favour of another person [Sec.81].

9. He has the right to receive copies of the annual report of directors, annual statements of accounts and the auditor’s report [Sec.219].

The annual reports and accounts are the instruments through which shareholders can know what is going on in the company. These enable them to know whether the board has utilised the funds entrusted to them properly or not. The shareholders can evaluate the performance of the company only based upon these documents. It is the medium through which, the board interacts with the members. If the members do not receive the annual report, they can demand it as a matter of right from the company.

The researcher comes to know that the shareholders rarely approached them for the non-receipt of annual report and other documents. Though purposefully this right is included under the Companies Act, it seems that shareholders are never bothered about the non-receipt of annual report and notice of the meeting. When the shareholders are not bothered to vote while
attending the meeting, we cannot expect the same shareholders to pursue for the non-receipt of the annual report and notice of the annual general meeting.

The environment is responsible for conditioning the management and the board. As the shareholders are least interested in either attending the meeting or in going through the annual report submitted to them, many companies gradually stop sending the annual report to the shareholders. They will respond if any shareholders demand for the same. Further the practice of sending the abridged annual report is becoming popular as well as it is legalised. The present legal position in this regard is that the company need not send the full annual report to all the members of a family. If more than one family member happens to be the shareholder in a company, it is just sufficient to send the abridged annual report and one unabridged version to any one individual of that family.

10. He has the right to inspect the statutory books, registers and the minute books of general meetings of the company free of cost and to take extracts from them [Sec.163, 196, 301, 304, 307].

The researcher constructed two questions to assess the extent to which the shareholders are exercising this right. The relevant questions are:

“Q.69. Do the shareholders visit the registered office to inspect statutory books & register? Yes ( ) No ( )”
“Q.69. a) How many shareholders visit the registered office during a year for this purpose?”

The response to the first question is shocking and revealing. It reveals the attitude of the shareholders in exercising their rights. It is shocking that the shareholders fail to exercise this right. The survey results revealed that no shareholders visited the office for exercising this right. All the companies covered under the survey had responded as ‘no’ for that question. Hence the response for the next question also showed ‘nil’ response for the subsequent question. Another question included in the questionnaire is question number 70, which has been reproduced below.
 Majority of the companies responded that they had not sold out any Memorandum of Association and Articles of Association. Only 12 companies stated that they had sold Memorandum of Association and Articles of Association and the average number of copies sold is 7 per annum. This shows the involvement of the shareholders in the company.

Under such circumstances it is ridiculous for the law to provide that copies may be inspected in person. Copies are not available to shareholders who are unable to carry out an inspection. It is also a time consuming job, both for shareholders as well as companies, as notes alone to be taken on complex documents, rather than copies to be provided on request. If at all the act stipulated for providing copies on request, the companies create artificial barriers in exercising such rights. Similarly, in the interests of openness, the Companies Act should require that shareholders should be entitled to copies of all relevant documents, at a reasonable cost, with maximum information content. This should include directors’ contracts, proposed amendments to the Memorandum and Articles, new Articles, list of shareholders with the names, address, number of shares held by them and share scheme rules. Many times companies resort to practices which result in loss of patience on the part of the shareholders in getting the information. Gradually the shareholders will be conditioned not to contact the company in order to get any information.

11. He has the right to receive dividends, when declared by the directors, and bonus shares issued by the company.

Of the rights given to shareholders, the most utilised right is this right. Those who drafted the Companies Act can be happy for including such provision.
12. He has a right to share in the surplus assets of the company on winding up [Sec. 511].

13. He has a right to petition the Court for winding up of the company under certain circumstances [Sec. 439].

14. He has a right to object to a decision to increase his liability without his written statement.

15. He has a right to apply to the Company Law Board for calling an annual general meeting or extra ordinary general meeting under certain circumstances [Secs. 167 & 186].

The secretaries of the companies expressed that this right is exercised by the warring groups if any, among the shareholders. Under other circumstances, no shareholders uses this right. The merger, acquisition and take-over episodes have sown the seeds of this right among the shareholders. However, small shareholders are not benefited from this provision, as the provision requires a minimum number of shareholders or voting right to make a requisition for convening the general body meeting, either annual general meeting or extra-ordinary general meeting.

16. He has a right to apply to the Company Law Board for ordering an investigation into the affairs of the company [Sec. 235].

17. He has a right to inspect, free of cost, the register and index of members and debenture holders, annual return and other documents attached thereto [Sec. 163].

The discussion with the companies' secretaries revealed that majority the individual rights given to shareholders are existing only in papers. They are not of much use in improving the efficacy of the corporate governance system. The failure may be on the part of the shareholders, besides the incumbent management and Government machinery.
5.4.2. Corporate membership rights

The Companies Act gives the shareholders, as a group, certain inherent powers with a view to ensure the proper working of the company. The act itself reserves certain powers, which can be exercised by the shareholders in the general meeting alone. That means shareholders have to make certain decisions collectively. Such decisions have to be made in the general body meeting. The rights that can be collectively exercised in the general meeting are referred to as corporate membership rights. The will of the majority prevails over the minority under such circumstances. The majority shareholders might be legally entitled to take such decisions. If it is detrimental to the interest of the company as a whole, the Act gives various rights to the minority or dissenting shareholders in the form of protection. Further, the Act of 1956 has strive to engraft the exceptions to the principle of “supremacy of majority” - enunciated in Foss v. Harbottle - and in such cases the minority shareholders have been given various rights. The Act of 1956 also qualifies certain rights of shareholders by requiring the consent of a particular number of shareholders or a percentage of shareholding, for exercising such rights. The most important of the collective or corporate membership rights of members is the right to determine the general policy of the company.

5.5 TYPES OF SHAREHOLDERS

Unlike the west, large companies in India have ownership patterns involving five different sets of partners consisting of the promoters, mutual funds, development institutions, banks, insurance companies like LIC and GIC, foreign institutional investors and, in addition, small private investors. The non-promoters group can be classified in to two categories viz., individual shareholders and institutional investors. Individual investors are scattered throughout the length and breath of country and one can say throughout the
world after the opening up of the Indian economy. On an average, institutional shareholders hold around 25 percent and the individual shareholders hold around another 25 percent of total share capital.

5.5.1 Individual Shareholders

India carries the distinction of having the largest number of listed companies in the world and an investor population of roughly 50 million in corporate sector which includes an illiterate framer, a pavement shopkeeper and ordinary resident of a moffusil town or village. The investor households have increased at a compounded growth rate of 22 per cent between 1985-86 and 1998-99. The number of individual investors in the Reliance Industries Limited alone is more than 3 millions. In the ownership pattern in India, the small investor continues to be a smaller player compared to the developed nations.

The individual shareholders category can be subdivided further into two divisions, viz., (i) Pre-globalisation and (ii) post-globalisation investors on the basis of the entry of the shareholders. Those shareholders who entered the share market prior to 1990 are categorised into pre-globalisation and those who entered after 1990 are termed as post-globalisation shareholders. The investors of pre-globalisation era were satisfied with the available dividend and performance of the company. At the most, they expected a decent return a little bit higher than the bank return with periodical bonus shares. If at all they attend the annual general meeting is to get snacks and gifts. They are satisfied with the performance whatever it may be. If not they had not agitated much. Shareholders' militancy is an unknown phenomenon at that time. Tolerant and lax attitude of the shareholders encouraged the management to take the shareholders for granted. At that time mostly belonged to high income group

6 The Hindu, 10th June, 2000.
and upper middle income group. Hence, the money invested in the shares constituted their own savings.

The profile of an average investor reflects a big transformation in the investment culture and large number of such neophyte investors have actually been lured to earn hefty gains in short term from the capital markets. “The 1990s was the decade of reforms of the Indian economy. It was the period of transformation of the Indian securities market; it was the age of the emergence of the securities market from the backwaters into mainstream of the Indian financial system. The process of change of the securities market had actually begun in the 1980s and its role in the economy had been growing since then; but it was during the 1990s that the process really accelerated. The financial sector reforms and the securities market reforms, especially the free pricing regime which followed the abolition of the controller of Capital Issues Act in 1992, seem to have encouraged corporate to rely on the securities market and substitute one source of long terms funds with another. This was evidenced by a significant increase in the number and diversity of issuers accessing the securities market and in the amount of capital raised from the market. The market also became more institutional in character with the presence of the foreign institutional investors and increase in the number of the domestic mutual funds. These two classes of institutional investors began to exercise an important influence in the market behaviour”. Thus the profile of the shareholders changed remarkably after 1991. Small investors instead of investing in the companies directly, are going towards the mutual funds. Shareholding patterns in companies are changing. It is a universal phenomenon. After the advent of LPG programmes, the scenario in India has also changed. Mutual fund has emerged as a preferred route for small investors.

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7 Survey of Indian investors by Pratip Kar, I. Natarajan and J.P. Singh, Mumbai, SEBI, 2000 – A survey conducted by National Council of Applied Economic Research, India on behalf of SEBI.
5.5.1.1 Strength of individual shareholders

The voting power of shareholders is too small and insignificant to influence the decision making process in the annual general meeting. It is interesting to go through the findings of a research report. “In order to have a precise idea about institutional voting power in Indian companies, we analysed the equity ownership pattern in a sample of 365 listed companies. Our analysis of ownership patterns is focused on the potential voting control of a holder. Since only holdings of significant size have such potential, we decided to restrict the analysis to the top ten shareholdings in each company on the basis of the records available with the Calcutta Stock Exchange. Equity holdings below the top ten holders are individually small. The tenth largest equity holder was found to hold just around 1 per cent of the total equity in most large companies. The percentage would be less as we go down.” For the mass of shareholders below the top ten, Galbraith’s sarcastic remark that ‘he can vote but his vote is valueless’ applies except in those rare instances when a proxy war flares up. Individual investors, who have build their own portfolio, usually hold only a tiny portion of the total share capital of a particular company. Hence they are powerless in influencing the decisions of the management. they are helpless citizens in the corporate kingdom. To help the small investors, an amendment is made to the Companies Act, 1956, which enabled them to have their representatives in the board.

The amendment to section 252, by the Companies Amendment Act 2000 is a drastic step towards empowering small shareholders. The new provision provides for appointment of at least one director on the board of certain large companies by small shareholders. This provision is applicable to a company with a paid up capital of at least Rs.5 crores. The term small shareholder refers

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to such shareholder who holds shares in the company having nominal value of a maximum amount of Rs. 20,000. The third condition laid down by the amendment act is that the company should have at least one thousand shareholders. Though a number of reservations are there regarding the effectiveness of such provision, this is a step towards empowering the small shareholders. One of the reservations, is that the small shareholders director has not been given any special powers. He does not have any veto right whereby he can stall certain resolutions or require that certain matters be referred to the decision of the small shareholders. At the most such director can voice his dissent at the board meetings and insist that his views be recorded. But even these notes of dissent will not reach the small shareholders. He does not have any statutory power to convey his comments to the small shareholders whom he represents.

The mechanism of the director of small shareholders should be still toned up. There should be a mechanism whereby he can convey along with annual report, his comments about the functioning of the company. The report of the small shareholders director should form part of the annual report. Further a separate office should be provided to such director, where the small shareholders can meet him. The procedure for appointment is yet to be announced. May be it may not see the light because of the pressure of the lobby of the industrialist, i.e., promoters' group. The Finance Ministry had informally asked the Department of Company Affairs not to notify the provisions for appointment of small investors on the board of companies. The pity is that the provision had already been passed by parliament. On the representation of the various associations of business community, like FICCI, the implementation was deferred. The provisions for the small investor representation on the boards of companies had been objected to by the industrialist tooth and nail from the onset. When the bill was originally introduced in the parliament, the opposition forced a dilution in the provision with the word "shall" being replaced with may in the statutes. As a
result of this dilution, the appointment of small investor representative on the board of companies became a voluntary one, rather than a mandatory requirement. The irony is that the opposition also fought tooth and nail to erase this provision from the act. The bill had the endorsement of the standing committee on home, the House Committee responsible for wetting the company law related bills. Now as per the Companies Act, the accommodation of the small shareholders in the board is only optional. But the promoters’ group seems to be opposed even to this enabling provision.\(^\text{10}\)

The reason being, the promoters never thought that they are the representatives of the public shareholders. Rather they are of the opinion that the company belongs to them and their legal heirs. Even the financial institutions holding around 25 per cent of a company’s equity are not able to stop a proposal from being approved, leave alone the individual shareholders.\(^\text{11}\) On one such occasion the institutional directors were removed in the annual general meeting. “\text{How far a poll can be effective has been proved by the recent removal of the institutional nominee from the Board of Shaw Wallace & Company Ltd in its general meeting.}”\(^\text{12}\) The financial institutions opposed the passing of the financial account of the Shah Wallace company for the year 1999-2000 and called for a poll at the annual general meeting conducted on 30\(^{th}\) December 2000. However, the management easily carried over the proposal as they were holding more than 50 per cent of the equity share capital. If that is the case for the shareholders (financial institutions) who are holding around 25 per cent, one can’t expect much from the small shareholders who were dispersed and scattered throughout the world.


The traditional focus of study in company law is on the rules and principles that safeguard the interests of the company's members and creditors. Though the shareholders' interests are attempted to be protected through legislation, in many situations, the violations are not seriously considered as an offence either by the Government machinery or the shareholders themselves that have been affected by such violations.

Inside every thinking Indian, there is a Gandhian as well as a Marxist struggling for supremacy. Whenever the shareholders' interests are ignored or their due rights are not granted, the system is not so active, to address the violations or to redress the grievances of shareholders, as they are considered as capitalists. On the other hand, when workers' interests are violated, the Government machinery reacts and sometimes the Government acts proactively. The reason being the Marxian inside the individual, who acts, dominates. Shareholders are considered as capitalists, and hence their sufferings are not as seriously considered as that of the employees. The members of the management were arrested on violation of labour laws. No such parallels can be shown for the violation of shareholders' rights in India.

On the contrary, the promoters and the management group are able to accomplish their objectives either by legislation or by violation of the enacted legislation. Here Gandhian's tolerance attitude of the average Indian influences the investor to ignore the deprivation of the rights by the incumbent management. Business is defined by an author as the utilisation of opportunities. The Indian businessmen utilises the soft attitude of the public and frequently violates the laws. The penal provision for the violation of law is also not so severe as to check the management. Hence the violators are conditioned and their attitude towards violation is re-inforced for such violations.

13 John Parkinson, Countdown to a new Companies Act: Key Committees in Place, PIRC Intelligence, www.pirc. August 1998
14 Ramachandra Guha, An Anthropologist Among the Marxists and Other Essays, Permananet Black, New Delhi.
The tolerance attitude prevails both in the minds of affected shareholders as well as the law makers. The affected shareholders never pursue after the people who have infringed their right who have failed to carry out their obligation towards the shareholders. Similarly the tolerance attitude of law makers results in framing the laws in such a manner that the offence is not seriously dealt with. Even if the law is serious about some offence, the functioning of the judicial system is conducive for the offenders. At times, if the law is serious the political interference, makes the life of the offenders normal. As a result, the affected shareholders never seek legal redressal.

The powerful lobby of the promoters group enables them to achieve their objectives, i.e., protection of their interest. The aftermath of the ITC episode witnessed a he cry and protest for the arrest of the directors, both executive as well as non-executive. The entire business community vehemently protested the arrest of the directors. Hitherto unaffected business community was alarmed, when their personal life comes to risk, they started reacting. The group, which controls the company, takes care of themselves leaving the interests of other shareholders in jeopardy. In a number of situations, the violations of any provisions in labour laws are considered as a criminal offence and hence the management also hesitates to violate such laws. The offences under the Companies Act are very cheap compared to the offences under other acts and hence the penal provisions are ineffective. Thus the purpose for which the Companies Act has been legislated cannot be said to have been achieved to the desired extent and under some circumstances the level of protection available to the shareholders, is a subject matter of mockery.

One of the rights given to shareholders is the right to transfer shares and right to receive dividend. In fact, these two rights are the most valuable rights as far as an individual is concerned. The biggest problem for the individual shareholders continues to be share transfers. The shares sent for transfer do not seem to come back in time. In many cases, they do not come back at all.
Dividends also are not received on time and shareholders have to often run from pillar to post for their dividends. The culprit companies range from top-notch corporates to the ordinary. The aggrieved shareholders keep complaining while the companies and their registrars mostly keep silent. SEBI too remains largely uncommunicative. The apex stock-market regulatory authority has a whole department to deal with the problems of minority shareholders. Yet the complaints are mounting. Only those investors who have the tenacity to pursue the matters with vengeance are able to get some redressal.

Protection of the rights of minority shareholders is an expression that adorns the law books in abundance. And certainly SEBI has tonnes of them. The apex stock-market regulatory authority also has a whole department to deal with the problems of minority shareholders. However, when comes in to practice, as usual the small shareholders will not get the due share of importance, even if it is SEBI. SEBI had constituted the Birla Committee on corporate governance and representation is given to various constituents. Only one member had been accommodated from the small shareholders group. Out of the twelve members, if the small shareholders are able to get only one member, how can the rest of the society reacts to the needs of small shareholders. The SEBI would have set a precedence by accommodating more members in that Committee. The neglect of small shareholders is not only in India. Now we are fortunate at least in getting a single berth for the small shareholders. In U.K., the Hampel Committee did not have any representation from the small shareholders.

5.5.1.2 Shareholders monitoring

Shareholders are the owners of the company. They delegate the authority of running the company to the selected few. Having delegated the authority, it is the duty of the shareholders to control i.e., review the performance of the board.

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Such review function is a pre-requisite for the successfully functioning of the corporate governance model. Shareholders monitoring can be either passive or active. Passive shareholders rely on "exit" route while active shareholders rely more heavily on "voice". The U.S. model is heavily weighted towards "exit," while the German and Japanese models rely more on "voice." The various systems in advanced market economies each have advantages and disadvantages. Each is in many ways a unique outgrowth of country-specific economic, political, historic, and cultural factors. It is neither desirable nor possible to "import" an entire model from one country to another. However, it is possible to isolate certain characteristics of particular systems that might work in the country which adopts those features either with or without modification. In Central and Eastern European countries, where stock markets are poorly developed the 'exit' route is unlikely to be an efficient option for some time to come. Thus, active shareholder monitoring is likely to be one of the most important modes of corporate governance in the near term.

The legal framework in an economy influences shareholder monitoring in two critical ways. First, it governs the ownership patterns: who may own companies, how much they may own, and to what extent they can exert an "active" ownership role. Secondly, it translates this ownership structure into shareholder influence through the definition of share voting rights and duties, share voting rules, and the structure and composition of oversight bodies within the company.

Experience in advanced market economies shows that ownership patterns and the legal frameworks in which owners exert control can vary immensely, leading to major differences in models of corporate governance, managerial behaviour, and arguably firm performance (although the latter relationship is difficult to prove empirically).

The Anglo-American Model of Corporate Governance is a market driven one. The objective under the Anglo-American Model is to maximise the
shareholders' wealth. Shareholders' wealth is computed by capitalising the market value of the outstanding shares of the company. If the shareholders are not satisfied with the performance of the management, the shareholders will vote against the management by selling the shares in the market. The increased supply of shares will further dampen the value of shares. They vote with their feet and wallets and the share price takes a knock and the management learns a lesson very quickly. The shareholders need not wait for the conduct of the annual general meeting to express their disapproval. In developed countries which follow the Anglo-American model, it is inconceivable, for instance, that any company management would think of taking major decisions without convincing first the large block holders of shares.

If the companies are confronted by the shareholders, then such companies provide individual and small institutional investors with all the information needed to become effective shareholder activists. Under such circumstances the society stands to gain. One incident where the company is forced to carry out the wishes of shareholders is given below. A proposal was filed with the Shell Transport & Trading Company, U.K., by a shareholder. The proposal was related to environmental and corporate responsibility issues. Although the directors convinced the shareholder, who had introduced, the proposal to withdraw the proposal, they took significant steps to answer its concerns in the period between the resolution being lodged and the date of annual general meeting. The process was not a stop gap arrangement. Since then further steps were taken by the company to address the problem raised by the shareholders.17 Once the shareholders start their exercise, the efforts will start bearing the fruits, by conscious attempts by the company management to address the grievances.

Therefore, such incidents clearly amplify that if the shareholders propose and pursue the matter vigorously, the company will take up steps to address the

17 The Tide Turns at Shell: The Oil Giant and a year of change, PIRC Intelligence, June 1998.
problem. The shareholders have to demand. They have to continually monitor the performance of the management. If they are not satisfied they have to mount up the pressure through the market, which is pivotal in the market mechanism. Under the Anglo-Amercian Model, the shareholders are the main players in disciplining the management. If the demands and expectations of the shareholders are genuine and if not met, large number of shareholders will dump the shares in the market. As a result, the management is compelled to heed to the wishes of shareholders. If not the market will be glut with the shares and as a result the share prices will slump towards the south. Too much fall the price of a share attracts the attention of the rival groups to consolidate the holdings by acquiring the cheaply available shares in the market.

Therefore only if the shareholders demand the promoters will come to know the existence of a need and there is a possibility of such need being satisfied. The management is compelled to take into consideration the markets latent reaction. They become more responsible. The market becomes an instrument in the check and balance mechanism. The shareholders monitoring assume more importance in lesser developed countries as markets for products, capital, and managerial labour are still underdeveloped. As a result, the laws for empowering the shareholders are so drafted that shareholders monitoring is concentrated and results in effective monitoring. Hence, the voting powers are completely different in East European countries, where the market is in the developing stage.

The individual shareholders in India are neither passive nor active. The individual shareholders, who entered the scene in the post globalisation era are active in monitoring the companies. Most of the shareholders are of passive type. Whenever, the shareholders feel that the company is not doing well, they will dump shares. The number of individual shareholders who are active is also on the higher side. The investors who entered the scene in the pre-LPG era are
neither passive nor active. However, the post-LPG era shareholders are both passive as well as active.

5.5.1.3 shareholders' activism

Shareholders activism is referred to as the model where the companies are monitored by shareholders through active participation in the general body meeting of the companies. In Japan, the shareholders rely heavily on the 'voice' model. According to Brancato, investor activism has gone through four stages. First the focus was on social issues, then opposing anti take-over devices, next urging structural and procedural changes, and finally analysing the performance of corporations in order to target under performing companies. However, in developing and poor countries, investors activism is required even for getting their personal rights from the companies, like getting notice and annual report, getting dividend etc. Only if this stage crosses, the Brancato levels will come into play.

Most recently, the focus is beginning to be on the positive potential for future performance...what practices add value? "Oddly enough, many of these non-financial issues are reminiscent of some social concerns, such as workplace practices and environmental compliance, formerly associated with the social- and religious-based institutional investors. They are increasingly perceived to add to the financial viability of the corporation."

The above observations are with reference to the U.S.A. Increased shareholders' activism in the U.S. and elsewhere stems from the conviction that better corporate governance will deliver higher shareholder returns. Yet repeated attempts by academics to show an irrefutable link between the two have failed, such is the complexity of the relationship. Shareholder activism to create value is

not new in the US. California Public Employees Retirement System (Calpers) has played a strong role since early '90s in bringing in accountability in boardrooms. It has, in the process, beaten the Standard & Process 500 Index for the last several years – something that only a few fund managers have been able to achieve. By making big investments and pulling the right strings with management, LENS, a $400 million fund in which George Soros has invested, has rewarded its investors well through shareholders’ activism.

Such funds are badly needed in countries like in India where there is too much babble about shareholder value and too little action on value-creation or enforcement of good governance. This is where AOAF, a U.S.A., based mutual fund, is a significant example. Calpers and LENS have enforced accountability by attracting institutional money and focusing on large corporations. They buy sizable chunks of large companies and then use the clout of their holdings to appoint board members and force changes. AOAF is the first fund that raises money from small individual investors and invests that money in small companies, shunned by the Wall Street.\(^ {19} \)

A growing body of data collected on U.S. and European companies suggests that effective shareholder involvement add value to companies. In the early 1990s, the movement played a role in the U.S. corporate governance movement where directors and shareholders succeeded in compelling management to cut waste and tie up their pay to performance. The movement helped to ignite the longest economic boom in U.S. history. Today, shareholder activism has the potential to prevent or correct many of the perceived evils of global capitalism. The market's invisible hand is connected to the arm of the institutional investor, which clearly holds the obligations of ownership. It's time to roll up the sleeve.\(^ {20} \)

\(^ {19} \) Debasis Basu, “Value Through Activism”, The Economics Times, 6\(^ {th} \) September 2000.
\(^ {20} \) Robert A. G. Monks; Shareholder Activism. The Right Response to Seattle's Warning: www.thecorporatelibrary.com/index.html
The directors and shareholders mutually benefit from their respective functions. Though the directors depend upon the shareholders for their survival in theory, the reality is the shareholders depend upon the directors for a decent return. In theory, if the shareholders are not satisfied with the performance of the management, they can throw away the management with a new board. However, the reality is such things are a rarity in Indian corporate sector. Generally the shareholders are at the mercy of the Board of Directors. It is only in theory that the shareholders are the owners and they are authorised to constitute the executive organ viz., Board of Directors. Normally, the board runs the company smoothly even if the shareholders are not satisfied with the performance of the board. They have to tolerate not with a tolerant attitude, but their inability forces them to accept such unacceptable performance. The resistance to such poor performance is rare in Indian corporate scenario.

The investors are at the mercy of the financial institutions prior to the arrival of foreign institutional investors. Even after their arrival, {PRIVATE} whenever the mutual funds or institutions violated their own promises, the investors digested the fact that the institutions owned by the government has cheated them. The supposed Xavier of the investors also – SEBI - a mute spectator. On a number of occasions the institutions have back-tracked from their earlier promises. Poor performance of the financial institutions, including the pioneer mutual fund organisation – UTI, never questioned by any investor in India. Fortunately or unfortunately UTI learned a very costlier lesson because of non-performance.

UTI was taught the rules of the game in foreign soil. UTI which was accustomed to polite and gullible investors faced a rough weather in U.S.A., by some American citizens. A startling experience, for the senior most citizen in the mutual fund industry in India, in U.S.A. An investor of UTI’s India Growth Fund – Mr.Chapman listed on the New York Stock Exchange, had moved a proposal to induct himself and two of his colleagues on the board of the fund as
the fund was not performing well. Hence, an individual unit holder filed a proposal for inducting himself and his colleague on the board. It is a rare incident, as far as Indian corporate world is concerned. Whatever may be the performance, shareholders India never would have thought of this move in India. Suddenly UTI was in the midst of a storm. It has to defend its position. Otherwise, it has to accommodate some Tom, Tick and Harry in the board. It started sending out messages to all its investors to ignore the vote sought by Mr. Chapman. UTI had to burn the midnight lamp and the UTI chairman directly intervened to tackle this crisis. In a message to all stockholders, UTI Chairman, PS. Subramanyam who is the president and chairman of the India Growth Fund, had said that “the Board of Directors of fund urges you not to sign any green proxy card you may receive from Mr. Chapman. Further, the management is in turn sending out white proxy cards intended to push a vote against Mr. Chapman’s nominees for election to the board”.21

An interesting development for an Indian agency, born and grown in a protected environment. Under no circumstances, Indian shareholders would have reacted to this extent seeking a berth in the board. The business families in India, contrarily, are throwing away the financial institutions nominees from the board and the financial institutions also accept such treatment. The provision of the proxy in the American statutes enables the dissatisfied shareholders to get a berth in the board under such circumstances.

As observed earlier in every Indian thinking, either Gandhian thought or Marxist thought will try to dominate. However, under most of the circumstances, an average Indian is influenced more by the Gandhian thought. Hence, the shareholders in India are not even focusing upon social issues, i.e., the Indian shareholders have not crossed even the first stage. Had they crossed the first stage, the problem of share transfer would not have been there. They

have not yet started claiming their rights. Of late the shareholders have realised their potentials and started reacting to the situation.

The shareholders’ activism is a new phenomenon in Indian corporate sector. Shareholders’ activism is not for social issues or for defending the anti-take-over move. The move is aimed at getting their basic rights like receiving notice of annual general meeting or getting dividend or getting the shares back which was lodged with the company for share transfer. The Indian shareholders have to go a long way to reach their American counterparts.

Prior to 1991, i.e. before the economy is liberated from the license raj, if at all there is any active participation in the annual general meeting and other shareholders meeting, it is due to a rift between two rival groups among the promoters. The rift might have led to some acrimonious scenery in the annual general meeting. Of late, after the entry of the predators’ in the game of merger and acquisition some activity is visible in the general body meeting.

However, with the arrival of a new breed of investors, after the Harshad Mehta episode, the new breed of retail investors demand results. They do not have the patience and tolerance to ignore and tolerate the poor performance. They are much more demanding. Having borrowed funds at a minimum rate of 36 percent, they are not ready to be patient and tolerant. They demand results, results and nothing but results. As a result, for the first time, in the 150 years of corporate history, the corporate world has started witnessing shareholders’ activism. However, resolutions tabled by individual shareholders are still rare scenes in Indian corporate sector. To find out the extent of shareholders’ participation in the annual general meeting, by way of submitting the proposals, an item was included in the questionnaire. The question was:

“Q.No:61. How many proposals came from the shareholders (not related to the promoter group) to appoint a person as director in the place of retiring director in the last five years?”
All the respondents gave a negative reply for this question. This clearly shows that the shareholders are not at all participating in the proceedings of the meetings. They were only silent spectators. The reason for not filing a single proposal can be attributed, not to their tolerant attitude alone but also the provisions of the Companies Act.

There are sporadic incidents of shareholders' activism in Tamil Nadu State as well as in other parts of other countries. Such incidents have not spread through out the state of Tamil Nadu. To ascertain the position in Tamil Nadu, the researcher asked a question and the question bears the number 50. For that question, no company secretary has responded affirmatively, indicating that still the shareholders' activism is not so much active as in the case of Japan, where the management are afraid of a group called as shokia. In fact, the management buy peace by bribing the shokia group. Even corporate watchers in U.S.A., are afraid, that in due course, the culture of Japan may enter in that country. Fortunately, still that culture is unknown to people India. Yet, to the researcher's knowledge, knowledgeable people used to benefit from the management, to shut their mouth during the annual general meeting. However, this is a new trend as far as India is concerned. Prior to LPG era, such incidents are rare. The researcher presents in the following paragraphs, such incidents, which is news for the corporate watchers, both within Tamil Nadu as well as outside Tamil Nadu.

One such incident is the annual general meeting of the Ralliwolf Company Limited, manufacturer of portable electric tool, during 1997. The individual shareholders of the company had elected a chairman for the meeting and passed resolutions rejecting the accounts for 1996-97 and recommended that the Company Law Board appoint different auditor and directors on the board. None of the directors attended the annual general meeting.\(^{22}\) Probably this was

\(^{22}\) "Ralliwolf Shareholders 'Hijack' Annual General Meeting As Directors Stay Away", Financial Express, 27\(^{th}\) September, 1997.
the first incident where the shareholders who do not control the company have selected the chairman of the meeting and rejected the accounts presented by the management. The venue of the meeting was Calcutta. This incident can be cited as the beginning of a new era of shareholders' activism.

Another milestone in the shareholders' movement is the 50th annual general meeting Shaw Wallace & Company Limited. A number of proposals were placed in the meeting for approval. When the chairman, Mr. Jain, asked for show of hands on the first proposal which was put to vote, a shareholder K.P. Roy demanded a poll. The chairman upheld the demand, citing rulings of the Company Law Board. This triggered off vociferous protests from members who had attended the meeting. Similarly, when other proposals were placed, demand for poll persistently put forward by the shareholders who were present in the meeting. Hence, it was decided to conduct poll on a subsequent day and publish the results in two city daily. The venue of the meeting was again Calcutta.

A group of shareholders in control of a major stake in the Bank of Rajasthan has sought removal of P K Tayal and four other directors from the board for their alleged failure to infuse a sum of Rs 60 crore in the bank's capital by March 1999, as per the Reserve Bank of India stipulation. They have also proposed the induction of professional directors on the board of the bank. Both the resolutions are likely to be tabled at the bank's annual general meeting scheduled for September 28, at Jaipur.23

The extraordinary general meeting of cement major Associated Cement Companies (ACC) saw angry shareholders express their rage at the financial institutions for scuttling the company's proposed preferential issue, while the financial institutions representatives squirmed in their seats. Institutional representatives watched in embarrassing silence as shareholder after shareholder

23 "Call to drop Tayal from BoR Board" Business Standard, September 16 1999.
lambasted the institutions for taking a negative view of the proposed issue. Several shareholders demanded that the resolutions be put to vote and that they would support the resolutions. Another incident to be recorded in the annals of the history of corporate sector.

Another incident that can be cited to trace the evolution of shareholders' activism is the annual general meetings of Tanfac. The company is a joint venture between A.V. Birla group and the state-owned Tamil Nadu Industrial Development Corporation. It had witnessed a rough weather in a row of two years in the subsequent two annual general meeting. During the 23rd annual general meeting, the attempt of the A V Birla group's bid to hike its stake in the joint sector from 19.96 per cent to 38.02 per cent was stalled by the individual shareholders who were present in the meeting. The venue of the meeting was Chennai. Following the stiff opposition from the shareholders, the company was forced to drop the resolution to chip in Rs.10 crores through a preferential offer at a premium of Rs.10 per share. The small shareholders even protested for this preferential offer which was to be taken up by the promoter group at a premium. Compared to the market price which was prevailing, no body is stand to loose.

Again in the 24th annual general meeting, the meeting witnessed pandemonium. The reason for the unrest in the meeting was shifting of the registered office from Chennai to Cuddalore where the plant was located. The shifting invited the wrath of the Chennai based small shareholders. They vociferously protested the move of the management. The reasons cited for such shifting is administrative convenience. However a team of shareholders who had attended the annual general meeting from Cuddalore helped the management in carrying through the motion comfortably.

Now-a-days, many management are adopting this strategy i.e., shifting of the Registered Office to some remote corners, so that the strength of the members in the annual general meeting, will be considerably reduced. Many gullible promoters who have started their venture with much fanfare in main
cities like Bombay, Calcutta, Delhi and Madras, after having harvested a good
Initial Public Offer, unable to face the persistent enquiry from the shareholders
and the annual general meeting, strategically shifted the Registered Office to
some remote villages and thus avoid the unnecessary confrontation. From the
shareholders point of view, they are losing the only opportunity of meeting the
management group and get the necessary clarification directly from them with
reference to the company operations. This leads to a new suggestion for altering
the provisions with reference to the venue of the conduct of the annual general
meeting, in the Companies Act. According to the Companies Act, the annual
general meeting should be conducted in the city in which the registered office
is located. Hence, it is suggested, that the company need not always conduct the
annual general meeting in the city where the registered office is located. They
may be permitted to conduct the annual general meeting at least in big cities
nearest to their registered office.

The management’s inability for not fully rewarding its shareholders, has
given a tough time for Nagarjuna Fertilisers and Chemicals (NFCL) at its 24th
annual general meeting. This was questioned against the management’s
prudence in taking up giant projects like a 1,050 MW power plant and six
million tonne petroleum refinery. The shareholders expressed their anger at the
board’s decision of slashing the dividend for 1999-2000 to 10 per cent from the
earlier year’s 20 per cent. Their contention was that the grassroot refinery
project, the company was setting up at Cuddalore in Tamil Nadu, would be
unviable and the power project proposed at Mangalore, requires a long gestation
period. Many shareholder expressed their concern over the deteriorating
performance of the company. They cited the erosion in bottomline which was
Rs.30 crores in the past financial year.24

24 Shareholders Flay NFCL Management. Business Standard. September 29,
2000.
TVS is a trusted name in the southern part of India. When the concept of deposit is new to many people in this part of the country, people trusted and deposited enough deposits, that the company very often has to reject the deposits from the public. Even promoters from such a group, at times, were taking the shareholders for granted. The following episode describes how the promoters respect the shareholders and also show the evolution of the shareholders' activism.

The promoters of Harita Finance Limited, part of TVS group had converted two category of warrants (Category A and Category B) into equity shares at a premium of Rs.15 per share in September, 1995. While shares allotted on conversion of Warrant A were fully paid, the promoters brought in only Rs 44 lakhs (representing Rs.2 towards face value and Rs.3 towards premium per share for 8,80 lakhs shares). The balance Rs.176 lakhs was payable by March 28, 1997. However, during the 15th annual general meeting, on 23rd August 1997, the promoters got the approval of shareholders for deferring the date for payment of final call money by the promoters. The original proposal was to permit them to pay the amount (without interest) in instalments in the next 36 months. However the shareholders resisted such move. The Chairman, Gopal Srinivasan assured them that the board would reconsider the issue and fix an early date before March 2000 for bringing the balance. Mr Srinivasan had to convince the members, as they were unhappy with such a move adopted by a TVS group company.25

For such default i.e., non-payment of called up money on shares, if the defaulter happens to be a small investor, the decision of the board will be forfeiture of such partly-paid up shares. The justification for the deferment is that the company did not require additional capital. Moreover, the additional capital has to be serviced. Hence, the board justified that they thought it fit to the grant more time to the promoters. The promoters are always in a favourable
position. What happened to the promise of the promoters to bring in the amount within March, 2000? Had they taken the agreed number of shares by paying the unpaid money on the allotted shares?

In the month of May, 1998, the group stroke a master plan. The group had decided to merge Harita Finance Ltd and TVS Lakshmi Credit Ltd with the newly floated Harita Srinivasa Finance Private Ltd and drew up a scheme. The stated reason was the need to overcome the adverse impact of the latest RBI guidelines. The hidden agenda is to help the promoters 'save' a hefty slice of bread (Rs.176 lakh) by putting an end to the contentious issue of partly-paid shares held by them. As per the scheme one fully paid up share in the new company will be allotted for every five Rs.2 partly paid up shares in Harita Finance Ltd. Thus, they will not be bringing in the promised Rs.176 lakh (representing 7.04 lakh shares at Rs.25 per share) for which they had secured extension of time.

At the instructions of the Madras High Court, the Company convened an extra-ordinary general meeting. In the meeting some shareholders raised the issue of the balance of the amount to be brought by the promoters. One shareholder asked whether the promoters would bring in the balance amount, for which the annual general meeting granted an extension of time. Interestingly, before answering the queries put forth by a few members. Srinivasan claimed that it was because of the groups motto of transparency that he was replying to the question which we was not bound to answer as per the law in a court-convened EGM. But then, the Company did not even bother to highlight this particular aspect of the scheme in the resolution put to the shareholders. When the shareholder pointed this out repeatedly, Gopal Srinivasan said "you are reading too much into the issue and we have taken legal advice." So much for transparency from one of the reputed groups of the southern part of the country.

The protestors could not block the resolution. The proposal was passed as a resolution.26

Thus, the shareholders’ activism is in its nascent stage. Had the stock market continued its activity with vigour and volatility, many more new investors would have entered the corporate constituency. However, whenever a scam broke out, most of the new breed of investors who had entered in the recent past invariably would have left the market, having burnt their fingers. With the arrival of more and more new breed of investors, shareholders’ activism is bound to be a crusading movement, which may check some of the poor practices of corporate management. Most of the companies in India are floated and run by the promoters. Many of such companies are in sick bed. Shareholders’ activism is one of the instruments available in the kit box of the corporate governance model. With the active participation of the shareholders, the mechanism of corporate governance will definitely be tuned and toned up.

No regulator can enforce discipline in thousands of companies in India. If the shareholders of individual companies started checking up the companies concerned, many ills of the present day corporate governance will be cured. Regulators are too busy enshrining the lofty and ineffective dos and don’ts of governance in stone. If the shareholders utilise the annual general meeting and exercise other rights bestowed upon them, a stage will come when one can be proud of corporate democracy in India. Market regulator, SEBI, alone cannot reverse the prevailing trend, unless and until shareholders exercise their due rights available to them.

5.5.2 Institutional Shareholders

Another important constituent in the shareholders of a company is institutional investors. The institutional investors have a sizeable investment in

the shares of the companies. They are a dominant group both in the pre and post LPG era. The financial institutions include UTI, LIC, IDBI, ICICI, IFC, General Insurance Corporation and other State Development Corporations (Tamil Nadu Industrial Investment Corporation for the State of Tamil Nadu), in the pre-reformation period. The financial institutions are public sector undertakings promoted for a specific purpose. The definition is only for the period prior to 1991. The financial institutions emerged as shareholders only in the post independent period.

The post-reformation India witnessed a new breed of institutions. One is mutual funds. An estimated 15 million or nearly 9 percent of all households in India have invested in units of mutual funds. There is likely to be at least 23 million unit holders in mutual funds. These institutions, mostly mobilised funds within India and in turn invest the mobilised funds by buying shares in the companies. Like individual shareholders, the institutions then become direct owners and the individual who have purchased the units of mutual funds are indirect owners. The number of households owning units of mutual funds is more than the investor households which have investments in shares and debentures. The existence of such large number of unit holders is a measure of confidence in the mutual funds.

In addition to the 19 million individuals who have direct ownership in corporations and 23 million individuals who are indirect owners through mutual funds, a host of other indirect owners of the corporates are also there. Millions more individuals also become indirect owners, by the status of insurance policy holders. Recently, even the pension funds are being permitted to invest their funds in the shares of limited companies.


\[\text{Ibid.}\]
The Institutions mentioned above are now referred to as financial institutions. Besides the financial institutions referred to above, now by the virtue of the policy level decision of the government, yet another institution which are more powerful with a different culture is entering the scene. They are foreign institutional investors. They are the financial institutions belonging to various nations. They came here to invest in the shares and securities of Indian companies. The entry of this participant altogether changed the scenario of the financial market. After the entry of the foreign institutional investors, the Indian financial market acquired a new dimension.

The foreign institutional investors were allowed to invest in the Indian securities market from the third quarter of 1992 consequent to the opening up of the economy earlier in that year. Their investments enjoyed full capital account convertibility. By the end of 1998-99, SEBI had registered 450 foreign institutional investors which had a net investment of US $8.9 billion as at the end of 1998-99. Their daily investments influenced the movement of the market indices for the most part of the second half of the 1990s.29

Besides the direct investment of foreign institutional investors, Indian companies were permitted to mobilise funds from the foreign countries by issuing Global Depository Receipts (GDR) and American Depository Receipts (ADR). This has resulted in the real globalisation of the market, though in a limited way at present and linked the Indian market with global markets. Now-a-days, if the Wall Street catches cold, the Dalal Street starts sneezing. An event which affects New York Stock Exchange, has an impact upon the Indian bourses also. A true global village. Although the linkages were weak, the movements in global capital markets began to have their impact on the Indian securities market, as the changes of capital flows into emerging markets and asset

29 Ibid.
allocation by the foreign investors across emerging markets as a class, influenced the investment levels of the foreign institutional investors.\textsuperscript{30}

Thus, many millions of people (both Indian public as well as people from different nations) have a direct or indirect stake in the performance of companies in India. Prior to the entry of foreign institutional investors, only Indian investors alone bothered about the performance of the Indian companies. Now many sections of the society, both local as well as foreigners, are interested in the well being of the companies or in other words the Corporate Governance system.

5.5.2.1 Nature and Scope of Financial Institutions

IDBI and IFCI are promoted by the Central Government, for the specific purpose of promoting and nurturing industries. State Governments also started similar institutions for the purpose of promoting industries in their respective State, Tamil Nadu Industrial Investment Corporation by the Government of Tamil Nadu. These Institutions promoted industries by subscribing to the share capital of the newly formed companies as well as existing companies, debentures and advanced loans. In that process, they acquire the shares of the companies and thus become the co-owners of many companies after the independence. The funds for these institutions are provided by the respective governments, by way of share capital, loans and debentures, and other funding agencies like the World Bank and IMF. Hence, the aim of the above mentioned institutions are not profit making but industrialisation of the country.

On the other hand, UTI is established for mobilising savings from small investors and invest the mobilised funds in the industrial securities. It is an institute established for helping the small investors to avail the benefits of investment in the shares. It is the first Mutual Fund of the country. It enjoyed\textsuperscript{30} Ibid.
monopoly in that sector since it's inception till 1987. Though the aim of the UTI till then is servicing the funds mobilised from the public, on account of the directions given by the Government, the task of industrialisation was the main agenda of the UTI. With the dawn of the reformation programmes, public sector institutions were also permitted to enter the mutual funds business. As the reformation programme gained momentum the monopoly enjoyed by the UTI and other public sector institutions were gradually withdrawn. Between 1987 and 1993, 8 public sector mutual funds were set up. The private sector mutual funds were established since 1993. Thus along with UTI other mutual funds also entered the group of institutional investors. Hence, after the launching of the LPG programmes, the objectives of the mutual funds including UTI is the maximisation of wealth for its unitholders and shareholders.

UTI which has been in existence for nearly 30 years and which will accounts for about 70 per cent of the investible resources of all the mutual funds, has been largely responsible for the growth of mutual funds. UTI itself has nearly 40 million accounts. As an individual may subscribe to more than one scheme of UTI and there are also trusts and body corporates who have invested in UTI, the number of individual unit holders without double counting is expected to be much less than 40 million. In all, by 1998-99, there were 40 mutual funds besides UTI, which had investible resources of Rs.150 billion and together with UTI, the total investible resources of the mutual funds grew to Rs. 682 billion or 13 percent of the market capitalisation of the market as at the end of 1998-99.

One another constituent of the “financial institutions” is LIC and General Insurance Corporation of India (GIC). The funds generated from the insurance business is invested in the shares and debentures of companies. The charter of
these institutions permitted such investment. The motive behind such move is to fund the development programmes and not maximisation of profits.

Prior to the Liberalisation, Privatisation and Globalisation (LPG) reforms, UTI, LIC, GIC, IDBI, IFCI and State financial Corporations were the constituents of financial institutions. They used to hold around 30 percent of voting rights in the assisted companies, besides holding debentures and providing term loans. The post reformation institutional investors include mutual funds including UTI as well as foreign institutional investors. The list also includes LIC and GIC.

In a survey conducted by Prof. L.C. Guptha, the combined equity-holdings of all the financial institutions and the government, at both all-India and state levels, amounted to an average of 24.2 per cent of the total equity of 365 sample companies.

5.5.2.2 Nominee Director System

As a major investor in the companies, the institutional investors demand board representation. The directors appointed to represent the financial institutions are known as nominee directors. It was not the general practice of the financial institutions before 1970 to nominate their representatives on the boards of assisted companies except in the problematic cases. While the financial institutions reserved the right of appointing their representatives in the board in the loan agreements, rarely this right was exercised. Till the end of sixties, the financial institutions had not appointed any of their representatives in the board of the assisted companies.

However, the Dutt Committee recommended the financial institutions to participate in the decision making body by sending their representatives. The reason for demanding a seat in the board was not from the angle of governance
of the companies. Inadequacies of the board is not instrumental in accommodating the financial institutions in the board. That aspect is nowhere mentioned in the Dutt Committee report. Their recommendation was the result of socio-political ideology. They are concerned about preventing the concentration of economic power and the need for ensuring that 'Public interest, not merely private profit', would guide the operations of the large industrial undertakings in the private sector'. The Dutt Committee recommendation inter-alia, includes:

- Appointing institutional nominees on company boards
- Conversion of institutional loans into equity

From then onwards the financial institutions started appointing the nominee directors. However, even prior to this, term-financing institutions had required assisted companies to broad-base their boards as a condition for providing assistance. This condition is a regular feature of term-loan and underwriting agreements. The idea behind is that the board should not be packed with promoters' family members and associates. It should include qualified personnel from various disciplines. This was an ideal thinking which was not seriously considered and implemented, both by the business houses as well as the financial institutions till the Dutt Committee recommended the practice. Thus the nominee director system came into being.

Ministry of Finance has issued guidelines, as far back as in March 1984, regarding the appointment of nominee directors, to be followed by the all India financial institutions. In the light of the said guidelines, financial institutions appoint officials as well as non-officials on the board of companies assisted and supported by them. Basically, the nominee directors are appointed if the paid-up capital of the assisted company is more than Rs.5 crores or institutional

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33 Ruddar Dutt and K.P.M.Sundharam, Indian Economy, S.Chand & Company Ltd., New Delhi, 2000.
shareholding is 26 percent or more of the share capital or when it is considered necessary to keep a closer watch for different reasons.\textsuperscript{36}

The financial institutions have also constituted a co-ordination committee of senior officers who constantly work on the modalities to implement of the said government directives. Each financial institution has set up a separate Nominee Director Cell headed by a principal officer, and the nomination is reviewed periodically. It is ensured that a nominee director nominated on the board of a company should remain for a reasonable period, but not for a period of more than 3 years, except in exceptional circumstances. Though, the nominee director is expected to be vigilant but he should not interfere in the day-to-day affairs of the company. The aforesaid guidelines are under review by the government.

The nominee director system, as it operates in India, amounts to more than a lender-borrower relationship. The system was adopted as a result of government's initiative, although nominee directors are actually appointed by term-financing institutions. The Government is as concerned as the financial institutions, about how nominee directors operate.

A survey conducted by the pioneer author in India in this area, by Prof. L.C. Gupta during 1982-83 revealed that all-India development institutions had a dominant position in the share of nominee directors appointed in the all India level, followed by State Level Finance Corporations. The investing agencies like UTI, LIC had only an ancillary role in the nominee director system. The following table shows the position of the financial institutions vis-à-vis nominee director:

\textsuperscript{36} R. Srivatsava, "Role of Directors Nominated by Financial Institutions", Chartered Secretary, New Delhi, May, 1997.
Table 5.1
Share of Nominee Directors among the Institutions

<table>
<thead>
<tr>
<th>Agencies</th>
<th>Percent of all nominee directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDBI, IFCI and ICICI</td>
<td>40</td>
</tr>
<tr>
<td>LIC, UTI and GIC</td>
<td>10</td>
</tr>
<tr>
<td>State Level Finance Corporations</td>
<td>38</td>
</tr>
<tr>
<td>Banks</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: L.C.Guptha, Corporate Boards and Nominee Directors.

Prof.L.C.Guptha’s survey revealed that for all the companies taken together, the institutions appeared among the top ten equity shareholders in 63 per cent of the companies covered. In the largest companies, institutions almost invariably figure among the top ten equity-holders. The majority of small companies with paid-up capital below Rs.25 lakhs each did not have institutions as shareholders. In the middle size (paid-up equity between Rs.25 lakhs and Rs.1 crore), a substantial majority of companies had institutions among their top ten holders of equity. As regards the size of institutional blocks, the noteworthy fact is that, for all company sizes together, institutional equity-holdings were 10 per cent or more of the equity of individual companies in approximately 45 per cent of the companies analysed. In nearly 30 per cent of the companies, the institutional blocks were 20 per cent or more of the equity.

Table 5.2
Nominee Directors in the Listed Companies of Tamil Nadu

<table>
<thead>
<tr>
<th>Agencies</th>
<th>Percent of all nominee directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDBI, IFCI and ICICI</td>
<td>53</td>
</tr>
<tr>
<td>LIC, UTI and GIC</td>
<td>12</td>
</tr>
<tr>
<td>State Level Finance Corporations</td>
<td>35</td>
</tr>
</tbody>
</table>

Source: Primary Data

The survey of the present researcher revealed the following position regarding the position of the financial institutions vis-à-vis nominee director.

Further analysis revealed that the institutions sought representation only in those companies where they had considerable exposure to equity share capital.
The following table shows the position with respect to paid up share capital of the companies vis-à-vis nominee directors:

Table 5.3
Nominee Directors and Paid Up Share Capital

<table>
<thead>
<tr>
<th>Size of the Companies (In terms of share capital)</th>
<th>Number of Companies</th>
<th>Percentage of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 25 Lakhs</td>
<td>15</td>
<td>Nil</td>
</tr>
<tr>
<td>25 Lakhs and above but below 50 lakhs</td>
<td>13</td>
<td>1</td>
</tr>
<tr>
<td>50 Lakhs and above but below 100 lakhs</td>
<td>18</td>
<td>3</td>
</tr>
<tr>
<td>100 Lakhs and above but below 300 lakhs</td>
<td>21</td>
<td>5</td>
</tr>
<tr>
<td>300 Lakhs and above but below 1000 lakhs</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>1000 Lakhs and above</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Primary Data

The average number of nominee directors, including the nominees of all-India and state-level institutions and the government, was 0.36 per company, for the entire sample covered. However among the companies which had nominee directors in their board, the average number of nominee directors works out 1.64. Of companies for which nominee directors were appointed, about 35 per cent had one nominee director each and in the remaining companies, the strength of the nominee directors in each company is only two. The number of nominee directors depended partly on company size and the investment of the institutions in the concerned company in the form of equity and loan. The survey responses revealed that the nominee director system has become a common feature of listed companies, especially big in size. To evaluate their level of involvement in the companies, in which they have invested, the following item was included in the questionnaire. The relevant question bears the number 37.

"37. Average percentage of attendance of Nominee directors for the Board Meeting."
The survey results revealed that the average attendance of the nominee directors is 75 per cent.

Another question, which was also included for the same purpose in the questionnaire. The relevant question bears the number 31.

"31. Proposals introduced by nominee directors are seriously deliberated:
Yes    No    Occasionally"

From the responses of the secretaries, the researcher comes to know that no nominee directors had filed any proposal in all the companies where the financial institutions were given representation.

To assess the level of participation in the board meeting, the following question is asked. The responses revealed that, their involvement is at the lowest level. However, one should also remember, that the financial institutions are represented in the respondent companies only in seventeen companies. Hence, one should not arrive at the conclusion regarding the participation of nominee directors on the basis of this research findings. Another question related to the nominee directors included in the questionnaire is question number 34. The responses of the secretaries revealed that the participation is very poor.

"34. Nominee directors' participation in the Board Meeting are:
  i) Active       ii) Very Active       iii) Indifferent"

5.5.2.3 Role of Nominee Directors

The nominee director should be vigilant. If any undesirable practice prevalent in the company, including any abuse by the promoter group of its powers and privileges comes to his knowledge, he should immediately bring this to the notice of his nominating financial Institution. The nominee director should make such suggestions as would be conductive to better management practices, effective functioning of the board, improvement in productivity, efficiency and continued growth of assisted companies. The nominee director is expected to keep himself updated with policies and current developments in the industry and to see that the company is run on sound lines within this dynamic
set up. It goes without saying that the nominee directors on the board are expected to have high degree of probity and independent approach.

The function of a nominee director deserves serious thought, keeping in view the role of the board as a whole, discussed earlier, and the perceived weaknesses of boards. According to the IDBI's Guidelines, a basic objective of making such appointments is to 'facilitate effective functioning of the Board of Directors.' Over the years, with experience, some clarity has emerged in this regard. The revised official guidelines on nominee directors issued by the Government of India in early 1984, and the detailed guidelines brought out by IDBI in early 1986, represent official thinking on the matter. The IDBI Guidelines are comprehensive and based on fifteen years' experience in operating the system. Government guidelines require nominee directors to be particularly vigilant about the following:

- financial performance of the company.
- payment of dues to institutions
- payment of government dues, including excise and customs duty, and statutory dues. Where the company feels that a particular tax demands is unjustified, nominee directors should satisfy themselves about the prima facie reasonableness of the company's case.
- inter-corporate investment in and loans to or from associated concerns in which the promoter group has significant interest.
- all transactions in shares.
- expenditure being incurred by the company on management group and policies relating to the award of contracts and purchase and sale of materials, finished goods, machinery, etc.

5.5.2.4 Role Perception by Nominee Directors

In order to ascertain how nominee directors actually viewed the board's (and hence their own) responsibilities, an opinion survey was conducted among nominee directors, both officials and non-officials, in 1982. Nominee directors were requested to rank five specific ways of looking at the board’s role viz.
• providing expert/professional advice to the chief executive on specific matters;
• acting as watchdogs against managerial abuse;
• acting as friend-philosopher-guide to the chief executive;
• generating pressure to drive the executive management to greater effort; and
• ensuring social responsibility.

The findings of the survey suggested the following inferences. The largest percentage of respondents (38.8 per cent) assigned Rank 1 to the ‘friend-philosopher-guide’ role or item (3) in the list. The next highest ranking (24 per cent) was attached to the ‘expert advice’ role, or item (1). The two forms of advisory functions (1) and (3) above, were together ranked the highest by as many as 62.8 per cent of nominee directors. On the other hand, items (2) and (4), the ‘watchdog’ and ‘control’ functions, were ranked first by only 18 per cent and 10.9 per cent respectively of the respondents, a total of 28.9 per cent. Thus, of the ‘advisory’ and ‘control’ roles of the board, the former was given distinctly more importance in the thinking and attitude of nominee directors so far. More than twice as many nominees gave Rank 1 to the advisory functions than to the control-watchdog functions. There was not much awareness of the ‘social responsibility’ role of the board. An significant fraction (4.4 per cent) of the respondents assigned Rank 1 to this function.

5.5.2.5 Shareholders’ Monitoring

Legally speaking, the owner of even one share is a co-owner of the company. An individual’s holdings of shares in any one company have been small, and hence the individual investors have had little inclination to interfere with the management of a firm. On the other hand, the institutions have a sizeable influence, unlike the individual shareholders. The holding of the financial institutions is sizeable. As dominant shareholders they can easily
block any resolution even in the annual general meeting. They are more powerful than the individual shareholders because of the following factors.\textsuperscript{37}

Institutions form a cohesive shareholder group and all institutions act in concert. They have the ability and willingness to challenge management. They have access to inside facts about company operations to enable them to judge whether shareholder interests are being compromised. Finally, they possess management and financial expertise.

Inspite of having significant investments in companies, in the form of debt and equity, financial institutions followed 'hands-off' approach and in most of the cases played the supportive role to management irrespective of their performances. These institutions nominate their representatives, usually senior level executives, to the Board of Directors of these companies. Till recently nominee directors were passive watchers and rarely intervened except in crisis situations.

The situations which warrant a stern action by the financial institutions as shareholders, witnessed a silent spectator attitude in the financial institutions. At times the financial institutions lend money. In the event of default, the financial institutions instead of recoursing to recovery procedure, efforts will be made for sanctioning further loan, on the pretext of completing the project which is incomplete. The funny part of the story will be that the funds previously sanctioned by the financial institutions had been siphoned off by the promoters for some other purpose. It is worth mentioning the editorial comment of the popular financial daily, ‘The Economic Times’, regarding this matter after the report of Reserve Bank of India made a comment on the role of financial institutions vis-à-vis the companies to which they have invested.

“We hope that the rap the financial institutions have received from the RBI for their board room passivity while JCT made large interest-free loans to

certain other companies will have the desired effect. It has been a time-
honoured practice for Indian corporates to milk certain companies dry while
enriching certain others in which the promoters of the first category of firms
have substantial interests. Financial institutions have, in general, played along
with such games, pretending that their interest was only to get their loans back –
as if shareholder value meant nothing. Such financial institutions acquiescence
in daylight robbery of shareholders must stop. In the instant case, JCT Ltd.
granted interest-free loans worth Rs.36 crores. The omission is not which
financial institutions have stoically watched the promoters looting the
companies in which financial institutions have a 47 per cent stake.

Given their public sector tendency to play safe, passivity of nominees has
been the norm rather than the exception. Few nominees are willing to risk taking
a stand at board meetings, especially if it means opposing powerful promoter-
groups. This is not surprising. Nominee directors have no incentive for
monitoring companies on whose boards they are members since they are neither
rewarded for good monitoring nor punished for non-performance. Such inaction
has often been criticised in the past. But criticism which is not backed by
punitive action serves no purpose. It is not surprising, therefore, that financial
institutions remained largely unfazed. This should now change. And with that
corporate culture too should undergo a change for the better. Once FI nominees
take the lead and begin questioning decisions taken in board meetings, promoters
will no longer be able to hold other shareholders of the company to ransom for
their own personal ends. And that should signal the beginning of a new era in
corporate governance”.38

On one occasion, the IDBI had sanctioned Rs.1080 crores, as a bail out
package to steel sector, subject to a condition. The condition being that the
promoters would have to return the funds – estimated at 1,190 crores - diverted

38 “Editorial Comments” The Economic Times. 27 November 1997 Volume 37 No 173
from their steel projects which is not a sin or news in Indian context. The financial institutions have nominees in all the boards of the companies seeking assistance. How have they permitted to siphon off the funds. The funds would have been diverted only with the approval of the board, in which the financial institutions representatives were also present. Why have they permitted hem to divert the funds for other activities?

Shareholders value eroded in companies belonging to established groups like Tata and Birla. Unfortunately they remained passive watchers. What action the financial institutions have taken to change the management.

Quite often the role of nominee directors become one of a watching brief. They are at the mercy of the promoters who will decide what information to give and what not. The promoters tell what it suit them to tell the Board. The Boards become bored stiff with volumes of non-essential information. Under the circumstances, as a big brother, these institutions owe a moral as well as legal responsibility to their investors regarding how well the companies in which their funds are invested, are being managed or governed. If the institutions like UTI fails to deliver the results now, especially in the post-LPG era, the investors will take them into task as had happened in India Growth Fund, by seeking board room representation by an American Citizen, quoted earlier in 5.5.1.3. The UTI burned midnight lamp to overcome this crisis.

The reasons for this type of behaviour of the nominee director are well reflected in the survey results conducted by Prof.L.C.Gupta. The survey results presented in 5.5.2.4 clearly showed that most of the directors prefer to act only as friend and philosopher. Thus the advisory role was perceived as the most important role by the institution of nominee directors rather than the control function.

In the light of the experiences of the counterpart of the financial institutions in the developed countries like U.S.A., the performance of financial
institutions in India vis-à-vis corporate governance may be very poor. However, one should not pass on the judgement, without considering the objectives of these financial institutions.

Most of the decisions and the behaviour of the financial institutions in the pre-LPG era, are seems to be highly contradictory when we try to judge the performance, without looking though the objectives clause. The financial institutions are all established by the Government, in the pre LPG era, by different charters of the Parliament. In most of the cases, the charters have stipulated for more social objectives, rather than the profit criterion. In fact, the main objective behind the setting up of IDBI, IFCI and State Level Finance Corporations are the promotion of industries. Profit is not at all a criterion. Similarly in the case of LIC and GIC, they are only investing agencies. Moreover, their objective is not to maximise the profits. They expect a return to service the claims of policy holders. The only exception in the financial institutions is UTI, where there is a compulsion to earn profit to service the unit holders. There again, since it is the Government created agency, the Government directed it to divert the funds as per it’s directions. Their primary motto being the promotion, development and sustenance of industries in India. Hence in the beginning, the financial institutions were not very serious about maximisation of profit for the shareholders. They were not serious about the profits generated from those ventures. They saw to it that the industries were alive and even had advanced further loans and advances to keep the industries alive, in spite of some deficiencies or faults on the part of the promoters. The primary objective of the financial institutions, then were industrialisation.

The financial institutions threatened to oust the management of Modi Rubber for mismanagement, a move that has been widely hailed as a step towards better corporate governance. An indignant lot of institutions comprising Life Insurance Corp (LIC), General Insurance Corp (GIC), Unit Trust of India (UTI), Industrial Development Bank of India (IDBI) and Industrial Finance
Corporate of India (IFCI) – which jointly control over 52% of the equity in Modi Rubber – concluded that the present management under managing directors B.K. Modi and brother V.K. Modi was running the company aground. The financial institutions, which were now answerable to the new masters, proclaimed that they would throw open the company to bids, and select a new team to run it, which created a furore in the corporate circle. A wide protest from the business families came, stating that the incumbent management should not be ousted. Even after five years, the problem is not resolved and the old team is still managing the affairs of the company. The reason in this case is again political. The institutions are not able to take the decisions, independently.

In the case of ITC, a professionally managed MNC, financial institutions are the largest shareholders with around 34 per cent stake, but as a policy, they have kept quiet at the board meetings despite scams, losses and tussles between the ITC management and BAT. When the executive directors and non-executive directors were arrested and thrown into jail, nominee directors species were alarmed and claimed that they should not brought into the scene for the misbehaviour of companies. A number of the such directors complained that many managements were never bothered about them and did not disclose properly.

Escorts Tractors merged with Escorts Ltd and as a result the public as well as financial institutions were stand to lose more than 100 crores. The promoters had not been affected, in fact they stand to gain. It is the result of the management decision. The irony is that the financial institutions are represented in the board. Subsequently the Government directed to enquire into the incident.

The financial institutions are considered to be the extended wings of the government. The government utilised these institutions for fulfilling other needs also. The financial institutions were advised to pump money into stock

39 Business World, 18 September - 1 October 1996.
exchange, whenever the market is in trouble. As it is perceived generally that the share market reflects the economy, the Government, which party may be in power, never bothered about the basic philosophy and mission of the institutions for which it is created. One such occasion is quoted below. “The finance ministry is seriously thinking of directing the financial institutions to pump in around Rs.45 billion in the domestic stock market. The ministry has arrived at this decision after looking at the current sentiment of the market. Union minister Yashwant Sinha is studying the proposal forwarded by some section of the exchange”. The Government as mentioned above has regularly utilised the funds of these institutions to prop up the share market, whenever the prices are plunging downwards. Thus the Government utilised these agencies as the Xavier of the stock market to prop up the image of the Government on the economic front. The agencies here are out and out controlled by the Government not for the sake of the purposes for which they have been chartered by the parliament.

To assess the role of financial institutions in shareholder, the following question is included in the questionnaire.

“48. Will all the Financial Institutions holding shares in the company attend the AGM? 
Yes No”

The response is very poor. Out of the 78 companies responded for the study, only 5 companies responded positively. On the similar line, yet another question is asked to assess the involvement of nominee directors in the activities of the companies. The nominee director is also a member of the board. Therefore, he has a duty to attend the annual general meeting. Hence, the following question is included in the questionnaire.

54. Had the nominee director attended all the AGMs?

The survey results revealed that most of the financial institutions had not attended the annual general meeting. The above responses led the researcher to

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conclude that the financial institutions' role as a shareholders is disappointing. They are more powerful group, compared to the individual shareholders. Had the institutional investors briskly participated in the annual general meeting, it would be a model behaviour for the individual investors.

Therefore, the conclusion arrived at by the present researcher, with reference to the function of monitoring is that the financial institutions as shareholders have failed. They have not rendered justice for these roles. However, if one takes into consideration the prevailing environment i.e., control of Government over these institutions, one cannot convict these institutions. It is only the Government to be condemned which has misapplied the agencies for their political causes. The decisions taken by the financial institutions are not commercially prudent only because of this interference.

However with the advent of LPG reformations, the scenario has completely changed. The development agencies like IDBI, ICICI and IFCI have to mobilise funds from the public. Now they are answerable to their shareholders. Similarly, a number of mutual funds entered the scenario. As a result, the UTI have to prove their performance in order to compete with other mutual funds. Hence there is a radical change in the attitude and mental make up of the financial institutions regarding the evaluation of companies in which these institutions have invested.

In the post-reformation period, most of the financial institutions including the Development Institutions like IDBI and ICICI were constrained to play their role pushing aside other incidental socio-political missions. Subsequently with the advent of LPG, shareholders community and other funding agencies look upon them only as a company which should generate decent profits. The World Bank and other institutions are very serious about Non Performing Assets (NPA). Therefore, the performances of the financial institutions were rated by the market and their shareholders in terms of profitability. Thus they were constrained to change their behaviour. Once Mr. K.V. Kamath, Managing
Director of ICICI, observed that “financial institutions historically saw themselves as development banks playing nurturing role. Since they have this “developmental mindset”, they also ‘tolerated’ a lot of ‘inefficiencies’, such as imperfect management or practices. But today, since we are both borrowing and lending at commercial rates, we do not have the luxury of not taking a closer interest in the clients of our books. If resource raising, lending and spreads are all market-driven, supervisory practices must also be market-driven”.

With the dawn of LPG programmes, there financial institutions have to show performance, through the performance of the companies in which they have invested. Hence, they started monitoring the companies which were in their portfolio. If the institutional investors are not satisfied with the performance of the management or with a particular decision, simply the institutional investors dump the shares in the market. Hence, the incumbent management are also worried, not because that their shares worth were eroded, but because such eroded share price will create a take-over opportunity for the opponents. Moreover, as did in the pre-LPG era, local business tycoons cannot dictate the foreign institutional investors through the local politicians. Any how, the influence of the business community still prevails over the Indian financial institutions.

The role of financial institutions as a shareholder is evaluated in the following paragraphs. To evaluate the extent of the participation of the financial institutions, as a shareholder, in the annual general meeting the following question is included in the questionnaire. The relevant question bears the number 37. The company secretaries have responded to the above question that most of the directors did not attend the annual general meeting.

5.6 Civil and Criminal Liability of Nominee Directors

According to the Indian Companies Act, 1956 there are only Whole-Time and Part Time Directors. Therefore the liability of nominee director is an
interesting topic in the light of the emerging trends. The ITC episode created a sensation in the media. It bring to light many things. One such item is the liability of nominee directors. The Enforcement Directorate filed charge sheets against the entire set of nominee directors in the ITC board, for the alleged Rs.100 million FERA violation offences committed by the ITC during the period 1991-1994. The filing of chargesheets in July 1996 was the first instance in Indian corporate history that FI nominees were held culpable of legal violations by companies. Technically, nominee directors do not owe any duty or responsibility towards shareholders of assisted companies and are not accountable to them. However, their moral as well legal responsibility is now a matter of great debate.

Section 9 of the Foreign Exchange Regulation Act also does not grant any such omnibus amnesty to any director, whether he is an institutional nominee or a nominee of foreign investors. If the violation of FERA is by a company, all directors are responsible in as much as sub-section 1 of Sec.9 makes it clear that “every person who, at the time of controvention, was commonly in charge and was responsible to the company for the conduct of business of the company shall be deemed to be guilty unless he proves that the contravention has taken place without his knowledge, the proof of which can be taken into consideration only at the trial, not at the stage of inquiry.”

The directors are considered as special agents of a company with a mandate to exercise powers conferred on them by the Companies Act, the memorandum and by resolutions passed in general body meetings of the company. As trustees of the funds, they are duty-bound to act in the interest of the company, without any exception. While performing such fiduciary duties, they have to be faithful as trustees whether they are dealing with the company, or on behalf of the company. Section 630 of the Companies Act makes it an

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offence punishable as breach of trust or misappropriation of funds by an officer, which term also applies to a director, if it is found that the funds of the company have been applied wrongly, for any purpose other than that of the business of the company.

The exemption available under Section 633 of the Act can be availed if it can be proved that the director had no knowledge or involvement in such breach of trust or misappropriation of funds. These provisions in no way constitute a bar on these offenses being tried under the general law laid down in the Indian Penal Code.

The second, which is based on the well-known principle of ‘vicarious liability’, makes a company, primarily liable as a legal person for any offence committed by it and some natural person must also be caught in the panel net because the company cannot commit an offence by itself. The Non-executive directors, however, can escape the vicarious liability arising from an offence by their company by claiming that they were not in charge of, and responsible to, the company for the conduct of its business. But to claim this, these directors will have to undergo the ordeal of prosecution. There is no automatic exemption.

In view of these legal provisions, according to current thinking among FIs, though for all practical purposes, the role of nominee directors should be similar to that of whole-time directors, a fine distinction should be drawn while determining the culpability of part-time directors during instances of legal violations by a company; the test for determining the culpability should be whether the nominee was in the know of violation, and if so, whether he had applied due diligence on the matter under consideration.

The nominee-directors are often kept in the dark on matter concerning the day-to-day running of the companies and even when there is a breach of law, the transactions are kept under wraps. The Working Group which
drafted the Companies Bill, 1997, also considered the matter and the Group felt that it would be a deterrent factor to easily secure the services of professionals as non-executive directors when they are often sought to be made liable for certain offences of the company even though they have far less information about the day-to-day running of the company. Therefore, an amendment of Section 2(39) in the Draft Companies Bill 1997 has been proposed and the amendment seeks to exclude non-executive directors from the definition of the term ‘Officer-in-default’ except when they are party to the decision. The FIs also recommend that when they are party to the decision. The FIs also recommend that there should be an explicit non-obstante clause excluding civil and criminal liability under all other statutes in respect of non-executive directors who have no say in the day-to-day working of the company.

5.7 CORPORATE DEMOCRACY

According to law, shareholders appear to possess effective powers for the control of the company’s affairs. These powers include the right to elect directors, the right to appoint auditors the right to summon meetings and to decide various matters by special or ordinary resolution. The meetings are supposed to be conducted properly and matters are decided by voting after shareholders have been given proper opportunity to speak. Thus, in theory, company management gives the impression of a perfect democracy in which the general mass of shareholders wield the supreme authority in all matters concerning the management of the company. However, in practice, the management of companies exhibits some marked features of oligarchy.

5.7.1 Reasons for the Oligarchy in Corporate Management

The reasons for the oligarchic character of the management can be attributed to the following features:
5.7.1.1 General Body Meetings

Numerous legal rules contained in company law, affect the way in which a firm's ownership structure is translated into shareholder influence through voting. The company laws of the countries decide the manner in which the ownership structure is to be translated. For example, a higher quorum will enable the minority shareholders to veto a proposal and on the other hand, a lower quorum enables the management group to carry on a proposal easily without any objection or hurdle. Therefore depending upon the necessity a country frame it’s companies act. For example the East European countries provide extensive flexibility for each company to adjust voting rights to suit its own needs. This flexibility is generally desirable because it allows control to be distributed differently from ownership. It is particularly appropriate for such countries in the short-run, because it allows focused control (crucial for quick, effective restructuring) in the absence of concentrated ownership or custodial voting power.

(a) Method of Ascertaining the Will of the Shareholders

The existing system of ascertaining the will of the shareholders encourages the management to ignore the sentiments of the shareholders in general. Though many shareholders are not satisfied with the performance of the management, the shareholders are not in a position to rectify the problem. This is the result of the shareholders’ attitude towards their responsibility. Hence they suffer in total. The poor turnout of voters is not only a problem in the corporate world but also in the civic life. Moreover one cannot expect the shareholders who are living in far of places to attend the meeting which is conducted in a distant place. The net result is a larger number of shareholders becomes passive shareholders. The votes of passive shareholders who do not participate in the voting process, helps the incumbent management. Though such votes are not cast directly, indirectly it amounts to casting in favour of the incumbent
management. This defect has been identified by the Birla Committee and recommended the postal ballot system to rectify the defect of the system.

Legally, the shareholders are authorised to appoint directors and auditor for a company. How the decisions are made by the shareholders? The general body meeting is an assembly of a number of individuals who are the shareholders or members of the company. The Chairman of the meeting will ascertain the will of the meeting. How does the Chairman ascertain the will of the meeting?

The Companies Act provides a mechanism to ascertain the will of the members. The will of the members of the company is ascertained on the basis of the will of the members who are either directly or indirectly through proxies present in the meeting. The opinions of the members who are not present in the meeting will not be considered. The chairman will ascertain the sense of the meeting either by show of hands or if demanded by members by poll. If the majority of the members who are present favour a proposal, the chairman will declare the proposal as having been passed by the general body meeting and it becomes the decision of the meeting. Depending upon the importance of the business, the Companies Act stipulates either for a simple majority, which requires 51 per cent support of the members present and a special majority, which requires 75 per cent majority of the members present in the meeting.

While counting the votes, the chairman will take in to account only the votes polled in the general body meeting and not the total eligible votes in the company. As the shareholding population is scattered - throughout the nation prior to LPG and throughout the world after the LPG - the number of members attending the general body meeting will be considerably lesser compared to the eligible members who can attend the meeting. In the annual general meeting of Reliance Industries Limited conducted on 25th June, 1997, only 5000
shareholders attended, compared to nearly 3 million shareholders. Under such circumstances, the incumbent management can easily muster the necessary majority to pass a proposal as resolution. This provision of ascertaining the will of the members who are attending the meeting alone, without considering the views of the members who have not attended the meeting leads to an anomalous situation. If this anomaly is to be removed, the views of all the shareholders should be ascertained. Then only one can be proud of corporate democracy. Corporate democracy can be achieved through the Postal Ballot System. For shareholders who are unable to attend the meetings, there should be a mechanism which will enable them to vote by postal ballot for key decisions. The Birla committee on Corporate governance fully appreciated this fact and had recommended for postal ballot method for ascertaining the sense of the meeting, instead of taking into consideration the will of the members present in the meeting only.

"With a view to strengthening shareholder democracy, it is felt that all the shareholders of a company should be given the right to vote on certain critical matters through the postal ballot system, which has also been envisaged in the Companies Bill, 1997." Further the committee has recommended the following businesses which are to be approved through the postal ballot system. They are:

- matters relating to alteration in the memorandum of association;
- sale of whole or substantially the whole of the undertaking;
- sale of investments in the companies, where the shareholdings or the voting rights of the company exceeds 25 per cent;
- making a further issue of shares through preferential allotment or private placement basis;
- corporate restructuring;
- entering a new business area not germane to the existing business of the company;
- variation in the rights attached to class of securities.

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43 Birla Committee Report on Corporate Governance - Annexure 3.
44 Ibid.
The committee also recommended the procedure for conducting such postal ballot.

The observers feel that the postal ballot system will change the scenario of Corporate governance, if introduced and implemented. The researcher uses the phrase "if introduced and implemented", because a number of proposals even after the enactment in the Companies Act remains in paper only. One such provision is the small shareholders' representation in the Board of Directors which is included in the Companies Act but failed to be implemented because of the lobbying of the incumbent management group. However, the amendment of the Companies Act, for the provision of the postal ballot system requires a Government with the will to introduce such provision which is against the interest of the Indian business families. The industrialists' lobby is so powerful that they are able to carry out their aspirations, irrespective of the party in power. The politicians also lack the will to amend the act for the cause of small shareholders. SEBI has already made recommendations in this regard to the Department of Company Affairs and the same was incorporated in the Companies Amendment Bill, 2000.

(b) Attendance of the shareholders in the annual general meeting

The widespread dispersal of the investors renders it difficult for those located in far-flung areas to participate in the decision-making process at the general body meeting of the companies. Hence the attendance of the shareholders is too thin in the annual general meeting. Another reasons for the poor attendance is the mental attitude of the shareholders. A shareholder, who regularly receives good dividends, thinks that the affairs of the company are being managed properly and hence there is no need for him to attend the annual
A shareholder who does not receive a fair dividend feels that it will be an additional wastage of money to go to the meeting. Hence, poor attendance at the shareholders' meetings. Those who attend the meeting are usually not in a position to make an intelligent criticism of the accounts because they rarely take the trouble of reading the directors' report and studying the annual accounts and the balance sheet properly. Many of them do not possess the competence required to make an intelligent assessment of the company report and accounts. Even if they are competent enough to assess the performance, sufficient information may not be available to small shareholders. The researcher framed a hypothesis to test the average attendance of the shareholders for the annual general meeting. The average attendance of the shareholders in an annual general meeting is taken at 250.

The researcher personally attended a number of annual general meetings and observed the attendance of the shareholders was very meagre, compared to the total number of shareholders. Hence, the researcher decided to test a hypothesis regarding the average attendance of the shareholders in the annual general meeting. A question was included in the questionnaire to ascertain the strength of the shareholders, in attending the annual general meeting. The relevant question is:

"Q.46: Normally, how many shareholders attended each AGM during the period 1992-97?"

The responses of the secretary for the above question is presented in the table number 5.4.
Table 5.4
Shareholders Attendance in the annual general meeting

<table>
<thead>
<tr>
<th>No. of Shareholders attending the meeting</th>
<th>No. of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-25</td>
<td>9</td>
</tr>
<tr>
<td>26-50</td>
<td>16</td>
</tr>
<tr>
<td>51-100</td>
<td>7</td>
</tr>
<tr>
<td>101-200</td>
<td>23</td>
</tr>
<tr>
<td>201-300</td>
<td>10</td>
</tr>
<tr>
<td>301-400</td>
<td>5</td>
</tr>
<tr>
<td>401-500</td>
<td>7</td>
</tr>
<tr>
<td>Above 500</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>78</td>
</tr>
</tbody>
</table>

Source: Primary Data

The analysis of the data revealed that the arithmetic mean of the shareholders attendance is 174.3 and the Median is 153. The average number of shareholders per company, for the companies taken for the survey, is 7,985. If one compares the average number of shareholders attended the annual general meeting against the average number of shareholders, it is a paltry 2.18 per cent. Annual general meeting is the medium through which shareholders are expected to interact with the Board of Directors and evaluate the performance of the management team. It is the mechanism provided in the Companies Act, 1956. If the responses of the shareholders are so poor, then the governance mechanism cannot be expected to generate the desired results. The standard deviation of the attendance is 152.4. Most of the shareholders consider it a waste of time to attend the general body meeting.

The following procedure was followed in testing the hypothesis, viz., the average attendance of the shareholders in an annual general meeting is 250, using Z test:

Null hypothesis:

There is no difference between the average attendance of the sample and the population.
Alternate hypothesis:

The sample average is different from the population average.

Level of significance: 5%

Conclusion: The calculated value is 0.999.

The table value at 5% level of significance is 1.96. As the calculated value lies in the acceptance region, the null hypothesis is accepted and alternate hypothesis is rejected. Hence, it can be concluded that the average attendance of the shareholders shall be 250.

The post Harshad Mehta era witnessed a larger turnout of shareholders in the annual general meeting fetching record attendance of shareholders for the annual general meetings. The average attendance per annual general meeting was more than 1000. Secretaries revealed that they find it extremely difficult to manage so much shareholders at that period. However, as the scam broke out, the new breed of shareholders who had invested in shares with the speculative motive, sold out their holding and left the scene. Once again the normal attendance was witnessed in the annual general meetings.

Though the Act of 1956 guarantees several rights to shareholders and regulates the affairs of a company with a view to ensure efficient functioning of a company, such guarantees become meaningless if the shareholders fail to exercise or assert these rights. In some cases, the shareholders can be denied certain rights and in some cases, companies are allowed to enjoy certain privileges. The present state of the corporate governance can be attributed to the shareholders indifference to the annual general meeting.

The shareholders who are outside the ambit of the controlling group of management cannot mobilise some strength not for dethroning the existing management, but at least to check the incumbent management. The financial institutions who hold 25 per cent of voting rights even cannot stop a proposal
from being passed into a resolution. If that is the fate of shareholders who hold around 25 per cent of the voting right, the position of the individual shareholders vis-à-vis their impact in the annual general meeting proceedings need not be elaborated. Hence, many shareholders consider it as waste of time, money and energy to attend the annual general meeting.

Many shareholders attend the annual general meetings to collect some gifts and the snacks provided by the management. In fact, the gift is a motivating factor for attending the meeting. In spite of the gift, the average rate of attendance is only 2.18 per cent, at the Tamil Nadu level. Under such circumstances, the Government has issued a direction which will further reduce the rate of attendance.

The government has been declaring from the rooftops that it is all for reforming the Company Law, but the Bill prepared over a year ago has not even been moved in parliament. Ad-hoc changes that have been made, favour the promoters. The working Group which was entrusted with the task of preparing the new Companies Act had suggested to the government that giving or taking of gifts in general meeting should be completely banned. The government has accepted this recommendation through clause 160 of companies Bill, 1997 which corresponds to Section 205 of the present Act, which reads as under.

“No company shall give, or no shareholder shall demand or accept, any gift either in cash or in otherwise in lieu of or in addition to the dividend payable under this section”.

The new provision shows the seriousness of lawmakers to support the management in curbing the militancy of some shareholders who virtually disrupt the proceedings of the meeting to demand gifts. Clause 160 provides that where clause 160 is contravened, the company and every officer of the company in default and the shareholders concerned shall be liable to fine which may extend to 10 times the value of the gift given and demanded or accepted. The new
provisions, which adopt a radical approach on the subject, need to be examined in proper perspective.

The Department of Company Affairs pursuant to representations of the corporate sector, has issued a directive that no gift should be distributed in the general meeting of the companies. Since this directive has not been issued pursuant to any substantive provision in the Act, it has no legal sanction. Many companies therefore still continue this practice either out of their own will or the compulsion of mollifying shareholders so as to get the business transacted smoothly in the general body meeting.

There is however a contrary view suggesting that the government has needlessly intervened in corporate democracy and, to an extent, done injustice to shareholders. For instance, though much hue and cry is made by company management over cost of holding general meeting when gifts are distributed, when it comes to holding directors’ meetings, cost is no consideration. Such meetings are held in five-star hotel and outstation directors are given airfare as well as expenses for hotel stay, all of which are borne by the company. Directors are also paid sitting fees. For a medium-sized company the cost of calling a board meeting in a metropolitan city is not less than Rs.1 lakh, whereas for big sized companies, it is not less than Rs.2 lakh. Since board meetings of companies are held frequently, there is heavy expenditure on holding of meetings. In some cases, the present researcher observed, that the sitting fees and other allowances are given to the directors, who are not at all present in the meeting, by marking attendance in the minutes.

The board members enjoy many benefits and perquisites, by virtue of their relationship with the company, whereas shareholders enjoyment from the company by virtue of their shareholders position, apart from the dividend is only this gift. Many a time, company have to spend additional expenditure to entertain directors and their family members to keep them in good humour. In the post-liberalisation era, directors have got added clout and respectability.
Corporate management on the one hand cry for more deregulation and liberalisation in the name of good corporate governance, and on the other hand, force the government to include such protective provisions like banning of gifts, which exhibits their hypocritical attitude. After all, shareholders are the owners of the company. They are the residual claimants. There is nothing wrong in distributing some gifts out of their money.

The funny part of the story is that the Government acts in extraordinarily fast manner whenever a representation comes from the corporate houses, whereas the representation from the small shareholders never falls on the ears of the Government machinery - after all it is only a machinery without a heart and soul.

Yet another reason for the poor attendance in the annual general meeting is the remote location of the registered office. Due to incentives offered by various state governments, plants are being put up in declared backward regions which are far away from the state capitals and other major cities. Companies discovered the virtues of holding the annual general meeting in a remotely located factory, where not a shareholder of the company resides. Hence, many companies are trying to shift their registered office to remote corners of villages on the pretext of one or other. This ensures that except the representatives of the promoters and financial institutions, no genuine shareholders will attend, and some employee of the factory may be given proxies. Whenever the management feels that the shareholders in the annual general meeting are active and put them in awkward position, they may take the decision to shift the registered office. By virtue of the provisions of the Companies Act, 1956 the annual general meeting is to be conducted at the place at which the registered office is located. Hence to avoid embarrassing position, at the stroke of the pen, they are able to turn the table against the shareholders.

One such incident has already been quoted viz., the annual general meetings of TANFAC.
(c) Duration of Annual General Meeting

Another factor which indicates the effectiveness of the annual general meeting is the duration of the annual general meeting. To measure the effectiveness of the annual general meeting by the criterion of the duration, the researcher has framed a hypothesis. The hypothesis is that the average duration of the annual general meeting in the state of Tamil Nadu is two hours. For this purpose the present researcher constructed a question. The relevant question is question number 45a in the questionnaire.

“Q. 45a): What is the normal duration of annual general meeting?”

The range of the answer for the above question is 20 minutes to 3 hours with an arithmetic mean of 1 hour and 43 minutes, and a standard deviation of 44 minutes. The median is two hours. The following procedure is adopted for testing the hypothesis by applying the Z test:

Null hypothesis:

There is no difference between the population mean (2 hours) and the actual mean (1 hours and 43 minutes).

Alternative hypothesis:

There is a difference between the population mean and the sample mean.

Level of significance: 5%

Critical value:

The critical value at 5% level of significance for two tailed test is 1.96.

Conclusion:

The calculated value is 1 and hence the null hypothesis is accepted and alternative hypothesis is rejected. Hence it can be concluded that the average duration of the annual general meetings in Tamil Nadu shall be two hours. The responses to the question number 45a is presented in table number 5.5.
Every shareholder is interested in getting back to his normal work after attending the annual general meeting. The Companies Act is specific that the annual general meeting should be conducted on a working day. This attitude is a blessing for the corrupt management who is interested in complying with the rituals and complete the proceedings of the meeting as early as possible. Though normally the shareholders are inactive, they tend to react violently provided a proper leader is available. In the Ralliwolf annual general meeting mentioned earlier, the incumbent management members did not turn up in the annual general meeting. Hence, the shareholders present in the annual general meeting had an opportunity. Had the management attended the meeting, even the dissatisfied shareholders could not have replace by virtue of their voting strength. Another factor which was responsible for the shareholders' activism on that particular date, was the venue of the meeting, viz., Calcutta. Calcutta is one of the major cities where shareholding population is concentrated. Moreover, the mental make up of the residents of Calcutta is different from the citizens of the rest of the country. Hence, one cannot expect such resistance and reaction from the shareholders of other parts of the country.

The present researcher observed that in many companies the annual general meetings are treated as rituals. The resolutions are passed at a fast pace, leaving no chance to the shareholders who have assembled there to discuss and deliberate. At the most the normal duration of the annual general meeting is two
hours. As indicated earlier, some companies have completed the rituals of the annual general meetings within 20 minutes even. The management cannot be blamed for the mistake of ritualisation of the annual general meeting. In fact, the shareholders are to be squarely blamed for such speedier disposal of the important business. The shareholders are more interested in collecting the snacks than drilling the management for their performance. The Companies Act has installed this mechanism of annual general meeting, inter-alia, for the purpose of evaluating the performance of the company by the shareholders. Contrarily, such evaluation is rarely attempted in the annual general meetings. Some shareholders who had attended the annual general meeting at least for the sake of collecting the gifts on the earlier occasions, now do not bother about the niceties of the corporate management. Thereby the aim of the Companies Act, i.e., empowering the shareholders in the corporate governance mechanism to evaluate and change the constitution of the board if required, is defeated.

(d) Venue of the Meeting

The annual general meetings of the company should not be deliberately held at venues or the timing should not be such that, which makes it difficult for most of the shareholders to attend. The company must also ensure that it is not inconvenient or expensive for shareholders to attend the meeting in full. Currently, although the formality of holding the general meeting is complied with, in actual practice only a small fraction of the shareholders of that company do or can really participate therein. The survey results revealed that only 2.18 per cent alone are attending the meeting, even if the meeting is conducted at Madras or Coimbatore. One need not wonder what will happen if the meeting is conducted in a remote village. This virtually makes the concept of corporate democracy illusory and mockery. It is imperative that this situation which has lasted too long needs an early correction. Perhaps the investors profile, at the time of framing the Companies Act, 1956 might have been instrumental in
drafting such proposals like the timing and date of the annual general meeting. Previously, only people who belong to high income group constituted the majority of the investors community. With the dawn of reformations, the representation from the middle income group far exceeded the proportion of the high income group population. Most of the middle income group population are salaried people. It will not be feasible for the shareholders who are employees in some Organisation to apply leave and attend the annual general meeting. Hence, the provision relating to the day, date and timing should be modified, if one is interested in democratisation of the corporate world.

(e) Shareholders Participation in the Annual General Meeting

Shareholders attendance and their participation in the deliberation of the meeting influences the effectiveness of the meeting. At present, one should have either sufficient voting right, a minimum of 10 per cent of voting right, to file a proposal. The annual general meeting is often sidelined by institutions who have access to private meetings, and analysts who have their own briefings at the time of the preliminary financial results. If companies want greater participation by shareholder they could use the event to provide information, rather than to rehearse the details in the report and accounts, which for most part is not forward looking. The researcher also feels that the minutes of the meeting should be circulated to all shareholders with the next routine mailing. The arrangements in the venue of the meeting could also be improved, with microphone and seating plans, which allow fuller participation. Best practice on such issue could be developed in consultation with shareholder groups. Apex institutions like Confederation of Indian Industries, Federation of Chambers of Commerce and the like should play a vital role in developing such infrastructure for the conduct of the general body meeting. The institutions which calls for the protection of Indian industries, when the MNCs are permitted to operate in India, never realised the need to protect the rights and privileges of innocent, gullible,
ingenuous shareholders. When the supposed saviour of the shareholders remained silent, how can one expect the beneficiaries of the system to call for reformation. The institutions like Institute of Company Secretaries of India should come out with plans for strengthening corporate democracy in the corporate sector. The leaders of various forums are merely paying lip service for toning up the Corporate governance system.

(f) Lack Of Unity And Organisation Among Members

In practice, the small shareholders do not form an organised group and are, therefore, not able to influence the decisions about the conduct of the business of the company. On the other hand, the top management or the inner ring is a well-knit and compact group consisting of persons who are much better informed than the general mass of shareholders. As a result, those people who are in control of management are able to see all their proposals through in no time. An authority studied the position in England and found that those holding barely 5% of voting rights can manage the affairs of the company to their liking if the rest of the shareholders are not organised. The researcher framed a question to find out whether shareholders have formed any association of themselves. The relevant question is:

"Q. 67. Is there any Shareholders Association for your company shareholders?
   Yes ⊕ No ⊗

   If yes, i) Address of the Association.

   ii) How does the Shareholders’ Association behave?"

The responses of the company secretaries revealed that 88.88 per cent of the companies do not have any shareholders association. None of the companies having the shareholders association provided the addresses of the association.

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They have also not provided any response to the sub-question viz., “how does the Shareholders’ Association behave?”

One more question was also included in the questionnaire to ascertain whether the small shareholders have formed any group. The question is question number 68, which is given below:

“Q.68. Have small investors formed a group for representation in the meeting:
  Yes   No”

The responses revealed that small investors too have not formed any group. This is not a surprise. This is the pattern prevailing all over the world with some exceptions, as in the U.S.A. and the U.K.

(g) Voting rights

One of the most valuable rights available to a shareholders is the voting right. The voting right is not only an asset but also a responsibility. As the owners of the company it is their right to constitute the board. The shareholders can be exonerated from their responsibility only if they cast their votes in the annual general meeting either in favour of or against the management. From the institutional shareholders’ point of view, the problem does not end there. Voting is not just an altruistic gesture. It is an essential tool in the hands of the institutional investors for the portfolio management.

In the corporate governance process shareholders have three fundamental interests, viz., rights, risk and value. Shareholders first interest is in preserving their rights as owners. Institutional shareholders have long been opposed to practices which diminish their rights as owners, such as the issuing of shares in such a manner to dilute their holdings. In fact, during 1994-95, many companies allotted shares on a preferential basis to promoters at a throwaway price. This eroded the net worth of shareholders, both institutional shareholders as well as individual shareholders. However, neither of them resisted it and had been a
mute spectator. Though the Government permitted such move, institutional shareholders and individual shareholders should have joined together in opposing the move. This is one area, where the shareholders have failed to protect their rights. The small shareholders could not have done anything because of their poor voting strength. However, the institutional shareholders solemn silence as well as the role of SEBI in permitting such companies to increase their stake only, which is supposed to protect the investors, is questionable. Similarly, there are many areas where shareholders need to be alert.

The second concern for the shareholders is to minimise the risk to their assets. Many corporate collapses in recent years can be linked to poor corporate governance. The system suffers from the lack of check and balance on the board, inadequate reporting of financial affairs by auditors and ineffective monitoring by non-executive directors. Though good Corporate governance cannot be a guarantee against loss, it can help to reduce the risk of business failure.

The third interest of the shareholders is to enhance the value of their holdings. Shareholders' activism aims to improve corporate performance and thus enhance returns. Many investors take the view that companies will benefit from a closer relationship between shareholders and the board, particularly on the question of long term strategy. One of the largest pension funds in the USA, CalPERS commissioned a study by Wilshire Associates in 1995 which demonstrated enhanced returns flowing from shareholders activism. A number of activist funds have now been established to exploit this 'Governance effect' in the UK also. However in India such activist funds are not in existence till date.

The rules of voting rights can sizeably influence the result of the election. Different shares can be assigned different voting rights. Even shares of the same variety can be assigned different voting rights. In the U.S., companies may issue
shares carrying more than one vote. However, firms listed on the New York Stock Exchange must comply with the one share-one vote principle. Under Japan's company law, all common stock is subject to the one-vote rule.\textsuperscript{48} Germany's company law has a similar one-share one-vote rule, although companies may issue multiple-vote shares in exceptional circumstances (if the public interest will be furthered).\textsuperscript{49} In the Central East European countries, many company laws allow different shares to be assigned different voting rights. In Poland, for example, one share can have up to 5 votes.\textsuperscript{50} In CSFR,\textsuperscript{51} Hungary,\textsuperscript{52} and Romania,\textsuperscript{53} the total votes of certain shareholders can be limited in the company statute. In this way, ownership can be widely disbursed yet more active and/or experienced shareholders can have greater weight in corporate decision making process. While the one share-one vote rule accords with intrinsic notion of fairness, it does not enhance the effectiveness of shareholder monitoring under conditions of widely disbursed ownership.

In India, a listed company can issue only two types of shares viz., equity shares and preference shares. However, prior to the commencement of the Companies Act, 1956 shares with different voting rights had been issued. However, after the Companies Act, 1956 comes into force, by virtue of section 89 the principle of one vote for one share comes into effect. With reference to the shares already issued, the act provided a period of one year within which the anomaly should be rectified and parity should be introduced with the amount of share capital contributed and voting rights.

By virtue of section 2(48) of the Companies Act, 1956, the total voting power has to be determined with reference to the particular or matters in respect of which votes may be cast at a general meeting. In respect of certain specified

\textsuperscript{48} \url{http://www1.worldbank.org/finance/cdrom/library/docs/gray/gray003b.htm}

\textsuperscript{49} \url{http://www1.worldbank.org/finance/cdrom/library/docs/gray/gray003b.htm}

\textsuperscript{50} Ibid.

\textsuperscript{51} Ibid.

\textsuperscript{52} \url{http://www1.worldbank.org/finance/cdrom/library/docs/gray/gray003b.htm}
matters which affects the preference shareholders, holders of preference shares are given the right of voting at general meeting equally with equity shareholders. In respect of all other matters, equity shareholders alone have the right of voting.\(^4\)

The Companies Act gives the equity shareholders the right to vote. The right to attend and vote at the general body meeting is the most valuable asset in the hands of the shareholders.\(^5\) It is the most powerful weapon in the arsenal of a shareholder. If the proceedings of the meeting are watched, it casts a shadow and a gloomy picture. The net result of the proceedings of the meeting becomes a mockery, if one compares with the expectation. Realising the importance of the voting right, how many shareholders are attending the meetings and participate in the deliberation and exercise their voting rights? It is a million dollar question, which decides about the corporate control and management. As revealed by the survey in the earlier paragraphs, only 2.18 per cent of total shareholders are attending the meeting. To what extent the shareholders who are attending the meeting are contributing to the governance mechanism? Of the shareholders who attend the meeting how many are interested in attending the business. Many shareholders attend the meeting for the sake of collecting their due share of snacks and gifts. If the shareholders fail to collect the and snacks within a short span of time, the snacks may not be available. Hence most of the shareholders who attend the meeting first attend the business of collecting the snacks and gift and then only to the business of the meeting. Many of the shareholders have not yet realised the value of their votes.

Under this situation, there is a lobbying for the issue of equity shares without voting rights. But still it is in the nascent stage. The equity shareholders even if equipped with voting rights are not able to get their due rights. If that is the case, what will happen to the equity shares without voting rights. They may

become another version of preference shares. They may continue to exist by sharing the poverty and not the prosperity of the company.

(h) Defective system of directors' election

The secretaries of the companies are of opinion that the problem can be rectified if the system of election of the directors is rectified. Though the directors are supposed to be elected by the shareholders, the 'inner ring' is able to get most of its own puppets elected as directors. This happens because the holders of the majority of the shares who are present in the annual meeting can elect all the directors. The law requires a separate resolution for the election of each director. As a result, a shareholder with as much as 49 per cent of voting rights can not secure representation in the board, if the other party holding 51 per cent of voting rights in the meeting, so desire. The directors are the elected representatives of the shareholders, only in name. Actually they are instruments of the continuation of the rule of the few at the top. Furthermore, the law requires that one-third of the directors must retire by rotation but it does not prohibit their re-election as such. Need it be said, then, that the same persons continue as directors year after year. The Companies Act permits proportional representation for the election of directors subject to the approval of Articles of Association. The researcher on going through the Articles of Association of all the companies covered under the survey comes to know that no company opted for such proportional representation for the election of directors.

(i) Proxy

Corporate democracy is ensured by the voting process. However it may not be possible for all the shareholders to participate in the annual general meeting to exercise their option. Hence, the system of proxy. The term 'proxy' is used to refer to the person who is nominated by a shareholder to represent him

at a general meeting of the company. A proxy is an agent of a shareholder. The relationship of a proxy and the shareholder is governed by the law of agency under the contract acts. Here the shareholder is the principal and the proxy is an agent. The term proxy also refers to the instrument through which such a nominee is named and authorised to attend a meeting. The right to appoint a proxy is conferred by the Companies Act 1956 upon a shareholder. The legislators are very serious in granting this right to shareholders. Hence, they instruct the companies to communicate to the shareholders very clearly that they have the right of appointing proxies. The Companies Act expressly requires that a statement that a member entitled to attend and vote is entitled to appoint a proxy or proxies and that a proxy need not be a member must be displayed with reasonable prominence in the notice for the meeting concerned. If default is made in complying with this requirement, every officer who is in default is punishable with fine of up to five hundred rupees. [under Sec.176(2)]

The right of shareholders to vote by proxy is first recognised by the English Companies Act, 1948. Similar to the English company law there was no statutory recognition of proxy in Indian company law until the Companies Act, 1956. Under the Companies Act, 1913 a shareholder could exercise this right only in case of express provision in the articles. Under section 79 of the Companies Act, 1913 as amended in 1936 a shareholder was entitled to vote by proxy unless such right was conferred by the articles of the company concerned. However, the present Companies Act confers on the shareholders a right to vote through proxy whether it is provided in the articles of association or not. One more step, in the right direction, to empower the shareholders in fostering corporate democracy.

As for the rights of the proxy, such a nominee cannot speak at the general meeting for which he is nominated nor can he vote unless there is a poll. The

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principle of proxy does not stand the test of parliamentary form. A proxy is a dummy at the meeting whose primary function is to cast the vote only and not to speak at the meeting. It is highly undemocratic to choose an agent to act without any authority to speak. So, the Company Law Committee in England in its Report of 1962 has recommended that a proxy should be allowed to speak at a meeting of a company.\textsuperscript{57}

If an officer of a company invites a member to appoint a person or any of a group of persons as proxies at the expense of the company, he or they will be liable to fine up to Rs.1,000. This fine will not be imposed if the member concerned himself requested the company to send a form of appointment naming the proxy or a list of persons willing to act as proxies and such a list is freely made available to every member [Sec.176(4)]. There is a legal precedence in Peel V.L. & N.W.Rly.Company in exempting a director for such invitation. If the directors acting bona fide in the interest of the company send out to the shareholders proxy papers in favour of the named directors at the expense of the company, they are not punishable.\textsuperscript{58} The exemption helps the management in collecting the votes in their favour at the cost of the shareholders in general. This again defeats the aim of promoting corporate democracy.

Two types of proxies are available in this context. A proxy authorised to vote only on a particular resolution is called a ‘special proxy’ while a proxy empowered to vote on all resolutions in a meeting is a ‘general proxy’. Under Sec.176(6) of the Companies Act and Articles 62 of Table A, an instrument appointing a proxy can be in either of the two forms prescribed in Schedule IX of the Act or as near thereto as circumstances admit. The first of the two forms, or the General Form, merely authorises the person appointed as proxy ‘to vote for me/us on my/our behalf. This implies that the proxy can only cast his vote in

\textsuperscript{57} H.K.Saharay, Principles and Practice of Company Law in India, Nababharat Publishers, Calcutta.

\textsuperscript{58} Ibid.
the affirmative. This is known as ‘One-way Proxy’. Where the appointer desires to provide an opportunity to the proxy to vote for or against a resolution, the second form is to be used. It specifies whether the form is to be used ‘in favour of’ a resolution or ‘against’ a resolution and allows the proxy to ‘act as he thinks fit’ if no specific instruction is given by the appointer. This is known as a ‘Two-Way Proxy’. The use of two-way proxies has, however, been opposed by some authorities on the ground that the right to vote for or against a resolution may be misused by hostile members frivolously to oppose schemes proposed by directors even if they are for the good of the company. This is a propaganda in favour of the management group for preventing the shareholders to use their right, as they desire.

Proxy rules can mobilise the votes of otherwise passive shareholders. Proxy rules are intended as a devise to inform voters about issues and candidates and let them exercise their "ownership voice" through designated agents rather than attend general meetings in person. The impact of the proxy process on corporate governance depends heavily on the specific rules regarding access to information, expense allocation, custodial powers, and control over the process itself. In the U.S. and Japan, incumbent managers prepare ballots and make formal recommendations on the items submitted for shareholder vote. The shareholder then has the opportunity to vote in person or through a proxy (to which the shareholder may give specific voting instructions or may delegate the voting decision). If the shareholder does nothing, that vote is never counted.

Access to shareholder lists in the U.S. tends to be controlled by incumbent managers and directors (who are required to disclose them only to shareholders with a "legitimate business purpose"), making it hard for dissident shareholders to lobby others to vote against incumbent's recommendations. In addition, dissident candidates and proposers of resolutions must pay for the

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reproduction and mailings of their proxy ballots, whereas management's are paid for by the corporation.

In contrast, German rules grant a right to the custodians of shares to vote on behalf of the shareholders. However, the opinion of the shareholders shall be obtained before exercising such rights, on each issue. If the shareholders are silent, it is left to the discretion of the banks to exercise the right. The custodians of shares submit their own recommendations to the shareholders for whom they serve as custodians. Unless the shareholders specify voting instructions, the banks are entitled to vote on those shares according to their own recommendations. Thus, in Germany, the vote of a passive shareholder is voted by an active shareholder, whereas in the U.S.A., the passive shareholder's vote is lost. Not only are more votes cast, but also the votes of passive shareholders are arguably more likely to be cast in their best interests. Most passive shareholders who vote in the U.S.A., vote along with management even though management's proposal may not be compatible with the shareholder's interest. In the German model, passive shareholders' votes will support the custodial bank's recommendation, which may sometimes differ from that of management.

The Indian position vis-à-vis proxy is similar to the U.S.A., model with some changes. The custodians are not given any rights. The passive shareholders' votes are lost. Similarly the custodians as in the case of Germany are not entitled to vote. Even some of the trustees are not allowed to vote with respect to the shares held by them. However, unlike in U.S.A., and Japan, the incumbent management are not making any formal recommendations on the items submitted for shareholders vote. The management will simply send a blank proxy form for authorising another person. Moreover, according to Companies Act, 1956, a proxy can neither participate in the discussion nor vote in the show of hands. According to the revised bill two valuable improvements have been made. The proxy may participate not only on a poll, but also in show of hands and the proxy can also speak at meetings. The oversight role of
intermediaries will be strengthened if their proxy-voting powers are enhanced, as in the German model.

In Japan, the annual general meetings of most of the companies are convened on a particular date, in order to avoid confrontation from a group of troublemakers, known as Shokia. The U.S.A., corporate sector started to feel the pinch of the shokia group, the process of convergence taking place. In India, certain elite citizens who are capable of reading the hidden messages in the annual report are taken care of by the management for making such elite citizens silent by duly rewarding them. But for such sporadic incidents here and there, neither the management is afraid of the groups like shokia or management groups have not yet started the practice of conducting the annual general meeting on the same date throughout the nation. The position is not worse in India. However, most of the annual general meetings are conducted in the month of June. If an individual happens to be shareholders in a number of companies, he cannot attend meetings of all the companies.

To ascertain the position of Tamil Nadu, the researcher has included an item in the questionnaire, bearing the number 47. The relevant question is:

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Proxies</th>
<th>Number of shares represented by the proxies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1993-94</td>
<td></td>
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<tr>
<td>1994-95</td>
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<td>1995-96</td>
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<tr>
<td>1996-97</td>
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</tr>
</tbody>
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The information provided by the secretaries exposed the prevailing situation in Tamil Nadu. The number of proxies attending the annual general meeting, ranged from 5 to 600. Many companies have not provided the details regarding the number of shares represented by the proxies.

(j) Quorum

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Quorum and/or majority voting rules can be adjusted to shift the powers of corporate voting blocks. Company laws generally set minimum requirements for both quorums and voting majorities, although companies are free to set their own rules above these minimum levels. Low quorum figures or majority vote requirements give minority block holders more power to push through their own initiatives if other shareholders are passive; high requirements (say 70 per cent) give minority block holders more power to veto the majority simply by not "showing up" or by voting against a proposal. The former is likely to be desirable if strong action is needed in the face of many dispersed and passive shareholders, as may be the case in countries pursuing voucher schemes of privatisation. The latter may be desirable in certain cases of less dispersed ownership where a minority shareholder wants firm control over the actions of the majority shareholder, as may be the case in joint ventures. In the U.S. the lowest possible quorum figure is 33 per cent, whereas in Japan it is 50 per cent. Germany has no minimum quorum rule. The company laws of East European Countries vary to about the same extent and provide highly desirable flexibility for companies to set rules that best suit their individual needs. The CSFR company law provides a minimum quorum of 30 per cent and requires a simple majority for most decisions, although either requirement can be increased by company statute.

Whereas section 174 of the Companies Act 1956 leaves the problem of quorum to the Articles of Association subject to a minimum of five members personally present in the case of public limited company and two members personally present for any other company (including all types of private companies). Though the Articles can fix up a higher forum, none of the companies surveyed by the present researcher revealed a higher quorum than fixed by the companies act. This provision assists the minority block holders, i.e., promoter group to carry over any resolution without any hitch. As observed earlier, the average attendance of shareholders to the total number of
shareholders is around 2 per cent. Hence the existing law facilitates the smooth conduct of the meeting. However, from the governance point of view, if the quorum figure is raised as in the case of U.S.A., or Japan to a stipulated percentage of existing shareholders like 10 or 20 per cent, rather than the number of persons to be present like 2 or 5, management will be motivated to attract more number of shareholders for the meeting at least for the sake of quorum. But at present they feel annoyed if more number of shareholders attend the annual general meeting as they ask more questions. The incumbent management wants to avoid the shareholders.

The company laws of East European Countries generally have quorum and majority voting rules of 50 per cent unless the company’s articles provide otherwise. Most of the CEE laws also require special resolution (two-thirds or three-quarters) votes at the general meeting for some important decisions, such as changes in the company’s articles, changes in the rights of certain classes of shareholders, or sale, merger, or dissolution of the company.

The U.S., Japan, and Germany all require at least a simple majority (50 per cent) to pass general resolutions, but minimum required majorities for fundamental changes (including amending the Articles of Association, mergers, or dissolution) range from a simple majority (in the U.S.) to 66 per cent (in Japan) to 75 per cent (in Germany). The Companies Act, 1956 also stipulates a 51 per cent majority for a simple majority and 75 per cent majority for special resolution, for seeking some fundamental changes.61

5.7.1.11 Closure of transfer books

Generally, the transfer books of the company are closed in advance of the meeting. As a rule, only those equity shareholders are entitled to receive a notice of the general meeting whose name appear in the company’s register of

members. In this way, many shareholders are denied the right to vote. The practice makes the whole thing a farce; the person who has transferred his shares and is no longer interested in the company meetings throws away the notice as a useless piece of paper while the new transferee who may be eager to attend the general meeting may be told that he is not entitled to receive the notice of the company meeting since his name has yet to be recorded in the transfer register and members' register.

5.7.1.12 Poor Disclosure Practices

Most companies try to paint a rosy picture for the shareholders by avoiding fullest disclosure of material information about the financial position of the company. As an instance, the operating results of various divisions may not be reported separately to the shareholders, so that they may not get information about the less successful departments running at a loss. In this way, lack of proper reporting of accounts etc to public helps the existing management in getting away with a report which reveals what is beautiful and conceals what is vital. With the arrival of SEBI, lot of improvement has been made in this area. Formerly companies used to publish results at the end of the year. Now the companies are to reveal the even the quarterly results. Segment wise reporting also becomes compulsory. Still a lot of improvement has to be made in order to declare that the corporate world lives in a democratic manner.

5.7.1.13 The ineffectiveness of employee shareholders

In the modern progressive companies, the employees are increasingly being given bonus shares and are thus being admitted to the ranks of shareholders. In companies where the number of such employee is sizeable, the existing management is able to browbeat and control them to its own advantage. This is easily done under the present system of voting according to which the votes are recorded by show of hands, and in exceptional cases through a poll.
The employees will naturally side with the existing management when they know that they are themselves at its mercy.

5.7.1.14 Corporate industrial groups

An important finding of Dr. R.K. Hazari and other authorities, committees and commissions is that the existence of a few big business houses or industrial groups in the corporate sector is directly responsible for the present-day evils of concentration of economic power. It may be said in continuation of this line that the prevailing oligarchy in company management and its evil can be traced to these very groups in large measure. For a long time, these groups functioned through the managing agency system which gave them some kind of lease of management for a long period. With the abolition of the system, these groups have undoubtedly lost an important tool but the very same promoter who controlled the company through the managing agency system, now they are in a position to control through the Board of Directors. The groups have been trying to retain their stranglehold on companies through various means like Boards of Directors, managing directors, managers and the most recent of them, the industrial consultants.  

“Ownership based governance is likely to reduce the corrupting influence of unaccountable power on government. At the same time, by transforming corporations into more democratic institutions, shareholders can unleash the wealth-generating capacity of ’human capital’ which is based in the skills and knowledge of corporate employees”. In other words, shareholders’ democracy is the need of the hours. All the constituents, Government, shareholders, promoters group, management – if it is different from the promoters’ group – should actively promote and propagate the concept of shareholders democracy in the interest of all the constituents including the society at large. Once the
shareholders are tuned to corporate democracy, they will pay attention to the political democracy also. The present state of affairs of corporate democracy is the reflection of the society’s attitude towards democracy. In assembly and parliamentary elections, the turn out of voters is around 40 per cent. The absence of this realisation on the part of the citizens is responsible for such a poor turnout. If the citizens as shareholders realise the value of voting, it requires no time for them to understand the significance of voting in the public elections. Ultimately the society is stand to gain.

5.7.1.15 Failure of Financial Institutions

The failure of corporate democracy can also be attributed to the institutional investors holding shares in the companies. Had the financial institutions exercised their due right by attending the annual general meeting of all the companies in which they are holding the shares, a lot more would have been achieved. The institutional investors remained, by and large, inactive. The reasons for such behaviour is political interference. The financial institutions have to dance according to the tune played by the ministers in the North Block. Hence, they remained inactive and failed to register their protest for poor or some times even worst corporate practices. By virtue of their voting right a lot would have been achieved, if the financial institutions have been permitted to act. It is a misfortune for the individual shareholders as well as the nation for having permitted and encouraged corporate houses to utilise the public money for their personal interest and not in the interest of the public or even that particular company.
This chapter evaluated the roles of different types of shareholders in the corporate governance mechanism. The rights available to the shareholders and to what extent such rights are utilised are also evaluated. There are two types of shareholders viz., individual shareholders and institutional shareholders. Shareholders are the owners of the companies. They are the residual claimants. Therefore they have to review the performance of the board. The chapter describes how the shareholders monitor the performance of the companies. If they are not satisfied, what they can and what they are at present doing is highlighted. The institutional investors are also shareholders with voting rights. In fact, they are far more powerful than the individual investors. To what extent they exert influence in the corporate democracy is also attempted at. The institution of nominee directors is also evaluated. The nominee directors, representatives of institutional investors, are also directors in the eyes of law. Therefore, an attempt was made to highlight their liability. In theory, democracy is said to prevail in the corporate sector. However, in reality, it is not there. Oligarchy rather than democracy is the order of the day, in the corporate sector. Reasons for this phenomenon are highlighted.