



Developments in shareholder activism in India

Dr. Vandana Gupta

Associate Professor, Department of Commerce, Deen Dayal Upadhyaya College, University of Delhi, Dwarka, New Delhi, India

Abstract

In the last two decades concerns regarding sound corporate governance system and practices in listed companies have gained quite an attention as large amounts of money is being invested by retail investors. This money finds its way in the coffers of companies through Initial Public offers (IPOs) and through investments in mutual funds. All this has been possible due to the rigorous and intensive efforts of the capital markets regulator, SEBI and Ministry of Corporate Affairs. This is done by bringing out changes in the existing rules and regulations and introducing new guidelines to safeguard the interests of the investors. More responsibilities and duties are now entrusted to big institutional investors like mutual funds, pension funds, insurance companies and independent directors on the boards to monitor the decisions of promoters. This paper traces the rise of recent investor activism and discusses the latest developments in this area of corporate governance.

Keywords: SEBI, related party transactions, minority shareholders, institutional investors funds, the companies act, 2013

Introduction

A company form of organization creates agency problems as the owners (the shareholders) and its management is different (Jensen and Meckling, 1976) ^[22]. Companies in India and for that matter around the world are predominantly managed and controlled by families. Thus, they are able to appoint the various categories of directors collectively known as the Board of Directors which formulate strategies and provide direction to the fulfillment of goals and objectives of a company. They appoint the key management personnel for the company. The small shareholders known as the minority shareholders do not have much say. In such a scenario the role of shareholder activists is quite significant. They are often looked upon as shareholders who are not satisfied with the working of any particular aspect of the company and would thus like to see radical transformation in its working (Gillan and Starks, 2007) ^[16]. One of the important characteristics of the listed companies in India is virtually all of them are family owned. There is a high concentration of ownership by the promoter groups (Ertimur, Ferri and Muslu, 2020) ^[9] which significantly control these companies (Ghalke *et al.*, 2023) ^[14] compared to the US where the ownership is widely spread and it is difficult to recognize a single promoter (La Porta, 1999) ^[25].

Increased shareholder activism has brought to light serious lapses and shortcomings in the functioning of renowned and big listed companies which brought to fore the role played by their promoters and highlighted their utter lack of professionalism (Biswas and Chakraborty, 2024) ^[24]. Some of such examples are Fortis Healthcare in 2018, where investors put forward their issues related to financial irregularities and serious corporate governance lapses. The institutional investors supported more clear working and answerability. In case of Coal India Ltd in 2019, the shareholders raised their concerns related to managerial remuneration, payment of dividend and certain corporate governance practices. Again, the institutional investors pointed out that there be more participation and engagement by shareholders in the working of the company (Biswas and Chakraborty, 2024) ^[2].

Therefore, the role of institutional investors which comprise domestic financial institutions, mutual funds, pension funds, large brokerage houses and foreign investors becomes pertinent in monitoring the decisions of a company. Globally, it has been observed that these institutional investors have a significant impact on various aspects of the working of a company (Velte, 2023; Drobetz *et al.*, 2022) ^[6, 43]. They are now an important stakeholder in listed companies as they own around 41% (US \$31 Tn) of market capitalization globally (Cruz, Medina and Tang, 2019) and thus have substantial influence on the voting on important decisions by companies (Dyck *et al.*, 2019) ^[7]. According to Prime Data base Indian securities markets have also witnessed the rise of institutional investors. Currently, the domestic institutional investors' (DIIs) ownership in the equities of listed companies is at an all-time high of around 17.2% increasing from 16.89% in the end of last calendar year. This is the result of a phenomenal net investment of Rs. 1.89 lac crore in the first quarter of the current financial year. It is important to see that it has overtaken the foreign institution investors (FIIs) share of 17.22%. Therefore, one can very well see the vast amount of money these institutions manage and the power and clout they bring to the Indian Capital markets. Lately, there has been a drastic increase in investments made by retail investors in mutual funds through Systematic Investment Plans (SIPs) with around Rs. 1.16 lac crore coming in the first few months on this year. Collectively, these mutual funds' share in firms on National Stock Exchange of India (NSE) is 10.35 %. The investments made by domestic insurance companies was to the tune of Rs. 47,500 crores. At the same time the alternate investment funds and Portfolio Management schemes bought securities worth Rs. 3,885 crore and Rs. 1,300 crores respectively. Despite this huge amount of investment and ownership in companies it has been observed that domestic financial institutions and mutual funds hardly participated in their corporate governance mechanism (Sarkar and Sarkar, 2022) ^[32].

Extant research in shareholder activism in India shows an impressive increase in the recent years (Shingade *et al.*, 2022, Islam, 2020) ^[20, 40]. One sees a drastic increase in the

resolutions from the management which has been turned down largely by the institutional investors after the introduction of a series of new regulations and reforms (Shingade *et al.*, 2022) ^[40]. This paper examines the recent developments in the shareholder activism in India and traces the reasons behind the same. The remaining paper is structured as follows. In the following section we do a literature review of the existing research in this area. Section 3 examines the new regulations brought out by SEBI to enhance corporate governance in Indian companies and for giving more responsibilities to institutional investors. Section 4 looks at the role of institutional advisory services in improving investor activism. Section 5 discusses the introduction of new provisions in the corporate laws in this direction. Section 6 examines the growing role of institutional investors in shareholder activism while section 7 highlights the stewardship code for insurers and pension Funds. The final section concludes.

Literature Review

In an important work Gillan and Starks (2007) ^[16] review the research carried out on various issues related to corporate governance and look at how activism which forms the basis of these issues affects the value for shareholders. They also look at the many different way's investors raise their concerns with the management of the firms; the different motives for shareholder activism; does it actually work and also examine the growing role of institutional investors in shareholder activism. A very comprehensive study was undertaken by Irfan *et al.*, (2023) to look at the role of institutional investors in enhancing the corporate governance through actively voting on resolutions in the meetings of the companies. They find that investor activism by such investors has seen an improvement in areas particularly related to corporate governance practices, related party transactions and directors' remuneration. They further observe that there is a growing tendency by mutual funds to rely on the advice given by proxy voting advisory services for voting on the proposals put forward by the management. However, they add that these institutional investors are unable to influence and change the decisions as the promoters have a majority of votes. Islam (2024) ^[21] does a detailed study on various aspects of shareholder activism. He brings out the major developments that have taken place in the area of shareholder activism in India particularly on the legal front and brings out the motives for undertaking shareholder activism and whether or not it has been able to bring out any positive changes. He finds a vast improvement in the instances where institutional shareholders have put their foot down on proposals put forward by the management particularly in the areas of corporate governance. He also finds evidence to show that there is a vast enhancement in financial performance.

Studies also show that generally the stance of the corporate governance policies have been towards resolving the conflicts between small shareholders and large shareholders and not on the agency problems of principal and agent in mature markets (Islam, 2024; Islam, 2020; Gupta, 2014) ^[18, 20, 21]. Biswas and Chakraborty (2024) ^[2] look at the changes in shareholder activism in the recent years and specifically look at three prominent legal cases which help to shape the present shareholder activism movement in India. They also reflect on the future prospects. Geis (2024) ^[13] concluded that the majority of Indian companies have high promoter

group ownership which would not cause them to be concerned about shareholder activism. Though the researcher feels that independent directors who have been given a larger role in governance would definitely help. Finally, better shareholder involvement could serve in reducing agency conflicts. The new regulatory changes could help protect the small investors and protect them from expropriation of resources by the majority shareholders by enhancing their fiduciary duties and responsibilities. This would be particularly useful in cases of related party transactions and other forms of oppressive behaviour. Brav *et al.*, (2008) ^[3] are of the opinion that the purpose behind shareholder activism could be either financial and/or social. In the same light Gillan and Starks (2000) ^[15] contend that one of the main reasons behind financial motives could be to enhance performance of companies for protect the interests of the investors and increase shareholder value. Lai *et al.*, (2023) ^[27] find the institutional investors and other big investors who have controlling stake could substantially enhance the corporate governance mechanism in these companies. The direction of study by Rashmi (2019) ^[31] is towards the regulatory changes brought in favour of shareholders and the advent of shareholder activism by using a case study approach. Varottil (2012) ^[42] concludes that shareholder activism has been the result of changes in the legal structure and regulatory changes which now ensure a better participation by investors in the decision making of firms. He also finds the emergence of proxy advisory firms as a positive step.

Introduction of New Regulations by SEBI

The Securities and Exchange Board of India (SEBI) has put in place many rules and regulations to augment the quality of corporate governance practices. From time-to-time various amendments are also carried out to further strengthen these regulations and to keep abreast of the changing times.

1. Listing Obligations and Disclosure Requirements (LODR), 2015

SEBI now requires all listed companies to adhere to these regulations. These are comprehensive set of guidelines to ensure that the publicly listed companies strictly follow the norms laid down for corporate governance and provide timely, accurate, and transparent disclosures to shareholders and other stakeholders. They also provide the manner in which the listed entities would share and report critical and important information with the stakeholders in a timely and well-organized manner. These regulations combine all the rules which are foremost in guiding a company's duties and responsibilities from the moment it enters into a listing agreement with a stock exchange whereby its securities are available for trading to its day to day working and functioning. It seeks to achieve many objectives which include safeguarding and ensuring transparency in operations of its business; to strengthen various corporate governance mechanisms in the business entity; to ensure timely disclosures of information and safeguard the interests of various classes of investors; it seeks to standardize the disclosure requirements for all listed companies. These regulations are quite exhaustive so as to cover a wide range of activities together with financial reporting, structure of the board, rights of shareholders, and timely dissemination of material information to all stakeholders. They contain

important stipulations to significantly improve involvement by shareholders. The amended Listing Obligations and Disclosure Requirements (LODR), 2018 have ushered in noteworthy changes in disclosure requirements and greater transparency and answerability of top management of firms. The listed entities are now required to phenomenally disclose information which pertains to their corporate governance structures and practices. These include to disclose the structure of the board, the manner in which the directors are appointed and reappointed; their qualifications etc. The objective of the market regulator is to reduce information asymmetries by better disclosures by companies to the stock exchanges and for faster; better dissemination of information in the market and to reduce agency costs. It seeks to ensure that the investors are better informed about the financial and operational performance of the company where they have sometime put in their lives' savings. Such regulations put in force the right checks and balances and strong internal controls necessary for the outsiders to have faith and trust in the functioning of the company. At the same time the regulations envisage punitive actions and detriments to the top management and the board of directors to follow these regulations in the true spirit of the word and not merely to provide lip service.

2. Compulsory Disclosure of voting policies by Mutual funds (2012)

SEBI has made it mandatory for mutual funds to disclose their voting policies (SEBI, 2012). It has introduced sweeping new rules and regulations to enhance disclosures, for investor education and consciousness campaign, for developing alternate supply networks for products of mutual fund products (SEBI, 2014). These changes widely affect the whole gamut of professional investors existing in the financial markets. These investors do not remain silent anymore but are mandatorily required to be more involved in companies by exercising their power through their voting rights to assert on positive changes that they would like to see in their investee companies for safe guarding their investments. This is an important change in the corporate governance practices of mutual funds which has been made possible by SEBI which has brought about whole array of guidelines for mutual funds for casting their votes on decisions in investee companies (SEBI, 2012; Irfan *et al.*, 2023). It is also observed that investors now take better informed decisions and about their rights. There has also been a steady rise in investors which own a large quantity of shares in listed entities (Khaitan and Company 2023) ^[23].

3. SEBI (Research Analysts) Regulations (2014)

SEBI has also brought about SEBI (Research Analysts) Regulations, 2014 in order to regulate a very important segment of research analysts who prepare equity and industry reports which sometimes form the basis of an investment decision by an investor. These regulations stipulate the necessary requirements for acting as a research analyst or for setting up of any research organization. These entities now require the consent of SEBI and are required to register with it. Before granting the registration, SEBI would look whether they possess the right kind of educational qualifications, experience and expertise of working in the securities market. Since the stock markets move and thrive on information, it is critical for the market regulator to oversee that they it should not be misled. This

could be the result of any wrong information or inputs provided by equity or industry reports prepared by equity research analysts or research-based organizations. Adherence to these regulations would go a long way in protecting the interests of shareholders. The regulations also now regulate the proxy advisory firms which have lately become very important in providing expert advice to mutual funds and other institutional investors on how to vote of resolutions brought forward by the management in the annual and extraordinary meetings of companies.

4. Share Capital and Debenture Regulation (2014)

Introduction of these regulations now ensure that shareholders of listed companies get to know about any changes that have been made in the capital structure of a company (Aslam 2023). The stipulations contained in these regulations make it mandatory for a company to get the consent of the shareholders, if it wishes to issue new securities of any kind whether these are equity shares or bonds or debentures. This is a very significant development as any changes in the capital structure of a company, changes the risk of the stakeholders and can affect the company's future cash flows and the returns in the form of dividends expected by the shareholders or the return of the principal payment at the time of redemption of dentures and the timely payment of their interests by the debenture holders.

5. Stewardship code for Mutal Funds and Alternate Investment Funds (2020)

Looking at the phenomenal growth of assets being managed by mutual funds and alternate investment funds and the extraordinary increase in other number, SEBI brought in a very comprehensive and exhaustive code for them. This came in the form of Stewardship code for Mutal Funds and Alternate Investment Funds (2020). The rationale and the objective behind this were to ensure that such large institutional investors which have substantial ownership stake in the listed companies in India should take their fiduciary responsibilities towards their clients more seriously. The aim was to inspire these investors to execute the best possible stewardship practices. This would require them to be better informed about companies they invest in; to periodically discuss with their top management, and if, the need be with their board of directors on matters, they feel are important and crucial for the future prospects of the investee companies.

Emergence of Institutional Investor Advisory Services

There has been an advent of proxy advisory firms which advise institutional investors on voting on resolutions in the annual general meetings of companies where these institutions have invested. At present, there are three major proxy advisory firms operating in India. These are Institutional Investor Advisory Services (IIAS), InGovern and Stake holder Empowerment Service (SES). Khaitan and Company (2023) ^[23] observe that such advisory services may have been instrumental in influencing the voting patterns of institutional investors who seek advice from them and thus have significantly contributed to the growth of shareholder activism in India. However, (Fukami *et al.*, 2022) ^[10] contend that these firms may not be very effective in voicing their thoughts against the management of companies as they are contained to represent only minority

shareholders. Sinha and Kerani (2021)^[39] show how they helped in thwarting the efforts of Shriram Transport Finance Company to reappoint an independent director. They highlight that there is a phenomenal increase in the importance being given to proxy reports generated by these advisory firms. Garg (2018)^[11] opines that when these institutional investors may not have the required knowledge and expertise in deciding about their voting on resolutions put forward by the management then such firms could be very beneficial. Such proxy advisory firms also contribute to strengthening the corporate governance framework by conducting a thorough review of companies' corporate governance practices. Particularly, they do a detailed study of the efficiency of the board of directors, how diverse the board is; various aspects of managerial remuneration and compensation, procedures and mechanisms for compliance of regulations, efforts in protecting the rights of shareholders. Thus, it is crucial that any recommendations provided by these agencies help in promoting and strengthening their corporate governance frameworks consistent with the best practices followed in the industry (Mittal and Sharma, 2024)^[28]. It is also noted that these firms may have a small part in corporate governance in contrast to their counterparts in the USA due to factors such as "concentrated shareholding structures, lack of accountability, resistance to best practices, limited awareness about proxy advisory firms, limited resources, and absence of effective stewardship duties exercised by investment advisors" (Khurana, 2023)^[24].

Changes in the Companies Act, 2013

New provisions have been introduced or amended in The Companies Act, (2013) which came into force after the repealing of the earlier Companies Act of 1956 to promote better transparency, accountability, and good corporate governance practices. Some of these provisions which are relevant and important for protection of the rights of the minority shareholders; for strengthening corporate governance mechanism in companies and for shareholder activism are being discussed below:

1. Class Action Suits

The Companies Act, (2013) through section 245, now provides new powers to the minority shareholders, depositors or any class of shareholders by empowering them to file a class action law suit against the company, if they feel that its management is carrying out the functioning of the company in such a manner which is detrimental to their interests or are unfavourable towards them (Rashmi, 2019)^[31]. Such an application can be made to the tribunal on behalf of the shareholders or the depositor.

2. Appointment of a Director

Section 151 now empowers the minority shareholders of a listed company to appoint a director on its board which would specifically protect their interests. A small shareholder is defined as the one who own shares not exceeding Rs. 20,000 in value of a company. More attention is now being paid to related party transactions by audit committees (Rajarao, 2015)^[30]. Numerous initiatives in strengthening and improving the corporate governance mechanism attempts to reduce agency problems arising out of minority and majority shareholders' conflict instead of resolving conflicts arising out of agency problem between

the principal –the shareholders and agents–the management of companies. In the past, shareholder activism led to changes in management and board composition. For example, two large shareholders of Fortis Healthcare Limited were successful in removing a director and appointing a new one in 2018.

3. Electronic Voting

It now prescribes the manner in which the investors can cast their vote through electronic voting (section 108). Shareholders can e-vote through platforms provided by NSDL or CSDL using their demat account credentials. Moreover, it is now possible for the companies to do the meetings through video conferencing in at least five locations in India (Rashmi, 2019)^[31]. It has brought in a very big change wherein shareholders are not required to physically go to the place of the general meetings of companies but can cast their vote electronically.

4. Related Party Transaction

Approval of related party transaction by minority shareholders is postulated in Section 88. It now requires that the Board must pass a resolution to give their consent for related party transactions. The directors are also required to report to their shareholders the same along with the necessary reasons and rationale for entering into such contracts (Rashmi 2019)^[31]. In a recent study, Irfan *et al.*, (2023) find that institutional investors have become very active in issues specifically related to related party transactions which have been a bane of Indian corporate; on issues related to corporate governance; on fixation of managerial remuneration and compensation.

5. Appointment of a Woman Director

SEBI now mandatorily requires that the top 500 companies based on their market capitalization which are listed on the stock exchanges must appoint a woman director on their boards. SEBI fixed the date as April 1, 2019. It also requires that the top 1,000 listed companies on the basis of their market capitalization must appoint a minimum of one independent woman director latest by April 1, 2020. Section 149 (1) stipulates that all companies must appoint a woman director within six months from incorporating a company. Section 149 (2) also provides that the existing companies must appoint a director within one year. It was observed that during the nine years from 2013 to 2022, the woman representation on boards of Indian companies improved drastically from a meagre 6% in 2013 to 18% in 2022 (EY India, 2022)^[8]. Thus, the compulsory fixation of a minimum of gender quota requirements yielded good results. Though it may only be a gesture of tokenism.

6. Constitution of an Audit Committee

Section 177 now provides for structure and functioning of Audit Committees in listed companies. At least three board members shall constitute the committee and independent directors should form a majority of the committee. This Committee is formed of board of directors with the Chairperson being an Independent Director. The chairperson and majority of members must be capable of reading and understanding financial statements. This committee has wide ranging powers and responsibilities for overseeing financial reporting, for putting in place adequate internal controls as befitting the size and operations of the business,

to put in place risk management structure This Committee is entrusted with the responsibility of safeguarding transparency, responsibility, and truthfulness in corporate governance structures. It has to see that the financial statements prepared by the company can be relied upon as to its accuracy and fairness and they adhere to the regulatory norms prescribed for their preparation. The committee should also review the significant accounting policies and estimates used in their preparation. It has to monitor the efficacy of internal control systems and risk management processes and address any identified deficiencies. The Committee also appoints both the statutory and internal auditors and their compensation. A listed company has a very big legal and regulatory environment. This Committee is responsible for overseeing all such compliances and to regularly monitor observance to proper benchmarks and ethical practices in every sphere of corporate life. It has the duty to create an environment for accounting reporting and auditing. It is stipulated that at least one member of the committee must possess experience related to finance, law or accounting.

7. Prevention of Oppression and Mismanagement

Through section 241 any member of a company is empowered to apply to the tribunal if they feel that the affairs of the company are being carried out in a prejudicial or oppressive manner and which are not in the interests of the company. On June 1, 2016, a National Company Law Tribunal was set up under the Companies Act, 2013 for quick and immediate redressal of investor complaints. Since its setting up many cases have been filed with the tribunal.

Growing Role of Large Institutional Investors

Companies in India are controlled by family promoters who hold phenomenally high shareholding in publicly listed companies through cross holdings, Hindu Undivided Families (HUF) and through Trusts. HUFs are a unique way to control ownership which is only found in India. Thus, in such a scenario of weak corporate governance mechanisms, the significance of large institutional investors in monitoring activities of promoter owned firms is of paramount significance. Concentration of ownership by a handful of shareholders is supposed to be a significant mechanism of corporate governance as these owners impact the processes, procedures and running of a company (Jensen and Meckling, 1976^[22]; Shleifer and Vishny, 1986^[41]; Nguyen, Locke, and Reddy, 2015)^[29]. Extant literature posits that the presence of institutional investors in companies help to enhance their performance and valuation by the stock markets (Yuan *et al.*, 2008)^[44]. Research by (Huang and Zhu, 2015^[19]; and Zhao *et al.*, 2021)^[45] examine the impact which large shareholders can have on corporate frauds in listed companies in China for the period 2010-2018. Their findings suggest that such investors in companies drastically lowers the likelihood and occurrence of frauds. This amply proves that institutional investors are effective monitors in supervising the activities of the boards and strengthen the internal control mechanisms. It's pertinent to note that in the last few decades there has been an incredible growth in active participation and voicing of concerns by institutional investors in the functioning of companies. (Lewellen and Lewellen, 2022)^[26]. Mutual funds are now more and more relying upon the expert advice provided by proxy voting services on crucial and critical resolutions on which they are

mandatorily supposed to vote in the companies where they hold investments. However, they are unable to significantly change the outcome of such resolutions as the majority of ownership still vests with the promoters (Irfan *et al.*, 2023). The importance of these investors can be gauged from the fact that they exercise control over 70% of equity share capital in the USA (Bebchuk *et al.*, 2017)^[1].

Stewardship Code for Insurers and Pension Funds

On the lines of stewardship code issued by SEBI for mutual funds and other alternate investment funds, The Insurance Regulatory and Development Authority of India (IRDAI) in March 2021 came out with its Stewardship code to ensure that insurance companies should interact with investee companies regularly to safeguard their investments (Aslam 2023, Goel *et al.*, 2022)^[17]. The Pension Fund and Regulatory Authority (PFRDA) issued its own code in 2021 for pension funds.

Conclusion

This paper examined recent developments in investor activism in India and looked at the various regulatory changes brought out in the corporate laws and by the Indian capital markets regulator, SEBI. Strengthening the existing corporate governance mechanism, changes in the composition of the board of directors and making them more accountable and responsible for the actions of listed companies. Emergence of proxy advisory firms which give their advice on resolutions proposed by the management of companies in their annual general meetings have a vital part in monitoring activities of promoters and management. Institutional investors like mutual funds have been forced by SEBI to become more active in participating in voting on important issues like appointment and reappointment of directors, fixing their compensation and on issues related to corporate governance. Mutual funds are now also required to reveal their voting patterns. Enactment of stewardship codes by the various regulatory authorities shall positively see more responsible and active involvement by institutional investors in monitoring the investee companies. All these recent measures will go a long way in enforcing a stricter compliance of safeguarding the interests of shareholders particularly the small or minority shareholders and a better corporate governance mechanism for listed companies.

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