

## EVOLUTION OF CORPORATE GOVERNANCE AND PROTECTION OF THE RIGHTS OF MINORITY SHAREHOLDERS

Tamanna Nayeem\*

### Abstract

*What comes to a person's mind when he thinks about corporations? It is usually imagined as a large company consisting of more than hundred employees. With these many people working together within a company there has to be a code of conduct which is to be followed by the employees so that no one abuses each other's rights. That code of conduct is called as corporate governance.<sup>1</sup>*

*Corporate governance is the process of directing and controlling a company. There have been a lot of conflicts arising between the management of the company and the shareholders due to the ownership division between the managers and the shareholders of the company. However, there are various rules existing for the protection of the rights of the minority shareholders been incorporated in the new Companies Act 2013, so that the powers are not abused by the majority shareholders. The rules of protection do exist but are either not efficient enough or are not implemented properly. This gap in the corporate governance regulatory framework can only be filled by propagating the laws relating to minority shareholder's right. The legal reforms taking place has renewed the role of shareholders as subject of great debate.<sup>2</sup> This paper will be dealing with the evolution of corporate governance and protection of the rights of minority shareholders.*

**Keywords:** *Evolution, Corporate Governance, Protection, Rights, Minority Shareholders*

---

\* Student-LL.M. @ Jindal Global Law School, O.P. Jindal Global University, Sonipat (Haryana); Email: [tamannanayeem@gmail.com](mailto:tamannanayeem@gmail.com); Contact: +917411815107

<sup>1</sup> Klazema (2014) 'The importance of corporate governance', *Udemy Blog*, <https://blog.udemy.com/importance-of-corporate-governance/> (Accessed 15 November 2016)

<sup>2</sup> Sara Pockkathayil Jacob, Shareholders' rights and empowerment in India & U.S. <http://arno.uvt.nl/show.cgi?fid=128853>

## INTRODUCTION

The country has seen a lot of major scams and scandals in the past few years. These scams and scandals have shaken the foundation of a lot of companies. These scams reveal the most commonly existing condition in the country i.e. lack of proper management. With the failure of companies like SATYAM, Enron etc. the need to improve the level of corporate governance in India was felt, and a committee was constituted by the SEBI (Securities Exchange Board of India) considering the emergence of best practices of corporate governance all over the world i.e. Cadbury reports, Greenbury committee reports etc.

Managing a company is like running that company and corporate governance is the procedure to see that it runs efficiently. The term 'governance' refers to the process of governing and 'corporate governance' refers to the process by which a company is governed. The concept of corporate governance has gained importance because of the demand of the public for a regulated and a more transparent market in order to cope up with the challenging environment. Sound corporate governance helps the companies to operate in a more efficient manner. Corporate governance is the framework as per which the business decisions take place.

The owner of a corporation is the shareholder and the effectiveness of corporate governance depends as to how the rights of the shareholders are protected. The recent financial crisis and failure of companies as discussed above had an eloquent impact on the shareholder's view on corporate governance, raising the question of their voices being heard in the management of the company.

The old Companies Act 1956 consisted of basic framework with which the companies were to be regulated. With the incorporation of certain provisions in the new companies act 2013, the minority shareholders have gained importance because the new provisions incorporated provide a check on the powers of the board of the companies.<sup>3</sup>

A committee on corporate governance was created by SEBI (Securities Exchange Board of India) considering the emergence of best practices of corporate governance all over the world i.e. Cadbury reports, Greenbury committee reports etc. This was done to raise the standard of

---

<sup>3</sup> SEBI, Available at: [http://www.sebi.gov.in/cms/sebi\\_data/boardmeeting/1392730475840-a.pdf](http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1392730475840-a.pdf) (Accessed 16 November 2016)

corporate governance of all the listed companies by inserting a new clause in the listing agreement i.e. clause 49.

The shareholder's trust has been shaken after the recent SATYAM scam where on average a shareholder lost about \$2.8 billion.<sup>4</sup> Unlike other countries, India follows an insider model of corporate governance,<sup>5</sup> where most of the companies are either controlled by the state or controlled by the family. Thus the corporate governance models of other countries are not much efficient here because of the issue of insider model of corporate governance being followed. This paper deals with the issue of protection of rights of minority shareholders with the present form of corporate governance and possible measures to improve the condition of the minority shareholders.

The structure of this paper starts with a brief introduction of corporate governance and minority shareholders under part I. The II part deals with the rights of the minority shareholders. Part III of the paper deals with the possible measures to improve their condition. The paper ends with the conclusion.

## **MINORITY SHAREHOLDER PROTECTION**

To start with the topic, it is important to understand who minority shareholders are and what the rights available to them are. Technically, a man who possesses even a solitary share is a minority shareholder yet this term applies to people who claim the shares in the organizations with bigger stake. Thus a minority shareholder is the one who holds less than 51% shares in a company for example a person having 5% shares in Johnson n Johnson will be considered as a minority shareholder.<sup>6</sup> A company's main concern is to protect the rights of minority shareholders. The rights of the minority shareholders are bound to be protected where there is proper corporate governance. And thus in order to protect the rights of minority shareholders, effective corporate governance is demanded. The companies Act of 1994 had this provision of protecting the minority shareholders as their priority but it is evident from the records that

---

<sup>4</sup> Tellis, O. (2009), "Whiter Justice for Satyam Investors?", Deccan Chronicle, December 02. <https://www.questia.com/library/journal/1P3-2170212581/satyam-fiasco-corporate-governance-failure-and-lessons>

<sup>5</sup> Varottil, U., "A Cautionary Tale of the Transplant Effect on Indian Corporate Governance", National Law School of India Review, Vol. 21, No. 1, 2010, pp. 1-49. [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1331581](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1331581)

<sup>6</sup> Farlex (2003) 'Minority shareholder', in Available at: <http://financial-dictionary.thefreedictionary.com/Minority+Shareholder> (Accessed: 16 November 2016)

the act has failed to deliver the security to the minority shareholders that were expected from the act.<sup>7</sup>

The main framework of effective corporate governance should be based on providing an equal treatment to all the shareholders who includes the equal treatment of minority shareholders because they should be treated as other shareholders. There should be a proper mechanism in order to ensure that the minority shareholders have reasonable grounds to believe that their rights in the company are protected. The directors of the company keep using the minority shareholder which has led to a lack of faith among the minority shareholders and that is why a strong need for an efficient corporate governance to govern the organisation has become the need of the hour so that no more minority shareholders are exploited.

There are various conducts done by the directors of the company and the majority shareholders which results in the exploitation of the minority shareholders and some of the conducts can be termed as frauds with the minority shareholders and are discussed below:

- The actions taken by the directors have to be discriminatory.
- The actions taken by the directors have to be in contravention of the provisions of the company.
- As it was held in the case of *Hogg v. Dymock*<sup>8</sup>, any improper exclusion of a minority shareholder from the management of the company was regarded as discriminatory and thus was regarded as oppressive to the minority shareholders.
- As it was held in the case of *Foody v. Horewood*<sup>9</sup>, it was held that the failure of the directors of the company to act in contravention of the provisions of the company and not giving proper notice to the minority shareholders about the meeting to be held was regarded as fraud done to the minority shareholders.

An economist indicates that equal protection of the rights of the minority shareholders is as important as equal treatment to other shareholders because these minority shareholders contribute a lot in the success of an economy.

---

<sup>7</sup> Priyanka Kanta Bose, "Corporate Governance & Plight of Minority Shareholders: An Attempt to Reconcile" <http://jassh.in/index.php/jassh/article/download/49/77>

<sup>8</sup> (1993) 11 ACSR 14

<sup>9</sup> (1995) 13 ACLC 1113 ; 17 ACSR 478

A minority shareholder is the one who does not exert control over the company. Majority shareholders are the one who have absolute control over the company. The minority shareholders do not even have the voting control of the firm in light of their underneath half proprietorship in the organization. There are various rights available to the minority shareholders in order to diminish the mishandlings by the directors which are discussed below:

- 1) They have the right of decision making in the appointment of the directors and the directors so appointed will be considered as independent directors.
- 2) When the management of the company goes in a direction which is prejudicial to the interest of the company, the minority shareholders have the privilege to apply to the tribunal.
- 3) The minority shareholders have the right to offer their shares to the majority shareholders.
- 4) The minority shareholders can file a class action suit as per the companies act 2013.

The companies have taken steps in order to protect the rights of the minority shareholders which are as follows:

- 1) *Piggybacking Provision*:\_This provision protects the interest of the minority shareholder by including him in any deal by the majority shareholder to sell his shares. This is called piggy backing.
- 2) *Compulsory Dividend*:\_There is a provision in every company to give compulsory surplus to all the minority shareholders.<sup>10</sup>

The beginning of the manhandling of minority shareholders comes basically from the insatiability of a portion of the dominant part shareholders, who now and again has no restriction. Those majority shareholders trust that they can do anything, chance increasingly, since they get themselves unpunished, while staying inside the vast edges of the law. This is the reason it is expected to look at top to bottom the legitimate security of those minority shareholders and its proficiency, keeping in mind the end goal to confirm if the law suffices

---

<sup>10</sup> *RIGHTS OF MINORITY SHAREHOLDERS AS PER COMPANIES ACT 2013 definitions: Rights of minority shareholders* (2013) Available at: [http://www.atulauto.co.in/upload/corporate\\_report/1431596881\\_Policy%20for%20safegaurding%20rights%20of%20minority%20shareholders.pdf](http://www.atulauto.co.in/upload/corporate_report/1431596881_Policy%20for%20safegaurding%20rights%20of%20minority%20shareholders.pdf) (Accessed: 16 November 2016).

for their assurance, or if the minority shareholders require a moral insurance, which has a much more extensive degree.<sup>11</sup>

The Indian corporate administration framework, as specified prior, has characteristics of insider framework. Indian corporate division like numerous other Asian nations illustrates prevalence of family-controlled organizations while state-controlled associations shape a basic segment of the corporate section. Moreover, predominant remote shareholders control various multinational organizations. As indicated by the Prowess database of the Centre for Monitoring Indian Economy (CMIE), in BSE 500 organizations that roughly represents 93 % of the market capitalization of all BSE recorded organizations, the normal promoter holding is 51.52 %, and organizations in which promoters have under 25 percent stake is just 7.8 %. In the BSE 500 list, percent of firms controlled by remote promoters (MNC) and state are 9% and 9.4 % percent separately. Rest of firms are predominately possessed and controlled by families and business bunches. In India, organizations with scattered shareholding just exist as an exemption. Notwithstanding immediate stake, the proprietorship fixation by promoters in the organizations is further expanded by a few different systems like cross holding, pyramiding and burrowing.<sup>12</sup>

The relative quality of shareholders and their impact in an organization rely on its possession structure. The above passage obviously infers that promoters are the insiders, which are most overpowering shareholders in the Indian corporate segment. Promoters, the dominant part shareholders, have capacity to control the undertakings of the organization by goodness of their controlling rights. Alternate shareholders of the organization shape the portion of minority shareholder fragment. Aside from direct possession, promoters, because of across the board burrowing, cross holding and pyramiding in enterprises obtain voting rights more than that of their proprietorship rights. In organizations with predominant shareholders, overpowered shareholder can seize riches from minority in a few ways. Predominant shareholders can redirect firm assets by offering resources, merchandise, or administrations to the organization through self-managing exchanges. Promoters, they can acquire advances on special terms. Researchers have alluded that noteworthy measures of burrowing in Indian business bunches happen by means of non-working part of the benefits. This helps

---

<sup>11</sup> *Definition of minority shareholder* (2003) Available at: <http://www.lawteacher.net/free-law-essays/business-law/problems-faced-by-the-minority-shareholders-business-law-essay.php> (Accessed: 16 November 2016).

<sup>12</sup> Chakrabarti, R., Megginson, W. and Yadav, P.K. (2008) 'Corporate governance in India', *Journal of Applied Corporate Finance*, 20(1), pp. 59-72 Available at: <http://onlinelibrary.wiley.com/doi/10.1111/j.1745-6622.2008.00169.x/full> (Accessed: 16 November 2016)

controlling shareholders to passage association's assets for their private advantages. What's more, Goswami point promoters act in subversive way that "denies the de jure rights of ownership of the minority shareholders without adversely influencing enterprises profits, including issuing special value portions to promoters and their partners at rebates or exchanging offers through private purchase-outs bargains at value well underneath those predominant in the auxiliary market".

There are a few different examples, where promoters, because of their overwhelming position and control over the organization administration removed more advantages at the cost of minority shareholders, records number of cases). The Satyam case is a run of the mill case in which promoters, because of their position and control on administration redirected firm assets for their private advantage and prompted a tremendous misrepresentation.<sup>13</sup> All the more as of late, SEBI has made a move to drop Initial Public Offerings (IPO) of seven organizations.<sup>14</sup> Promoters of these organizations were included in controlling the IPO that brought about enormous misfortunes to open. Every one of these occurrences involve that proprietorship fixation close by of controlling shareholders, the promoters, give noteworthy powers and raise the potential corporate administration issue of ensuring minority shareholder rights.

Shielding minority shareholders have likewise other imperative ramifications. Security of minority shareholders is considered as a vital determinant of accomplishment of its capital market. Nations that don't give adequate security to financial specialists and shareholder have negligible obligation and value advertise. Interestingly nations that have better security to minority shareholders and financial specialists' rights have more esteemed and wide value showcase<sup>15</sup> and valuation of firms is likewise higher. India, in the contemporary situation, needs more prominent security to minority shareholders and speculators to pull in outside capital and venture, important to maintain and move its monetary development.

---

<sup>13</sup> Singh, J.P., Kumar, N. and Uzma, S. (2011) *Satyam fiasco: Corporate governance failure and lessons therefrom* by J.P. Singh, Naveen Kumar, Shigufta Uzma: SSRN. Available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1736505](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1736505) (Accessed: 16 November 2016).

<sup>14</sup> Economic Times (2012), "Sebi's Tough Stand Against IPO Cheats Sends Out Right Signals", January 2, [Online] Available: [http://articles.economictimes.indiatimes.com/2012-01-02/news/30587433\\_1\\_ipo-market-ipo-process-merchant-bankers](http://articles.economictimes.indiatimes.com/2012-01-02/news/30587433_1_ipo-market-ipo-process-merchant-bankers) (Accessed 15 November 2016)

<sup>15</sup> La Porta, R.; Lopez-de-Silanes, F.; Shleifer, A., "Law and Finance", Journal of Political Economy, Vol. 106, No.6, 1998, Available at: <http://www.isid.ac.in/~tridip/Teaching/DevEco/Readings/06Institutions/06LaPorta&LopezDeSilanes&Shleifer&Vishny-JPE1998.pdf>



## ANALYSIS OF INDIAN FRAMEWORK OF PROTECTION OF MINORITY SHAREHOLDERS

This segment surveys current Indian practices and benchmarks it on the OECD Principles of Corporate Governance that proposes that every shareholder ought to be dealt with similarly including all the minority and foreign shareholders.<sup>16</sup>

1. *Impartial Treatment of Shareholders Particularly in Reference to Minority Shareholders:* Minority shareholders have been given insurance under the Companies Act, 1956. The Section 397 and 398 of the Companies Act, lays down that minority shareholders may look for alleviation by drawing nearer the Company Law Board (CLB) if there should be an occurrence of persecution or blunder by controlling shareholder/administration. Be that as it may, minority shareholders may look for redressal from CLB just under state of no less than 100 shareholders or hold no less than 10% of shares under segment 399 of the Act. Minority shareholders if not fulfilled may document an appeal to in the High Court or Supreme Court of India.
2. *Restrictions on Insider Trading and Self-Abusive Dealing:* Insider trading is restricted in India and controlled by SEBI's Prohibition of Insider Trading Regulations, 1992. Under Clause 49 of the Listing Agreement, senior administration needs to make revelations to the board identifying with all material monetary and business exchanges, where they have an individual interest that might be conceivably clashing with the enthusiasm of the organization on the loose.
3. *Disclosure of all Material Interest by the Directors and the Managers:* As per the code of Conduct & Ethics for the directors, the directors and the managers are required to disclose all the material interest which they have in the company which might affect the corporation. For a good governance, it is a good practise of revealing any material interest in the standing notice at the time of the director's meeting.<sup>17</sup>

Certain measures to ensure protection to minority shareholders and raise the standard of Indian corporate administration are discussed below:

---

<sup>16</sup> Naveen Kumar, J.P. Singh "Corporate Governance in India: Case for Safeguarding: Minority Shareholders Rights" IJMBS Vol. 2, Issue 2, April - June 2012 <http://www.ijmbs.com/22/naveen.pdf> (Accessed: 12 November 2016)

<sup>17</sup> Code of Conduct and Obligations for Board Members and Senior Management [http://new.abb.com/docs/librariesprovider19/default-document-library/code-of-conduct\\_duties-of-ind-directors-updated.pdf?sfvrsn=2](http://new.abb.com/docs/librariesprovider19/default-document-library/code-of-conduct_duties-of-ind-directors-updated.pdf?sfvrsn=2) (Accessed: 12 November 2016)



1. *Appointment of Directors:* Currently, the promoters hold a dominant position in the appointment of directors and controlling of the board. The minority shareholders must be given rights to appoint the directors in proportion to the shares they hold.
2. *Checking the Related Party Transactions:* The role of the audit committee should be more specified in relation to the related party transaction. The approval of the transactions by the board should be limited and the minority shareholders should be given more preference over them.
3. *Enforcement:* Stringent punishments and even thorough detainment are required in the event of non-compliance that truly affects the rights of the minority shareholder.

### **HOW EQUITABLE TREATMENT TO THE MINORITY SHAREHOLDERS CAN BE ENSURED**

- It is important to ensure that the board of directors adopt the perspective of minority shareholders while making important decisions related to the company.
- The company belongs to the minority shareholders also irrespective of the amount of shares they hold in the company, so any suggestions regarding the governance of the company should have equal participation by the minority shareholders too.
- Having time to time communications with the minority shareholders, increasing interactions between the board of directors and minority shareholders is very necessary to build strong relations between the company and the shareholders.
- The minority shareholders must be communicated well in advance of the meetings to be held and they possess the rights to seek information from the company in relation to the registers of the board or directors, they have the right to audit the accounts, they have the rights to inspect minutes of the meetings held etc.
- The minority shareholders have the right to voice their opinion in the cases of appointing of directors, right to vote etc.<sup>18</sup>

### **CONCLUSION**

With the series of recent scandals and scams, a plenty of corporate administration standards and gauges have grown far and wide. The development of guidelines and setting up of various administrative norms or standards are a good way of improving the corporate

---

<sup>18</sup> Priyanka Kanta Bose, "Corporate Governance & Plight of Minority Shareholders: An Attempt to Reconcile", Available at: <http://jassh.in/index.php/jassh/article/download/49/77>

governance. The bigger challenge faced by India however, is the implementation of such norms at the ground level. There exist various provisions relating to the protection of the minority shareholder's rights but they are not properly implemented. Thus having a proper law on the protection of minority shareholders also is of no use because it is not been looked upon and the majority shareholders end up abusing the rights of the minority shareholders. Thus it is very important to secure protection of the rights of the minority shareholders and setting up of good governance guide helps in achieving the guaranteed protection to the minority shareholders under the act.

The above examination plainly sets up that the best way to enhance the corporate administration in India is to give enough protection to minority shareholders. An analysis of minority shareholder's rights and assurance<sup>19</sup> implicates that India is stagnant in giving sufficient protection to the investors. There exist laws on the protection of minority shareholder, however they are not satisfactory. Comparably, there exists a critical hole in Indian corporate administrative system that warrants most extreme shields to minority shareholder rights. The makers of the policy can do this by making a helpful domain and proclaiming laws for security of minority shareholder rights. The issue has additionally genuine implications on Indian economy that is searching for more noteworthy remote capital and venture to support its financial development. The above recommend various measures unquestionably will give more protection to minority shareholders and raise the Indian corporate administrative norms. The above mentioned actions should be taken care of in order to provide equitable treatment to the minority shareholders.

---

<sup>19</sup> World Bank, Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment: India, World Bank-IMF, Washington, DC, USA, 2004 <http://www.nfcgindia.org/rosc.htm> (Accessed 15 November 2016)