Shareholder Stewardship in India: The Desiderata

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At least three reasons necessitate such a departure from the UK stewardship approach. First, while the prominence of institutional investors in the UK in the context of companies with dispersed ownership inspired the UK-style stewardship code, the roles and challenges that institutional investors experience in India in the context of concentrated shareholding are considerably different. Second, the goals of stewardship vary from the UK, where the focus is on the long-term financial sustainability of beneficiaries of institutional investors, to India, which follows a pluralistic stakeholder approach to corporate law. Third, the traditional mode in the UK of using a code-based soft law approach to implementation of stewardship is unsuitable to the Indian circumstances that steadfastly rely on mandatory rules in the form of hard law in the corporate arena.

Keywords: Stewardship, corporate governance, institutional investors, India

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I. INTRODUCTION

Stewardship codes have proliferated around the world during the last decade. It is possible to attribute the driving philosophy behind this phenomenon to the pioneering effort in the form

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of the Stewardship Code in the United Kingdom (UK).[1] Although there is some variation in the nature and content of the stewardship codes, they focus on the 'stewardship'[2] role that institutional investors are to play in the governance of companies in which they have invested.[3] In some cases, the codes extend beyond shareholder interests and nudge investors to focus their attention on environmental, social and governance (ESG) matters.[4] Moreover, the stewardship codes are essentially 'soft law'.[5]

In this background, the goal of this paper is to examine whether the stewardship code, which emanated in circumstances that are specific to the UK, is capable of being transposed to other jurisdictions that experience different corporate structures as well as legal and institutional mechanisms. It does so in the context of India, which has introduced a series of stewardship codes for different types of institutional investors. This paper advocates against the adoption of a UK-style stewardship in India, due to the specific factors that are at play in that jurisdiction, and instead calls for a *sui generis* approach to stewardship.

While the terminology of 'stewardship' is relatively new in the Indian context, the concept itself endured a longer path and has now become well entrenched among institutional investors. From the turn of the century, the Indian government began encouraging various voting methods that enabled shareholders, particularly institutional investors, to be more participative in the decision-making of companies in which they have invested. More recently various Indian regulators have taken steps that are more concrete. The Insurance Regulatory and Development Authority of India (IRDAI) issued a set of guidelines in 2017 on a stewardship code for insurers in India,[6] the Pension Fund Regulatory and Development Authority (PFRDA) issued guidelines in 2018 on a stewardship code for pension funds,[7] and the Securities and Exchange Board of India (SEBI) issued a stewardship code in 2019 for

1 Although the UK itself has reformed its stewardship code more recently, see Financial Reporting Council (FRC), *The UK Stewardship Code 2020* < https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf> accessed 24 January 2020, the dissemination of the UK-style stewardship is based on its predecessor code, see FRC, *The UK Stewardship Code* (September 2012) <https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf> accessed 29 August 2019.

2 Stewardship has been defined as "the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, the economy and society". Financial Conduct Authority/Financial Reporting Council, 'Building a regulatory framework for effective stewardship', *Discussion Paper DP19/1* (January 2019), at 11.

3 Jennifer G Hill, 'Good Activist/Bad Activist: The Rise of International Stewardship Codes', (2018) 41 *Seattle U.L. Rev.* 497, 506-07.

4 Dionysia Katelouzou, 'Shareholder Stewardship: A Case of (Re)Embedding the Institutional Investors and the Corporation?' in Beate Sjafjell & Christopher M. Bruner, *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge: Cambridge University Press, 2019), at 585.

5 Gen Goto, 'The Logic and Limits of Stewardship Code: The Case of Japan', (2018) 15 Berkeley Bus. L.J. 365, 382-83.

6 Insurance Regulatory and Development Authority of India, *Guidelines on Stewardship Code for Insurers in India*, IRDA/F&A/GDL/CMP/059/03/2017 (22 March 2017).

7 Pension Fund Regulatory and Development Authority, *Common Stewardship Code*, PFRDA/2018/01/PF/01 (4 May 2018).

mutual funds and alternative investment funds (AIFs).[8] These represent an important step, as several large institutional investors have either adopted or are in the process of adopting stewardship codes along the lines of the guidelines issued by their respective regulators.

While there has been a concerted move towards institutional shareholder stewardship in India, it has been a fragmented effort at best. Despite strident calls for a broader stewardship code from SEBI that encompasses all types of institutional shareholders, none has been forthcoming. There is a dire need for a consolidated effort among the Indian regulators in addressing investor stewardship.

As much as some may consider this situation ambiguous and unsatisfactory, it provides a suitable opportunity to engage in a pre-emptive exploration of what an optimal stewardship code might look like for India. This paper argues that, given the different corporate structures and legal and institutional mechanisms in India, the Indian regulators would do well to deviate from a UK-style stewardship in India. To that extent, this paper echoes the concerns of commentators who note: 'For designing a 'stewardship code' for India, although the UK Stewardship Code might be a useful starting point, it would be wrong to transplant the UK Code's principles and supporting guidance without adapting them to the special features of the Indian capital market'.[9] At least three reasons necessitate such a departure from the UK approach to stewardship.

First, while the prominence of institutional investors in the UK in the context of companies with dispersed ownership inspired the UK-style stewardship code, the roles and challenges that institutional investors experience in India are considerably different. Indian companies largely display concentrated shareholdings with the dominance of either business families or the state as controlling shareholders.[10] In such a scenario, the influence of the institutional investors, while gradually increasing, may be insufficient to bring about the level of engagement witnessed in companies with dispersed shareholding.

Second, the goals of stewardship may depend significantly upon whether a jurisdiction's corporate law and governance systems are largely shareholder-oriented or whether they place considerable emphasis on non-shareholder constituencies as well. In the UK, stewardship is essentially a means by which institutional investors ensure sustainable long-term financial returns for their beneficiaries, which thereby broadly benefits society. Jurisdictions such as India, however, go further in imposing considerable stakeholder responsibilities on boards and managements, wherein shareholders (whether institutional or otherwise) are only one

[8] Securities and Exchange Board of India, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities*, CIR/CFD/CMD1/168/2019 (24 December 2019).

[9] Guy Jubb & Nirmal Mohanty, 'An India Stewardship Code: Imperatives and Challenges', *Quarterly Briefing: NSE Centre for Excellence in Corporate Governance* (No. 19, October 2017), at 3.

[10] This compares with the position in the rest of Asia. See, Gen Goto, Alan K. Koh & Dan W. Puchniak, 'Diversity of Shareholder Stewardship in Asia: Faux Convergence', *NUS Law Working Paper No. 2019/027* (2019) <https://ssrn.com/abstract=3481543> (accessed 17 January 2020).

among several stakeholders. In such a scenario, an appropriate stewardship regime would help supplement the stakeholder approach of Indian corporate law.

Third, the UK-style stewardship follows a code-based implementation using soft law. This has traditionally functioned in the UK context given specific circumstances that exist in that jurisdiction, including its historical affinity towards a code-based approach towards corporate governance and takeovers, among others. However, India has steadfastly relied on hard law in the form of the corporate statute or SEBI's regulation as a method to enforce norms in the corporate sector. The UK-style stewardship code may have crucial limitations in its applicability to the Indian circumstances. The Indian regulators may instead need to consider other approaches, including by imposing stewardship or engagement duties on specific types of shareholders,[11] which is more in tune with India's corporate regulatory philosophy.

Given the above reasons, among others, this paper cautions against the wholesale adoption of the UK-style stewardship code in India. Instead, the Indian regulators would do well to introduce a consolidated *sui generis* stewardship model for all institutional investors that would fit with the Indian corporate ownership structure, legal and institutional mechanisms and corporate culture.

Section 2 of the paper outlines the evolution of institutional shareholder participation and activism in Indian companies, and discusses the extent of regulatory efforts to facilitate stewardship among such institutional shareholders. Section 3 focuses on the specific agency problems prevalent in India in the context of concentrated shareholding, and the inappropriateness of the UK-style stewardship code in that context. It argues that the stewardship concept must extend beyond institutional shareholders and encompass actions of the controlling shareholders as well. Section 4 addresses the question of whether stewardship's orientation towards long-term sustainable value adequately addresses the stakeholder theory of the corporation. While ESG considerations are integral to stewardship, and indeed receive recognition as such, this paper argues for a greater stakeholder emphasis through shareholder stewardship. Section 5 considers whether the voluntary 'comply-or-explain' model that underpins the shareholder stewardship movement around the world is apposite for jurisdictions such as India where mandatory rules-based governance has been the norm. It argues that voluntary guidelines are unlikely to have effect, and instead a movement towards shareholder duties will be more appropriate. Part 6 concludes with a call for a consolidated stewardship code for all institutional investors that befits the specific Indian market circumstances.

[11] See, Ernest Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (Cambridge: Cambridge University Press, 2019); Iris Chiu & Dionysia Katelouzou, 'From Shareholder Stewardship to Shareholder Duties: Is the Time Ripe?' in Hanne S Birkmose, *Shareholders' Duties* (Wolters Kluwer, 2017).

II. SHAREHOLDER ACTIVISM IN INDIA: FRAGMENTED STEWARDSHIP EFFORTS

Before undertaking a critical assessment of shareholder stewardship in India, it would be necessary to analyse the evolution of shareholder activism in India and the extent of its success in Indian companies. While institutional shareholders have become considerably active, their impact on the governance of companies continues to suffer from limitations due to the influence of controlling shareholders. Moreover, while regulators have begun to initiate reforms towards engendering a culture of shareholder stewardship, their efforts are at best fragmented and inchoate.

A. Evolution of Institutional Shareholder Activism

Historically, institutional shareholders in India were rather passive.[12] Several banks, development financial institutions and mutual funds, most of whom were government-owned, held large stakes in Indian companies, but they were never perceived to be independent investors nor a threat to management and controlling shareholders. They usually voted along with the controlling shareholders and management. Similarly, foreign investors who either held shares in Indian companies or depository receipts seldom exercised voting rights, except in exceptional circumstances.[13] This position ensued until about a decade ago when regulatory reforms as well as market pressures triggered shareholder activism in Indian companies.

In 2010, India's market regulator, SEBI, took an important step towards stewardship when it issued a circular to mutual funds (as they were within its regulatory purview) requiring them to 'play an active role in ensuring better corporate governance of listed companies'.[14] By imposing disclosure obligations and thereby enhancing transparency, it compelled mutual funds to take a more active and considered role while exercising their voting rights in companies. In parallel, other regulatory reforms provided investors in Indian companies with greater access to their exercise of the corporate franchise. For example, the Companies Act, 2013 confirmed the ability of shareholders to engage in e-voting, and to attend shareholders' meetings virtually.[15]

Another significant development is the evolution of a home-grown proxy industry in India, which has come to exert a significant influence in corporate decision-making in Indian companies. Since 2010, three proxy advisory firms have established themselves in India,[16]

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12 Varottil, 'The Advent of Shareholder Activism in India', (2012) 6 *Journal on Governance* 582.

13 Ibid.

14 Securities and Exchange Board of India, *Circular for Mutual Funds*, SEBI/IMD/CIR No 18/198647/2010 (15 March 2010).

15 Companies Act, 2013, s 108.

16 They are (i) InGovern (<http://www.ingovern.com/> accessed 29 August 2019); (ii) Institutional Investor Advisory Services (IIAS) (<https://www.iiasadvisory.com/> accessed 29 August 2019); and (iii) Stakeholders Empowerment Services (SES) (<https://www.sesgovernance.com/> accessed 29 August 2019).

and they have been extremely active in issuing recommendations regarding corporate proposals pertaining to various listed companies in India.[17] Furthermore, several global proxy advisory firms are also active in issuing recommendations in relation to voting in Indian companies, and they have published proxy voting guidelines specific to India.[18] The global proxy advisory firms also hold considerable sway among institutional shareholders, particularly foreign investors.[19]

In light of the decade-long regulatory and market developments relating to shareholder activism in India, it is worth considering the growth of institutional shareholding in Indian companies during that period and the influence they exercise in corporate decision-making. Available empirical evidence set out in Table 1 indicates a perceptible growth in institutional shareholding and a concomitant reduction in controlling shareholders' stake.

Table 1
Shareholding Pattern of Indian Companies[20]

Shareholder-Type	**March 2008**	**March 2019**
Controlling Shareholders (Promoters)	**58.7%**	**49.3%**
Mutual Funds	3.7%	7.6%
Development Financial Institutions	5.8%	6.3%
Foreign Institutional Investors	14.5%	20.7%
Total Institutional Shareholders	**24%**	**34.6%**
Corporate Bodies	3.7%	5.5%
Individuals	8.2%	8.3%
Others	5.4%	2.3%
Total Non-institutional Shareholders	**17.3%**	**16.1%**

[17] For example, IIAS notes on its website that, since its inception in 2010, it has covered more than 6,800 shareholders' meetings in respect of over 780 companies, and issued more than 41,000 voting recommendations. IIAS <https://www.iiasadvisory.com/> accessed 24 January 2020.

[18] Institutional Shareholder Services, *India: Proxy Voting Guidelines – Benchmark Policy Recommendations* (6 December 2018) <https://www.issgovernance.com/file/policy/active/asiapacific/India-Voting-Guidelines.pdf> accessed 29 August 2019; Glass Lewis, *Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice – India* (2019) < https://www.glasslewis.com/wp-content/uploads/2016/12/Guidelines_India.pdf> accessed 29 August 2019.

[19] BQ Desk, 'Two U.S. Advisory Firms Asked Investors To Vote Against Parekh's Reappointment', *BloombergQuint* (31 July 2018).

[20] Institutional Investor Advisory Services, *The Corporate Governance Landscape in India* (August 2019) < https://docs.wixstatic.com/ugd/09d5d3_0e4114fb614e402c9719ecb28836e9f1.pdf> accessed 29 August 2019, at 8, relying upon data from Edelweiss.

Not only has the quantum of institutional shareholding increased, but also the institutions have become more active with regard to their investments. As many as 105 resolutions put forward by company managements were defeated since 2014,[21] a phenomenon hitherto unheard of in the Indian corporate sector. The defeated resolutions include director reappointments, director remuneration, employee stock option plans, related party transactions, and raising debt or equity.[22] In several other cases, resolutions that company managements proposed scraped through with wafer thin margins due to excessive opposition by institutional shareholders, thereby causing considerable consternation among managers and controlling shareholders. Anecdotal evidence from certain high-profile transactions, as outlined in Table 2, supports the increasingly activist stance of the institutions.

Table 2
Specific Instances of Institutional Shareholder Activism

Maruti Suzuki Limited	2014-15	Institutional shareholders such as private sector mutual funds and insurance companies applied pressure on management to rework the terms of a related party transaction before approving it.[23]
Tata Motors Limited	2014-15	The shareholders, on the advice of proxy advisory firms, initially rejected the company's proposals to fix remuneration for top executives. It was only after the company approached the shareholders a second time with more detailed explanation that they received approval.[24]
Raymond Limited	2017	Shareholders overwhelmingly (with a 97.67% vote) rejected a related party transaction involving an undervalued sale of the company's property to its controlling shareholders.[25]
Alembic Pharmaceuticals Limited	2017	In an unusual move, Unifi Capital, a shareholder holding about 3% shares in the company mustered the support of nearly 1,000 'small shareholders' to seek a board representation.[26] However, the company rejected Unifi's proposal on the ground

21 Ibid, at 5.

22 Ibid.

23 PTI, 'Maruti-Suzuki deal: Institutional investors approach Sebi', *Business Today* (13 March 2014); Amrit Raj, 'Maruti wins shareholder nod for Gujarat plant pact', *The Mint* (18 December 2015).

24 Shally Seth Mohile, 'Tata Motors shareholders approve remuneration proposals', *The Mint* (22 January 2015).

25 Moneylife Digital Team, '2017 becomes tipping point of shareholder activism in India: Report', *Moneylife* (28 November 2017).

26 Sohini Das & Sudipto Dey, 'Drama in Alembic Board room as minority shareholders rise', *Business Standard* (24 July 2017).

		that the small shareholders had a relationship with Unifi.[27]
HDFC	2018	The reappointment of the chairperson as a director passed with 77.36% out of the 75% required for the purpose. A large number of institutional investors voted against the resolution on the ground that the director was on too many boards and also that the board of the company was not independent enough.[28]

Several other factors aid the efforts of institutional shareholders. *First*, while the shareholding in Indian companies on average continues to be concentrated, the holdings of several large listed companies have undergone dispersion. They are devoid of controlling shareholders. Well-known examples include Housing Development Finance Corporation (HDFC), ICICI Bank and Larsen & Toubro.[29] *Second*, as in several other jurisdictions, foreign institutional ownership is on the rise in India.[30] For example, foreign portfolio investors hold just short of 75 percent in HDFC.[31] This allows outside shareholders to exert pressure on management. *Third*, even in companies with concentrated shareholding, institutional investors may, in certain cases, have the ability to determine the outcome of certain resolutions to the exclusion of the controlling shareholders. For example, the law on related party transactions, which came up for consideration in the Maruti Suzuki case, requires a 'majority of the minority' voting in approving material transactions wherein the promoters are deprived of voting rights on that decision.[32] Here again, outside shareholders such as institutional investors may wield considerable influence – that too in controller-owned companies. Such a paradigm shift in share ownership patterns, at least in large listed companies, alters the rules of the governance game.

The available empirical and anecdotal evidence indicate a clear trend whereby institutional shareholders (both domestic and foreign ones alike) are no longer passive, but participate extensively in corporate decision-making. Although some of the anecdotal instances listed in Table 2 above (such as Maruti Suzuki and Alembic Pharmaceuticals) display trends of active engagement by institutional shareholders with management of companies, which go beyond simply exercising their voting rights, more specific empirical evidence regarding such engagement is hard to come by as it takes place behind closed doors. With this background,

27 Reeba Zachariah, 'Board seat: Alembic junks small shareholder plea', *Times of India* (29 July 2017).

28 Shilpy Sinha, 'Being on boards of eight other companies went against Deepak Parekh at HDFC vote', *The Economic Times* (1 August 2018).

29 Mahesh Vyas, 'Beyond promoter power', *Financial Express* (2 February 2009).

30 See the change in shareholding of foreign institutional investors in Table 1 above.

31 Housing Development Finance Corporation Limited, *Shareholding Pattern* < https://economictimes.indiatimes.com/housing-development-finance-corporation-ltd/shareholding/companyid-13640.cms> accessed 9 September 2019.

32 Companies Act, 2013, s 188(1).

the paper now turns to examine the manner and extent to which the regulatory regime surrounding shareholder stewardship has evolved in India.

B. Stewardship Efforts in India

Although regulatory efforts in India over the last decade catered for greater participation and activism among shareholders, the need for a specific stewardship code became evident only more recently. In 2016, the Financial Stability and Development Council (FSDC), a body that coordinates various regulators in the financial sector, expressed the need for such a code in India.[33] The FSDC in turn formed a committee with representatives from SEBI, the IRDAI and the PFRDA to consider the introduction of a stewardship code in India. While reports indicate that the committee has already made its recommendations to the FSDC, the FSDC is yet to approve an umbrella stewardship code for Indian companies and their institutional investors.[34]

A plethora of committees and working groups have, in the meanwhile, strongly recommended that SEBI issue a uniform stewardship code for India's capital markets. The influence of the UK Stewardship Code is unmistakeable in the process. In November 2016, the India-UK Financial Partnership recommended that the Indian regulators adopt an 'Indian Stewardship Code', which 'will strengthen the ability of Indian shareholders to perform their fiduciary duties, improve the relationship between the boards of Indian companies and their shareholders and help foster shareholder loyalty'.[35] Although this effort did not recommend the text or contents of an Indian stewardship code, the UK Stewardship Code and the experience thereunder evidently underpin the rationale for such a code.[36]

On similar lines, an influential 2017 report on corporate governance issued by a SEBI-appointed committee recommended that 'a common stewardship code be introduced in India for the entire financial sector … by SEBI for investments by institutional investors in Indian capital markets' on the lines of codes followed in several countries such as the United Kingdom, Malaysia and Japan.[37] A more recent working group report looking into the regulation of proxy advisors noted that 'SEBI should make a Stewardship Code (like the UK Stewardship Code) mandatory for all institutional shareholders, and such code should be publicly available. This should be on a comply or explain basis'.[38] Despite repeated calls for

[33] Jubb & Mohanty, 'An India Stewardship Code: Imperatives and Challenges', at 3.

[34] Ibid.

[35] India-UK Financial Partnership, *Responsible Shareholder Engagement: An Indian Stewardship Code* (November 2016).

[36] Ibid.

[37] Securities and Exchange Board of India, *Report of the Committee on Corporate Governance* (5 October 2017).

[38] Securities and Exchange Board of India, *Working Group's Report on Issues Concerning Proxy Advisors* (May 2019).

a stewardship code that encompasses institutional investors in the Indian securities markets, a comprehensive code has not been forthcoming, at least yet.

Curiously enough, while SEBI had been actively considering a code for institutional investors in the Indian capital markets, two other regulators that oversee significant types of institutional investors, viz. insurance companies and pension funds, went ahead and released versions of stewardship codes that apply to these respective investors. While these efforts may be welcome in rendering express recognition of stewardship in the Indian capital markets, these efforts pushed India into a rather unintended path of utter fragmentation in stewardship efforts, which will arguably result in adverse outcomes in comparison with a unified approach among Indian regulators to the idea of shareholder stewardship.

In March 2017, the IRDAI issued a set of guidelines on stewardship codes for insurance companies in India.[39] Insurers are required to adopt specific stewardship codes based on these guidelines, which will operate on a comply-or-explain basis.[40] Since then, at least 25 insurers have issued their stewardship codes based on the IRDAI guidelines.[41] Similarly, in 2018, the PFRDA issued its own common stewardship code that all pension funds are required to follow.[42] In these circumstances, with the likelihood of a consolidated stewardship code for institutional investors in India beginning to look bleak, SEBI issued its own code applicable to mutual funds and AIFs, which is effective from 1 April 2020.[43] At a broad level, there are similarities in the approaches adopted by the IRDAI, the PFRDA, and SEBI. In addition, it is inevitable to note the similarities with the UK Stewardship Code as well, which demonstrates the strong influence of the UK-style approach among the Indian regulators. Although the UK Stewardship Code has undergone reform,[44] the stewardship codes prescribed by the Indian financial regulators continue to track the previous UK Stewardship Code of 2012.[45]

Table 3
Comparison of Stewardship Codes of the IDRAI, the PFRDA and SEBI

	IRDAI Guidelines on Stewardship Code for Insurers	**PFRDA Common Stewardship Code & SEBI Stewardship Code**	**The UK Stewardship Code of 2012**
Principle 1	Insurers should formulate a policy on the discharge of	Institutional investors should formulate a comprehensive	Institutional investors should publicly disclose their policy

[39] IRDAI, *Guidelines on Stewardship Code for Insurers in India*.

[40] Ibid.

[41] Information on file with the author.

[42] PFRDA, *Common Stewardship Code*.

[43] SEBI, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities*.

[44] FRC, *The UK Stewardship Code 2020*.

[45] FRC, *The UK Stewardship Code* (September 2012).

	IRDAI Guidelines on Stewardship Code for Insurers	PFRDA Common Stewardship Code & SEBI Stewardship Code	The UK Stewardship Code of 2012
	their stewardship responsibilities and publicly disclose it	policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically	on how they will discharge stewardship responsibilities
Principle 2	Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it	Institutional investors should have a clear policy on how they manage conflicts of interests in fulfilling their stewardship responsibilities and publicly disclose it	Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed
Principle 3	Insurers should monitor their investee companies	Institutional investors should monitor their investee companies	Institutional investors should monitor their investee companies
Principle 4	Insurers should have a clear policy on intervention in their investee companies	Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors, where required, to preserve the interests of the ultimate investors, which should be disclosed[46]	Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities
Principle 5	Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interests of the policyholders (ultimate investors), which should be disclosed	Institutional investors should have a clear policy on voting and disclosure of voting activity	Institutional investors should be willing to act collectively with other investors where appropriate
Principle 6	Insurers should have a clear policy on voting and disclosure of voting activity	Institutional investors should report periodically on their stewardship activities	Institutional investors should have a clear policy on voting and disclosure of voting activity
Principle 7	Insurers should report periodically on their stewardship activities		Institutional investors should report periodically on their stewardship and voting activities

[46] Note that the PFRDA and SEBI codes have combined principles 4 and 5 of the IRDAI code and the UK Stewardship Code of 2012. Hence, the serial numbers of the principles thereafter do not match.

As Table 3 indicates, the principles enshrined in the stewardship codes of the PFRDA and SEBI are identical, while there are some differences in the IRDAI's code. With the benefit of the IRDAI and PFRDA codes available before it, SEBI appears to have made a choice to adhere almost identically to the PFRDA model.

While there are broad similarities among the three stewardship codes, they display some significant distinctions in the details. For instance, the PFRDA and SEBI guidelines place considerable emphasis on the engagement of pension funds, mutual funds and AIFs with their investee companies on ESG opportunities and risks,[47] the IRDAI guidelines impose no such specific requirement on insurers. Moreover, the PFRDA and SEBI guidelines are more elaborate on how pension funds, mutual funds and AIFs may exercise their monitoring responsibilities over the investee companies, as they not only delineate areas for monitoring, but also caution the respective institutional investors to bear in mind the regulations on insider trading.[48]

When it comes to the implementation of the various codes, stark divergence is writ large. The IRDAI guidelines indicate that they apply on a comply-or-explain basis, and that all insurers must file an annual report 'indicating the reasons/justification for the deviation or non-compliance with the principles indicated' in the guidelines.[49] The PFRDA, however, stipulates that pension funds 'shall follow' the stewardship code,[50] which indicates an obligation that is not subject to the 'comply-or-explain' approach. The SEBI code goes even further to explicitly state that all mutual funds and AIFs 'shall *mandatorily* follow' it.[51] While the PFRDA and SEBI approaches appear to introduce a great deal of stringency in ensuring compliance, they lack a concrete enforcement mechanism. It is yet unclear what consequences will visit upon an institutional investor who fails to comply with their stewardship codes. Arguably, the PFRDA and SEBI codes remain mandatory in intent, but will fail to translate that into action unless they are accompanied by detailed enforcement mechanisms. The lack of uniformity in the implementation of the various stewardship code by their respective regulators exacerbates the drawbacks of the fragmented approach followed in India in establishing and operating a regulatory regime for stewardship.

Overall, the evolution of stewardship codes in India represents a rather unusual, unexpected and arguably undesirable trajectory of events. A process that was initially meant, through the efforts of the FSDC, to materialize in the form a consolidated stewardship code that

[47] See PFRDA, *Common Stewardship Code*, Guidance to Principle 1; SEBI, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities*, Guidance to Principle 1.

[48] See PFRDA, *Common Stewardship Code*, Guidance to Principle 3; SEBI, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities*, Guidance to Principle 3.

[49] IRDAI, *Guidelines on Stewardship Code for Insurers in India*, (introductory letter accompanying the Guidelines).

[50] PFRDA, *Common Stewardship Code* (introductory letter accompanying the Stewardship Code, para. 3).

[51] SEBI, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities* (introductory letter accompanying the Stewardship Code, para. 4) [emphasis added].

encompasses all types of institutional investors to be regulated by SEBI as the capital market regulator has wound up in a trifurcated approach. Depending on the nature of the investors, they are subject to a different set of stewardship guidelines to be implemented by varied regulators, a phenomenon that is bound to result in incongruities.

In this background, the remainder of this paper adopts a critical analysis of the existing stewardship efforts and seeks to adopt a normative approach by proposing the key aspects that the Indian regulators, in particular SEBI, must consider in evolving a consolidated and uniform stewardship code that applies to all institutional investors in the Indian market. This paper argues that the present trifurcated dispensation cannot be an end in itself, and must only be a transitory mechanism towards a consolidated approach. The regulators, under the aegis of the FSDC, must continue to formulate a code that uniformly applies to all types of institutional investors. To reemphasise, this paper also adopts the strong position that the Indian regulators must adapt any such stewardship code to the specifics of the Indian market and legal system, and must avoid placing excessive reliance on a UK-style stewardship code.

III. SHAREHOLDING STRUCTURE: THE ROLE OF INSTITUTIONAL INVESTORS

The UK has been a supplier of voluntary codes that operate as 'soft law' in several areas affecting the governance and ownership of companies. For instance, the Cadbury Code popularised the use of corporate governance codes in a number of countries around the world.[52] While the Cadbury Code and subsequent corporate governance codes have evolved in the background of the dispersed ownership of shares in the UK and the continued influence of institutional shareholders, such a concept has found its place in other jurisdictions with considerably divergent share ownership structures. The recipient countries are generally dominated by companies with concentrated shareholding and with varying legal systems and institutional structures. While convergence advocates argue that such efforts are symptomatic of a common framework in corporate governance,[53] others counter that path dependent tendencies would prevent a full convergence.[54]

A similar phenomenon arises in the context of stewardship codes as well. The UK-style stewardship code evolved in the backdrop of dispersed shareholding that is replete with agency problems between managers and shareholders.[55] Here, the exertion of greater participation and engagement by institutional shareholders against managements of investee

[52] Francesca Cuomo, Christine Mallin & Alessandro Zattoni, 'Corporate Governance Codes: A Review and Research Agenda', (2016) 24(3) *Corporate Governance: An International Review* 222.

[53] Henry Hansmann & Reinier Kraakman, 'The End of History for Corporate Law', (2001) 89 *The Georgetown Law Journal* 439.

[54] Lucian A Bebchuk & Mark J Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance', (1999) 52 *Stanford Law Review* 127.

[55] Brian R. Cheffins, 'The Stewardship Code's Achilles' Heel', (2010) 73 *Modern Law Review* 1004, at 1011-13.

companies is altogether understandable. The dominance of institutional shareholders in the UK context is what drives the stewardship idea.[56] In such circumstances, the stewardship role that institutional investors play will likely have an impact on corporate governance in the investee companies, and thereby enable such investors to enhance the corporate returns to their beneficiaries.

The dissemination of such a UK-style stewardship code to countries that carry considerably different ownership structures, i.e., mainly concentrated shareholdings, is bound to give rise to incongruities in the implementation of such codes. One commentator has noted that 'the chances of a stewardship code increasing ownership behaviour in any particular jurisdiction will be partly dependent on the structure and legal framework of the local investment market and the power of the different market players'.[57] Similarly, another commentator has observed that 'it may very well be the case that the true intention behind adopting a stewardship code in a jurisdiction could be highly contextual and contingent upon jurisdiction-specific factors'.[58] While the UK-style stewardship code has largely emanated in the shadow of the agency problems between managers and shareholders, it is yet unclear whether, and to what extent, such a measure is suitable to address the agency problems between controller and the minority in jurisdictions such as India where concentrated shareholding is the norm.

Despite the gradual rise in shareholder activism and institutional stewardship efforts in India, the role of institutional shareholders is likely to be substantially limited in view of the dominant role that controlling shareholders play in Indian listed companies. To that extent, the scenario that operates in India is entirely different from that in the UK. In jurisdictions such as India, shareholder activism may have a different effect on companies with controlling shareholders as opposed to those without. For example, in companies without controlling shareholders, the influence of the activist shareholders and increasing participation and engagement by institutional shareholders may have a direct bearing on the outcome of proposals made by management. On the other hand, where controlling shareholders are influential, it is unlikely that efforts on the part of regulators to enhance shareholder participation and engagement through stewardship measures will have the same beneficial effect as in companies with dispersed shareholding. The diffusion of UK-style stewardship codes across various shareholding structures overlooks this material difference.

In economies such as India, activist investors would be hard-pressed to alter the outcome of decisions made at shareholders' meetings due to the influence of controlling shareholders.

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56 Ibid.

57 Alice Klettner, 'The Impact of Stewardship Codes on Corporate Governance' (25 May 2018) at 6 < https://www.researchgate.net/profile/Alice_Klettner/publication/325358712_The_Impact_of_Stewardship_Codes_on_Corporate_Governance/links/5b0785060f7e9b1ed7f1e6a2/The-Impact-of-Stewardship-Codes-on-Corporate-Governance.pdf> accessed 5 September 2019.

58 Goto, 'The Logic and Limits of Stewardship Code: The Case of Japan', at 369. See also, Goto, Koh & Puchniak, 'Diversity of Shareholder Stewardship in Asia: Faux Convergence'.

Even though the number of resolutions where institutional shareholders have made a difference is increasing gradually,[59] it still represents a miniscule proportion of all resolutions put to vote by Indian publicly listed companies. Moreover, despite the overall growth of institutional shareholding in Indian companies and the decline in controller shareholding, critics have argued that the role of institutional shareholders is useful only in theory, and that efforts towards shareholder activism are unlikely to have any significant impact on corporate governance in India, primarily due to continued concentration in shareholdings.[60] Hence, the effect of shareholder activism in Indian companies is likely to be minimal at best.

The constraints imposed on the transportability of a UK-style stewardship code to other jurisdictions such as India raise several crucial questions. Does the definition and understanding of the concept of shareholder stewardship from a UK approach apply equally to jurisdictions with concentrated shareholding? Does the identity or image of the 'steward' remain the same across various jurisdictions? The remainder of this Part argues that the question of identity of the stewards must necessarily vary across jurisdictions, and that the conventional UK-based approach of treating predominantly institutional shareholders as stewards requires careful reconsideration. Accordingly, the concept of stewardship requires a paradigm shift and must extend beyond institutional shareholders and to controlling shareholders as well in jurisdictions such as India, which are replete with companies that have concentrated shareholding. In such companies, undue focus on institutional shareholders will yield much less results than in companies with dispersed shareholding.

At the outset, the UK approach defines stewardship from a narrow perspective to encompass only institutional shareholders. For example, the UK regulator defines 'stewardship as the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, the economy and society'.[61] The academic community too tends to adopt a similar definition and scope that is limited to the stewardship of institutional shareholders.[62] While such a compass is appropriate for jurisdictions with dispersed shareholding, it covers an extremely narrow domain in jurisdictions with concentrated shareholding such as India. A pure focus on institutional shareholders tends to be rather myopic. As Professor Geis notes:

> Ultimately, however, Indian corporate insiders simply own too many shares to worry about activist institutional investors. Any near-term regulatory reliance on outside shareholder power as a strategy for sound governance is likely to disappoint. This does not necessarily mean that efforts to give independent shareholders a greater role

[59] See note 21 above and accompanying text.

[60] George S Geis, 'Can Independent Blockholding Play Much of a Role in Indian Corporate Governance?', (2007) 3 *Corporate Governance Law Review* 283.

[61] Financial Conduct Authority/Financial Reporting Council, 'Building a regulatory framework for effective stewardship', at 11.

[62] See e.g., Iris H-Y Chiu, 'Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance', (2012) 6 *Brooklyn Journal of Corporate & Financial Law* 387, at 387; Goto, 'The Logic and Limits of Stewardship Code: The Case of Japan', at 368.

> in firm governance should be abandoned. But near-term priorities for regulatory reform should likely focus on protecting minority shareholders from the threat of controller opportunism – and not on strategies that rely on the flexed muscles of the outside owners.[63]

In such a scenario, the concept of stewardship must extend not only to institutional shareholders, but also to the controlling shareholders. Such a broader stewardship theory finds place in family-owned businesses, where 'the goal orientation that is manifest in stewardship behaviors emphasizes a commitment to the continuity and longevity of the company and its stakeholders'.[64] This is somewhat consistent with the UK-style stewardship code's endeavour to address the problems of short-termism by focusing on sustainable value of the companies.[65] In such circumstances, stewardship is a collective concept embodied in the relationship between the controlling shareholders and the outside institutional shareholders. They adopt a collective responsibility not just for the sustainable growth of the company, but also to act in the interests of all stakeholders.[66]

In countries such as India, controlling shareholders are either business families or the state. When it comes to business families, the concept of stewardship applies squarely to those companies given the multigenerational considerations involved.[67] Family owners' stewardship is a measure of their need for the company's continued success in the long term.[68] Some attribute the performance of family firms to the fact that 'the family understands the business and that involved family members view themselves as the stewards of the firm'.[69] In addition, such an approach 'is conducive to corporate longevity and favourable relations with stakeholders'.[70] The expansive stewardship approach that encompasses family owners is consistent with the broader outlook towards stakeholders and not limited to protecting the interests of beneficiaries of institutional investors under the narrow conception of the UK-style stewardship.

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[63] George S Geis, 'Shareholder power in India' in Jennifer G Hill & Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), at 607.

[64] Morela Hernandez, 'Towards an Understanding of the Psychology of Stewardship', (2012) 37 *The Academy of Management Review* 172, at 176.

[65] Arad Reisberg, 'The UK Stewardship Code: On the Road to Nowhere?', (2015) 15 *Journal of Corporate Law Studies* 217, at 246.

[66] The aspect of stakeholder responsibility is addressed in Part 4 below.

[67] Tarun Khanna & Yishay Yafeh, 'Business Groups and Risk Sharing around the World', (2005) 78 *The Journal of Business* 301, at 340.

[68] Danny Miller, Isabelle Le Breton-Miller & Barry Scholnick, 'Stewardship vs. Stagnation: An Empirical Comparison of Small Family and Non-Family Business', (2008) 45 *Journal of Management Studies* 51, at 51; Loraine M Uhlaner, Roberto H Floren & Jurgen R Geerlings, 'Owner Commitment and Relational Governance in the Privately-Held Firm: An Empirical Study', (2007) 29 *Small Business Economics* 275, at 275.

[69] Ronald C Anderson & David M Reeb, 'Founding-Family Ownership and Firm Performance: Evidence from the S&P 500', (2003) 58 *The Journal of Finance* 1301, at 1324.

[70] Miller, Le Breton-Miller & Scholnick, 'Stewardship vs. Stagnation', at 73.

This idea of extending the concept of shareholder stewardship beyond institutional investors is not an obscure one confined to academic soul-searching. In fact, in Singapore, the relevant body, viz., Stewardship Asia, has already published a set of stewardship principles applicable to family business.[71] According to these principles, 'stewardship encapsulates the essence of responsible and meaningful value creation in a sustainable way to benefit stakeholders, as well as the larger community that they are part of. It underscores the importance of an ownership mind-set, a long-term perspective and an inclusive approach'.[72] Such a stewardship approach considers the family controllers as stewards, and introduces an altogether different lens through which one can view corporate governance in family-owned firms.[73]

It is eminently feasible to extend such a broader stewardship concept to the state as a controlling shareholder in state owned enterprises (SOEs) listed on the stock exchanges. The government may be less inclined to tunnel financial wealth from SOEs in which it has invested, but it runs the risk of managing the SOEs to gain political capital.[74] In such circumstances, the extension of the wider stewardship concept to SOEs will be beneficial.

In concluding this section, it is clear that the UK-style stewardship code, which emanated in the context of dispersed shareholding and the significant influence of institutional investors, cannot find its way into jurisdictions such as India where concentrated shareholding is the norm. Institutional investor participation and engagement is likely to have limited impact in India. However, there is considerable merit in extending the concept of stewardship beyond institutional shareholders and to controlling shareholders such as the business families and the state, which requires a paradigm shift in the stewardship discourse.

IV. STAKEHOLDER CONSIDERATIONS

The goals of stewardship may differ across jurisdictions, depending upon the orientation of each jurisdiction's corporate law and governance along the shareholder-stakeholder spectrum, although issues of corporate sustainability and social responsibility have begun to take strong hold within the idea of stewardship around the world.[75] Given the distinctions in the goals

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71 Stewardship Asia, *Stewardship Principles for Family Businesses: Fostering Success, Significance and Sustainability* (2018).

72 Ibid, at 01.

73 For a detailed discussion of stewardship of family businesses in Singapore, see Dan W. Puchniak & Samantha Tang, 'Singapore's Puzzling Embrace of Shareholder Stewardship: A Successful Secret', *NUS Law Working Paper No. 2019/022* <https://ssrn.com/abstract=3474151> (accessed 17 January 2020).

74 Curtis J Milhaupt & Mariana Pargendler, 'Related Party Transactions in State-Owned Enterprises', in Luca Enriques & Tobias Troeger, *The Law and Finance of Related Party Transactions* (Cambridge University Press, 2019); Mariana Pargendler, 'State Ownership and Corporate Governance', (2012) 80 *Fordham Law Review* 2917.

75 Katelouzou, 'Shareholder Stewardship: A Case of (Re)Embedding the Institutional Investors and the Corporation?'

and objectives of corporate governance and thereby stewardship in different jurisdictions, the diffusion of the UK-style stewardship principles to jurisdictions such as India that adopt a different orientation in the shareholder-stakeholder debate could portend unintended consequences.

UK corporate law and governance embodies the enlightened shareholder value (ESV) principle,[76] which takes the position that the ultimate objective of company law to generate maximum shareholder value is also the best means of securing protection of all interests and thereby overall prosperity and welfare.[77] The law reforms that led to this position expressly rejected the stakeholder theory embedded in the pluralist approach whereby the company is to serve a wider range of stakeholder interests, without subordination to the need for achieving shareholder value. More recent reforms in the UK reemphasise the importance of the ESV approach, and introduce greater recognition of stakeholder interests and engagement.[78] Nevertheless, even with these reforms, the underlying idea remains embedded in the ESV approach and does not embrace the broader pluralist ideas.

Conversely, the stakeholder approach has remained the foundation of corporate law in India, and has received even greater statutory and regulatory attention in recent years. For example, Indian company law has preferred to adopt the pluralist approach by providing recognition to both stakeholders and shareholders, without necessarily indicating a preference to either.[79] Moreover, the Indian Parliament has gone much further to legislate the concept of corporate social responsibility (CSR),[80] thereby moving the needle considerably towards a stakeholder approach to corporate law and governance. This fundamental difference in the philosophy of corporate governance needs to find a crucial place in the discourse on stewardship.

Focusing specifically on stewardship, the concept arose in the UK on the back of the global financial crisis, which generated calls for greater shareholder engagement.[81] Stewardship was intended to address the malaise of short termism that had afflicted the companies engulfed in the crisis. The concept therefore sought to motivate shareholders, essentially being institutional investors, to engage in a long-term focus on their investments in companies. The concept of sustainability came to be equated largely with financial sustainability, although the

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[76] Companies Act 2006, s 172.

[77] Deryn Fisher, 'The enlightened shareholder – leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) 20 *ICCLR* 10; Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 *Sydney Law Review* 577; Virginia Harper Ho, '"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 *Journal of Corporation Law* 59.

[78] FRC, *The UK Corporate Governance Code* (July 2018), applicable from 1 January 2019.

[79] Companies Act 2013, s 166(2).

[80] Companies Act 2013, s 135.

[81] Cheffins, 'The Stewardship Code's Achilles' Heel', at 1005.

concomitant benefits of such an approach to the broader gamut of stakeholders and positive societal impact cannot be ignored.

As one scholar notes, in the UK 'the goal of a stewardship code is to advance the public interest by restraining excessive risk-taking and investor short-termism'.[82] In such an approach, the focus is on the beneficiaries of the institutional investors: if institutional stewardship is able to generate optimal long-term results to the beneficiaries, the argument goes that it will lead to greater societal benefit.[83] In such a construct, institutional investors as stewards have an interest in ensuring that companies perform in a financially sustainable manner in the long term so that it is consistent with the expectations and interests of the beneficiaries of such institutional investors. Such an approach remains akin to the ESV model rather than a broader stakeholder approach.[84]

The latest round of stewardship reforms in the UK recognise the intersection between stewardship and sustainable investing and, more specifically, ESG matters.[85] While this represents a material shift in the UK position, the recognition of ESG considerations is still entrenched in the financial impact of the investment over time.[86] It does not embrace the stakeholder theory in a pluralistic paradigm.

The transplant of such a UK-style model that provides for the broader public interest of the beneficiaries, and one that steeps itself in the ESV model of corporate governance with its emphasis on ESG considerations in that light, is nevertheless inadequate to blend in with a pluralistic approach towards stakeholders in India. Even the reformed UK position arguably does not comport well within the Indian circumstances.

First, the three stewardship codes in India adopt the same approach as in the UK without having any regard whatsoever to the philosophical variations in the stakeholder orientations in the two jurisdictions. For example, the IRDAI stewardship guidelines are focused on insurers 'as custodians of policyholders' and stewardship is seen as a means to 'ultimately improve the return on investments of insurers'.[87] Similarly, the PFRDA views stewardship as being 'intended to protect the subscribers' pension wealth' and that corporate governance in the investee companies must give 'a greater fillip to the protection of the interests of the

82 Goto, 'The Logic and Limits of Stewardship Code: The Case of Japan', at 398.

83 Chiu, 'Institutional Shareholders as Stewards', at 396.

84 Ibid, at 398.

85 FRC, *The UK Stewardship Code 2020*, Principle 7 (for asset owners and asset managers).

86 Financial Conduct Authority/Financial Reporting Council, 'Building a regulatory framework for effective stewardship', at 15. See also, Alice Klettner, 'Stewardship Codes and the Pursuit of Corporate Sustainability' (January 2018), at 18 < https://www.latrobe.edu.au/__data/assets/pdf_file/0005/855338/Klettner,-A-Stewardship-codes-and-the-pursuit-of-corporate-sustainability.pdf> accessed 6 September 2019.

87 IRDAI, *Guidelines on Stewardship Code for Insurers in India* (introductory letter accompanying the Guidelines).

subscribers in such companies'.[88] Even SEBI intends for institutional investors to engage in stewardship 'to protect their clients' wealth' and 'as an important step towards improved corporate governance.[89] Again, in these cases, the objectives of stewardship are to protect the interests of the respective beneficiaries, namely insurance policyholders, pension subscribers and mutual fund unitholders. While the PFRDA and SEBI codes allude to the need for investors to engage with companies on ESG opportunities or risks, the IRDAI guidelines are silent on that aspect.

Second, the stakeholder approach in India imposes obligations on the boards of companies to 'act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment'.[90] Similarly, the provisions relating to CSR focus on the boards of companies to constitute a committee to examine the issues, formulate a policy and undertake CSR spending to the extent prescribed by law.[91] Furthermore, through its business responsibility reporting requirements, SEBI nudges companies to act in a sustainable manner. The combined effect of these measures is that the boards and managements of Indian companies bear stakeholder and social responsibility. On the other hand, not only are shareholders devoid of any such responsibilities, but the stewardship codes emanating in India expressly seem to be driven by the need to protect the long-term interests of the beneficiaries of various types of financial investors. While it is generally the case that the long-term interests of the beneficiaries would be consistent with the sustainability interests of the company under the stakeholder theory, the current dispensation does not provide clear guidance towards the resolution of potential conflicts between these interests, were they to arise.

Third, and extending from the previous point, the introduction of the UK-style stewardship code in jurisdictions such as India undermines the pluralistic stakeholder approach. While the regime expects boards to be stakeholder-focused, the stewardship codes expect institutional shareholders to be focused on the long-term interests of their beneficiaries. As Professor Chiu notes: 'It could be argued that the Stewardship Code mistakenly concentrates monitoring in the hands of shareholders, where other stakeholders may have greater incentive to monitor, thereby unnecessarily relegating the importance of other stakeholders.'[92]

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[88] PFRDA, *Common Stewardship Code* (introductory letter accompanying the Common Stewardship Code).

[89] SEBI, *Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities* (introductory letter accompanying the Stewardship Code, para. 1).

[90] Companies Act 2013, s 166(2). For a comparison between this and section 172 of the UK Companies Act 2006, see Mihir Naniwadekar & Umakanth Varottil, 'The Stakeholder Approach towards Directors' Duties under Indian Company Law', in Mahendra Pal Singh (ed), *The Indian Yearbook of Comparative Law* (Oxford University Press, 2016).

[91] Companies Act 2013, s 135.

[92] Chiu, 'Institutional Shareholders as Stewards', at 428. See also, Reisberg, 'The UK Stewardship Code: On the Road to Nowhere?', at 230.

Fourth, and lastly, a well-designed stewardship regime could help address some of the concerns emanating from the structure of the stakeholder approach in Indian corporate law and governance. One of the primary criticisms of the stakeholder approach towards directors' duties under Indian corporate law is that there is a lack of clarity whether non-shareholder constituencies can exercise any direct remedies or enforcement mechanisms in case of breaches of directors' duties to take into account stakeholder interests.[93] To that extent, despite the superficial difference between the ESV approach in the UK and the pluralist approach in India, the lack of stakeholder remedies and enforcement mechanisms makes the Indian regime similar to that of the UK. An appropriate stewardship regime that enables shareholders (who bear remedies such as shareholder derivative actions and shareholder class actions) could potentially use those tools to benefit broader stakeholder interests. It can thereby fill the gap in enforcement that the stakeholder regime in India presently suffers from.

In considering the shareholder-stakeholder aspects of corporate governance, as this section demonstrates, the transplant of the UK-style stewardship code into India without necessary adaptations will result in an avoidable mismatch of philosophies.

V. IMPLEMENTATION OF STEWARDSHIP

When it comes to implementing the concept of stewardship, the UK model initially adopted the 'comply-or-explain' approach, whereby parties subject to the stewardship code could choose to either comply or disclose the reasons why they failed to comply.[94] While this was entirely understandable in the UK context, the transposition of this model to other jurisdictions that have different corporate structures, legal and institutional structures and business culture is altogether surprising. Moreover, when there are doubts about the robustness of implementation of the code in the UK, the issues are likely to be magnified further in other jurisdictions. As noted in this section, the use of soft law approach to stewardship in the Indian context militates against the regulatory framework in India and legal culture. It is bound to raise significant implementation problems. Also worth noting is that the UK stewardship regime itself has moved away from the traditional comply-or-explain approach to the apply-and-explain approach.[95] This would ensure that companies not only apply the principles of the stewardship code, but they also adopt a proactive approach in explaining their manner of application of the code. This is expected to ensure compliance with the code in spirit and eschew a check-the-box attitude on the part of companies and service providers.[96]

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93 Naniwadekar & Varottil, 'The Stakeholder Approach towards Directors' Duties under Indian Company Law', at 108.

94 FRC, *The UK Stewardship Code* (September 2012), at 2.

95 FRC, *The UK Stewardship Code 2020*, at p. 4 (Introduction).

96 For a discussion on the concept of "apply and explain", see Parmi Natesan & Prieur du Plessis, 'Why King IV's "apply and explain" is so important', *Institute of Directors South Africa* (20 February 2019)

Despite the transition from a comply-or-explain approach to the apply-and-explain approach, the UK continues to rely on the use of soft law, and has not embarked on a mandatory rules-based regime. One can attribute a number of reasons for this phenomenon. *First*, the UK has displayed a consistent pattern in the use of codes, whether it be the City Code on Takeovers and Mergers or the Corporate Governance Code.[97]

Second, it is the large and influential group of institutional investors in the UK that have orchestrated a code-based regulatory set-up, as they have a distinct preference for soft law over mandatory governmental regulation.[98] As repeat players in the market, institutional investors are subject to reputational incentives to adhere to codes even in the absence of strict sanctions for non-compliance. The evolution of the UK stewardship code occurred in two steps wherein an initially voluntary investor based initiative led by the Institutional Shareholders' Committee (ISC) morphed itself into one administered by the regulator, the Financial Reporting Council.[99]

Third, such a market-oriented approach relies extensively upon a robust system of legal institutions and mechanisms with sophisticated legal and supportive institutions. These include corporate governance intermediaries such as auditors, compliance professionals, other informational intermediaries and proxy advisory firms that create the necessary ecosystem for shareholder participation and engagement.

This constellation of factors, being hallmarks of the UK corporate governance system, form the bedrock on which a stewardship code based initially on a comply-or-explain approach took shape in that jurisdiction. However, despite the ideal conditions for such a stewardship model to thrive, it has attracted strident criticism. This is on the ground of fragmentation of institutional investors, the increasing influence of foreign investors who stand outside the scope of the stewardship code, and the fact that a voluntary system is likely to have limited bite even in the purportedly ideal regulatory climate in the UK.

It would now be appropriate to explore the reasons why jurisdictions such as India might find it difficult to emulate the UK in implementing a code on stewardship that operates on a voluntary comply-or-explain basis or even an apply-and-explain basis. *First*, unlike the UK that has extensively relied on code and soft law in the sphere of corporate law and governance, India has displayed a consistent dependence on government regulation of the

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<https://www.iodsa.co.za/news/438882/Why-King-IVs-apply-and-explain-is-so-important.htm> accessed 24 January 2020.

97 Umakanth Varottil, 'Corporate Governance in India: The Transition from Code to Statute' in Jean J. du Plessis & Chee Keong Low (eds.), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Switzerland: Springer International Publishing, 2017), at pp. 102-03.

98 Bernard S Black & John C Coffee Jr, 'Hail Britannia?: Institutional Investor Behavior under Limited Regulation' (1994) 92 *Michigan Law Review* 1997.

99 Cheffins, 'The Stewardship Code's Achilles' Heel', at 1012.

corporate sector. For instance, India's basic corporate law enacted by Parliament, i.e., Companies Act, 2013, set out detailed rules and regulations regarding corporate governance such as the roles and responsibilities of independent directors and auditors, the treatment of related party transactions and the like. In most jurisdictions, these detailed governance requirements are contained either in voluntary codes or in stock exchange listing rules. To that extent, India follows an extreme system of mandatory and prescriptive regulation on matters of corporate governance.[100] The statutory mandate is supplemented by listing regulations issued by SEBI, again representing a mandatory approach.[101] To consider the infusion of a UK-style code-based approach of stewardship in such a milieu would certainly give rise to difficulties.

Second, the influence of the institutional investors in the UK that has led to a code-based approach in that jurisdiction is far more limited in India. Despite the growing incidence of shareholder participation and engagement in Indian companies, the influence of institutional shareholders in the design of the governance regimes is almost non-existent. *Third*, the prevalent legal institutions and mechanisms in India have not stimulated a culture of voluntary compliance. This is likely to make a soft law approach subject to large-scale deviance, and that too with minimal and unsatisfactory explanation of the reasons for such non-compliance.

For these reasons, a mandatory regime in the form of hard law is more suitable for India rather than a voluntary code-based soft law approach. Even when the Indian corporations and regulators have relied upon the comply-or-explain approach, whether for corporate governance, corporate social responsibility or even for ESG reporting, it has been short-lived. Such a reliance on soft law has been a purely transitional mechanism before the contents of the soft law are granted the imprimatur of hard law. In that sense, the soft law approaches in the corporate sector have hardly endured in India.

Despite these circumstances, the three stewardship codes currently in vogue in India do not share common characteristics. While the IRDAI code is explicitly on a 'comply-or-explain' basis, the PFRDA and SEBI codes are designed to be mandatory in nature. Even in the case of the PFRDA and SEBI codes, it is not clear how the regulators will address instances of non-compliance, and what the accompanying sanctions might be. Hence, unless accompanied by appropriate consequences that operates as a deterrence against breach, even the supposedly mandatory codes lack legal bite.

Indian regulators would instead do well to pay heed to developments that resulted in the pan-European initiatives that led to the EU Shareholder Rights Directive in 2017.[102] Scholars

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[100] In another writing, this author refers to this phenomenon of including corporate governance requirements in the basic corporate statute as the 'ultra-mandatory' approach. Varottil, 'Corporate Governance in India: The Transition from Code to Statute', at 98.

[101] See, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

[102] (EU) 2017/828) (also referred to as 'SRD II').

have observed that this 'introduces a duty to *demonstrate* engagement on the part of institutional investors and asset managers, and is, therefore, a tentative step towards hardening of stewardship/engagement duties'.[103] Such a duty-based approach is likely beneficial in jurisdictions with concentrated shareholding such as India, as it will 'introduce more clarity into the expectations for shareholder conduct and intra-shareholder relations'.[104] In such a case, the statutory or legislative backing will tremendously aid in the enforcement of the requirement. The mere use of soft law for this purpose is unlikely to cut ice.

The transition from voluntary stewardship based on soft law to a shareholder participation and engagement duty embedded in hard law[105] would be more suitable for India rather than the traditional UK-style stewardship code. Therefore, rather than heedlessly being influenced by the UK, the Indian regulators must explore elsewhere to find the appropriate regulatory tools that fit within the Indian legal, institutional and cultural contexts.

VI. CONCLUSION

This paper set out to examine whether the UK-style stewardship code, which emanated and is operating under circumstances specific to that jurisdiction, is capable of being transplanted to a jurisdiction such as India which has divergent corporate ownership structures as well as legal and institutional mechanisms. While India has sought to move towards a UK-style stewardship code, the developments have been fragmented, largely due to the involvement of various sectoral regulator such as the insurance regulator (IRDAI), the pension regulator (PFRDA) and the securities markets regulator (SEBI). While there was an expectation that the regulators will collaborate to introduce a uniform set of guidelines that apply to all types of institutional investors, the developments thus far have been unsatisfactory. The IRDAI, PFRDA and SEBI have each issued their own sets of guidelines, and a consolidated and uninform set of stewardship principles applicable to all institutional investors is nowhere in sight.

In such a context, this paper sought to identify certain considerations, which the regulators ought to bear in mind while introducing a uniform set of stewardship principles. The crux of this paper is that, at least on three counts, the UK-style stewardship code is inappropriate for India and an ill-considered introduction of its principles and implementation tools into India will not fetch the desired results. First, the shareholding structure in India is different from that in the UK, which alters the focus of stewardship. Second, the emphasis of corporate law and investor engagement in the UK is driven by the ESV principle, while in India it is founded on the pluralist stakeholder theory. Third, the soft law-based approach that has characterised UK stewardship as well as other codes will face considerable resistance in India

103 Chiu & Katelouzou, 'From Shareholder Stewardship to Shareholder Duties', at 133.

104 Ibid.

105 The hard law could be in the form of fiduciary duties on shareholders imposed in certain specific circumstances under company law.

where a mandatory hard law-based approach has become the norm in the corporate sector. The regulators in India will be well advised to cast a wider net in terms of adopting principles and best practices that are suitable for implementation in India.

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