

## DEVELOPMENT OF THE RIGHT TO VOTE OF SHAREHOLDERS

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Shareholders meetings have been held to be of utmost importance ever since shares of companies have been traded so as to ensure a forum for discussion of vital business policies and decisions. After shareholding became more scattered and diffused, legislature has taken the initiative to make laws to provide for the rights of the shareholders to vote and make proposals.

Shareholder voting is the crux of a spectrum of corporate governance protections. The rights of shareholders to choose members of the board of directors, approve mergers and acquisitions, authorize new equity issues, and amend the firm's articles of organization give them ultimate power over important corporate decisions. Conversely, a large concentration of voting power in the hands of management tends to negate the discipline of corporate governance and the market for corporate control, especially when management's voting rights exceed its cash flow rights due to the use of devices such as multiple classes of common stock or pyramidal business groups.<sup>1</sup>

In the project, the authors have tried to analyse the impact that shareholder voting has on the scenario of corporate governance in any corporation. This has been done through exploring the different voting principles and their consequence upon different elements of corporate governance. Tentatively, the authors will cover the following:

- One share-one vote
- Cumulative Voting
- Proxy Voting
- Empty Voting

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<sup>1</sup>David Yermack, *Shareholder Voting and Corporate Governance*, Annu. Rev. Financ. Econ. 2010, available at [http://www.mfsociety.org/modules/modConferences/uploadFiles/miscFiles/1339670183-Plenary\\_Talk\\_Paper\\_David\\_Yermack.pdf](http://www.mfsociety.org/modules/modConferences/uploadFiles/miscFiles/1339670183-Plenary_Talk_Paper_David_Yermack.pdf), last visited 22<sup>nd</sup> 3<sup>rd</sup> February, 2017.

## CUMULATIVE VOTING

Cumulative voting allows shareholders to cast all of their votes for a single nominee for the board of directors when the company has multiple openings on its board. In contrast, in regular voting, shareholders cannot give more than one vote per share to any single nominee. With cumulative voting, one could choose to vote all available votes for one candidate, split his vote between two candidates, or otherwise divide his votes whichever way he wanted.<sup>2</sup> Cumulative voting indicate that it was a prevalent practice in the early part of the 20th century, and was even a mandatory provision for director elections in some states in the U.S. This practice witnessed its demise first in the 1950s and thereafter in the 1980s due to pressure from the managerialist forces.<sup>3</sup>

Under the new Companies Act, Section 163 allows Indian companies to adopt cumulative voting practices, but this isn't mandatory. Previously, it was incorporated in Section 265 of the old Act. It is suggested that this provision be made mandatory as it helps better protect the interests of minority shareholders. Cumulative voting enhances the potential influence of a cohesive minority. Cumulative voting can be particularly beneficial for firms facing a competitive environment wherein the adaptability of the firm become increasingly valuable. An objection to cumulative voting is its potential for boardroom disruption—that distracts management from its tasks.<sup>4</sup>

The advantage of cumulative voting is that it ensures that a minority group of shareholders or unit owners can be represented on the board. Therefore, the minority have a say in the management. This ensures the protection of their interests as well. Cumulative voting gives minority shareholders a say in majority dominated corporations as well as management oriented organizations. Cumulative voting also reduces costs of organisations. Minority representation on the board could add independent, critical scrutiny of management action and thereby improve corporation decision-making and managerial accountability.<sup>5</sup>

## PROXY VOTING

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<sup>2</sup><http://www.sec.gov/answers/cumulativevote.htm>, last visited 22<sup>nd</sup> September 2014

<sup>3</sup>Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, Hastings Busi. LJ, Vol. 6, 2010, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1548786](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1548786), last visited 8<sup>th</sup> February, 2017

<sup>4</sup>Jeffery N.Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, Columbia Law Review, 1994, available at [http://www.law.yale.edu/documents/pdf/CBL\\_Symposium10\\_05/S1-6%20Gordon.pdf](http://www.law.yale.edu/documents/pdf/CBL_Symposium10_05/S1-6%20Gordon.pdf), last visited 8<sup>th</sup> February, 2017

<sup>5</sup>*Ibid.*

The proxy process — or proxy voting — is the term used to describe the means for shareholders to participate in a company's annual shareholders meeting, without attending the meeting. This way, shareholders who do not attend a meeting may vote on the matters to be considered at the meeting. These votes typically are held once a year in connection with the company's annual shareholders meeting.<sup>6</sup>

Section 105 of the Companies Act, 2013 which corresponds to Section 176 of the Companies Act, 1956 is the enabling provision for proxy voting in India. The delegation of one's voting right, or proxy, was developed to enable the shareholder to exercise his or her voting right in the corporation. It is required of companies that they<sup>7</sup>:

- publish full proxy materials
- distribute material well ahead of the meetings
- participate in electronic voting
- confirm that a shareholder's vote has been confirmed and counted

In many countries, including India, there are several proxy advisory firms that advise shareholders and companies on matters of proxy shareholding, and also vote on behalf of the shareholders. The SEC has issued its long-awaited guidance on proxy advisory firms, in the form of Staff Legal Bulletin No. 20 from the Division of Investment Management and the Division of Corporation Finance. SLB 20 makes clear that investment advisers are required to vote in accordance with their clients' wishes, including not voting at all, only voting on some matters, or voting in favor of management or certain proponents. To appropriately carry out their voting responsibilities, according to SLB 20, investment advisers should establish policies and procedures, which may include the ability to retain third parties that provide voting recommendations. Investment advisers that retain proxy advisory firms for this purpose should undertake due diligence to ensure that those firms have the capacity and competency to adequately analyze proxy issues. In this regard, SLB 20 suggests that advisers consider whether proxy advisory firms have proper resources and robust policies and procedures regarding conflicts of interest, and are providing voting recommendations based on accurate information, including investigating any material factual errors made by proxy advisory firms that affect the voting recommendations.<sup>8</sup>

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<sup>6</sup><http://www.investopedia.com/articles/basics/04/082704.asp>, last visited 10<sup>th</sup> February, 2017

<sup>7</sup>Corporate Governance Principles And Proxy Voting Guidelines, available at <http://www.bcimc.com/publications/pdf/responsibleinvesting/corporategovernanceprinciplesproxyvotingguidelines.pdf>, last visited 22<sup>nd</sup> September, 2014

<sup>8</sup><http://www.sec.gov/interps/legal/cfslb20.htm>, last visited 11<sup>th</sup> February, 2017

In India, the SEBI has recently made draft guidelines to ensure proxy advisory firms are kept in check. It has finalised detailed norms for 'research analysts' to ward off any conflict of interest in their activities. The new norms, which would also cover 'proxy' advisors or those providing advisory services similar to research analysts, have been framed in the wake of various instances of 'mischievous' research reports having been circulated among the investors in the past to manipulate the overall market trends or share price of individual companies. As per the draft norms, every individual or entity desiring to function as a research analyst would need to get registered after meeting the prescribed criteria regarding qualifications, capital adequacy, establishment of internal policies and procedures, firewalls against conflict of interest, sufficient and timely disclosures, among others. The regulations also provide for penal actions that Sebi can take against erring research analysts. Such actions would include cancellation of registration, debarment, or penalties similar to any other market intermediary.<sup>9</sup>

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<sup>9</sup><http://www.vccircle.com/news/finance/2014/06/17/sebi-finalises-norms-research-analysts-proxy-advisory-firms>, last visited 11<sup>th</sup> February, 2017