FESTINA LENTE: INSTITUTIONAL INVESTORS AND THE QUEST FOR BOARDROOM DIVERSITY IN INDIA

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Abstract

Gender diversity in the boardroom is espoused in corporate law literature for two main reasons first, equality between the genders; and second (and more contentious), the 'business case', that is, the idea that gender diversity improves business performance of the company. In 2013, India introduced a gender-based quota aimed at ensuring at least one female director on the board of a listed company, which yielded little success in the quest towards substantial gender diversity. This paper argues that there is a new phenomenon in Indian corporate governance that may help bring about the much-desired gender diversity – institutional investor activism. Institutional investors have a two-fold incentive to push for gender diversity in their portfolio companies. First, as minority shareholders institutional investors are vulnerable to being exploited by the management, and the increase in monitoring brought about by gender-diverse boards safeguards their interests as shareholders. Second, the rise of ESG investing focused on gender equality impels index funds to strive actively towards ensuring boardroom diversity in their portfolio companies with a view to distinguishing themselves from their competitors. Taking into account the increasing potential of activist funds to bring about meaningful change in corporate governance practices, this paper argues that market-driven measures such as the disclosure of stewardship activities and the enforcement of the Shareholder Stewardship Codes may be much more successful than the quota-based laws in driving India Inc. to substantial gender diversity.

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I. INTRODUCTION

The statue of the Fearless Girl, installed by State Street Global Advisors on the Wall Street on the eve of Women's Day in 2017, immediately caught global attention as a radical icon in the quest towards gender equality in corporate America.[1] While the installation of the statue was an innovative attempt at raising the question of boardroom diversity, the necessity and urgency of including more women in corporate boardrooms has been a consistent theme in corporate governance over the last few years.[2] Although a number of large index funds as well as securities regulators around the world have begun engaging with the management of public companies on the theme of board diversity, substantive gender equality in the boardroom remains elusive.[3]

The demand for gender-diverse boardrooms is premised on two key rationales – *equality* and *efficiency.* The former is premised on arguments of gender equality, anti-discrimination, fairness and as some European countries have stated, the principle of democratic representation. The latter, and perhaps more contentious, is the '*business case*' – it is based on the argument that gender diversity improves corporate governance and decision-making of the corporate board, thereby increasing the value of the company. While the equality argument is no longer contested, the 'business case' for boardroom diversity relies on empirical studies that show a causation/correlation between female directors and improved corporate governance, and therefore increased firm value. However, the studies[4] are often inconsistent and fail to show a causal connection/correlation between female directors and improvement in the value of the firm. Nonetheless, regulators and policymakers across the world routinely proffer both arguments in their advocacy for gender-diverse boards.

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[1] Sheelah Kolhatkar, 'The Ongoing Saga of the "Fearless Girl" Statue' (*Wall Street Journal*, 7 January 2022) <https://www.newyorker.com/business/currency/the-ongoing-saga-of-the-fearless-girl-statue> last accessed on 30 May 2024.

[2] Renee Adams & Daniel Ferreira, 'Gender Diversity in the Boardroom' (2004) ECGI Working Paper No. 57/2004; Steven Ramirez, 'Diversity and the Boardroom' (2000) 6 Stanford Journal of Law and Business 85.

[3] Michal Barzuza, Quinn Curtis & Daniel Webber, 'Shareholder Value(s): Index Fund ESG Activism and the New Millenial Corporate Governance' 93 Southern California Law Review 1243 (2020) (hereafter *'Barzuza et al'*); Yaron Nili, 'Beyond the Numbers: Substantive Gender Diversity in Boardrooms' (2019) 94 Indiana Law Journal 145.

[4] Katherine Klein, 'Does Gender Diversity on Boards really boost Company Performance?' *Knowledge at Wharton* (18 May 2017) <https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/> last accessed on 30 May 2024.

The first legislative intervention in this regard came in 2003 when Norway introduced quotas for women on corporate boards.[5] Germany, France, and a number of European countries that have a long history of stakeholder-oriented corporate governance soon followed suit.[6] Gender-based quotas in corporate boards were introduced in India through Section 149(1) of the Companies Act, 2013, which stipulated that companies that fell within a certain prescribed category must mandatorily have at least one female director.[7] A similar provision is present in Regulation 17(1) of the SEBI Listing Obligations and Disclosure Regulations (LODR), mandating all listed companies to have at least one woman director on the board of their directors. The Regulation further provides that the 500 listed companies are to have at least one independent woman director by 1st April 2019, while the top 1000 listed companies are expected to meet the requirement by 1st April 2020. The quota, however, failed to yield much, as most companies engaged in tick-the-box compliance, and appointed family members of promoters (i.e., controlling shareholders), or inexperienced and underqualified women in a manner that benefited neither the company nor the women appointed.[8] The sole woman on the board was seen to be overshadowed by professionals who were more experienced than her and could not effectively raise her voice against management, thus failing the regulation's primary purpose of monitoring the activities of the board and merely becoming a representative female in an all-boys' club.[9]

While the efficiency of legally mandated gender diversity remains questionable, activist index funds in the US and elsewhere have been successful (at least to some extent) in pushing their portfolio companies to include more women in their boardrooms. For instance, in the US, the Big Three index funds of BlackRock, State Street and Vanguard have launched a vigorous advocacy campaign for gender-diverse boards, and often voted in accordance with such advocacy, pressuring the portfolio companies into yielding to their demand.[10] The global

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[5] *See generally* Aaron Dhir, *Challenging Boardroom Homogeneity: Corporate Law, Governance and Diversity* (CUP 2015).

[6] Mari Teigen, 'Gender Quotas on Corporate Boards: On the Diffusion of a Distinct National Policy Reform' in Mari Teigen & Frederick Engelstad (eds), *Firms, Boards and Gender Quotas: Comparative Perspectives* (2012); Douglas Branson, 'Initiatives to place women on Corporate Boards of Directors – A Global Snapshot', (2012) 37 Journal of Corporation Law 793, 803.

[7] Companies Act, 2013, sec 149(1).

[8] *See* part IIB infra.

[9] Sumru Erkut, Vicki W Kramer and Alison M Konrad, 'Critical Mass: Does the Number of Women on a Corporate Board Make a Difference?' in: Susan Vinnicombe and others (eds), *Women on Corporate Boards of Directors: International Research and Practice* (Edward Elgar Publishing 2008) 350.

[10] Anthony Goodman & Rusty O'Kelley, 'Institutional Investors Lead the Push for Gender-Diverse Boards', *Harvard Law School Forum on Corporate Governance* (26 April 2017) <https://perma.cc/43TH-CFFY> last accessed on 30 May 2024; Barzuza et al (n 3).

proliferation of stewardship codes indicates a growing consensus on the potential and necessity of institutional investors to act as responsible stewards driving meaningful change in corporate governance - stewardship codes across jurisdictions seek to incorporate environmental, social and governance ('ESG') principles into corporate decision-making, nudging index funds to push for boardroom gender diversity, amongst other stakeholder concerns.[11] The growing concern among investors regarding issues of diversity and equality also motivates institutional investor activism aimed at enhancing gender diversity in boardrooms.

In India, institutional investor activism has increased drastically over the last decade. Departing from the passive role institutional investors in India have typically played, a number of index funds are frequently opposing the management and promoters (the controlling shareholders) on issues like director appointment and remuneration.[12] The stewardship codes promulgated by the Insurance Regulatory and Development Authority of India ('IRDAI'),[13] the Pension Fund Regulatory and Development Authority ('PFRDA')[14] and the Securities and Exchange Board of India ('SEBI')[15], recognize institutional investors as central to responsible business practices and invite investors to actively engage in monitoring the business decisions of their portfolio companies. In August 2023, SEBI also amended the real estate investment trust and infrastructure investment trust regulations to require unitholders holding more than 10% of outstanding units to issue and publish stewardship policies.[16] Although the Indian stewardship codes have generally been lauded as a welcome move that provides a blueprint for responsible stewardship by institutional investors, their relationship with the Companies Act and the listing regulations, and their practical implications on the operation of investment funds remain unclear. Despite their rising prominence in the Indian corporate governance landscape, there is little academic literature in India on the role played by these institutional investors in

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[11] Dionysia Katelouzou & Mathias Siems, 'The Global Diffusion of Stewardship Codes' in Dionysia Katelouzou & Dan W. Puchniak (eds), *Global Shareholder Stewardship: Complexities, Challenges & Possibilities* (CUP, forthcoming, European Corporate Governance Institute – Law Working Paper No. 526/2020).

[12] Umakanth Varottil, 'Shareholder Stewardship in India – the Desiderata', in Dionysia Katelouzou & Dan Puchniak (eds), *Global Shareholder Stewardship: Complexities, Challenges & Possibilities* (CUP, forthcoming, NUS Law Working Paper No. 2020/005) (observing that since 2014, institutional investors have defeated at least 105 different proposals put forth by the management on crucial issues like the reappointment and remuneration of directors, employee stock option plans, and raising debt or equity.)

[13] Insurance Regulatory and Development Authority of India, Revised Guidelines on Stewardship Code for Insurers in India, IRDAI/F&A/GDL/CPM/045/02/2020 (Issued on Feb 7, 2020).

[14] Pension Fund Regulatory and Development Authority, Common Stewardship Code, PFRDA/2018/01/PF/01 (Issued on May 4, 2018).

[15] 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 (Issued on Dec 24, 2019).

[16] SEBI (Infrastructure Investment Trusts) (Second Amendment) Regulations, 2023, reg 3(II), 3(IX); SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023, reg 3(II), 3(VI).

the running of a company, and in particular, the commitment of these funds to the interests of stakeholders, whether on issues of gender-diversity, environmental protection or labour relations.[17] There is no explicit mandate on institutional investors in India to push for sustainability or diversity, apart from the limited exhortation under the stewardship codes, which, as we argue, lacks bite. As such, few have openly advocated ESG concerns, and their potential to aid the Indian quest towards stakeholder capitalism remains untapped.[18]

This paper argues that institutional investors in India have both the incentives as well as the avenues to push for greater gender diversity on corporate boards. *First,* institutional investors in India are generally minority investors who will benefit from an increased monitoring ability of gender-diverse boards. *Second,* a public commitment to ESG motives helps investment funds, and in particular index funds, to appeal to increasingly socially conscious investors who take into account issues like sustainability or gender diversity, in their investment decisions. The paper argues further that a push for gender diversity by institutional investors, facilitated and furthered through market-based regulatory measures like disclosures (and tiering of these disclosures) could help bring about *meaningful* gender diversity in Indian corporate boardrooms. Part I of the paper discusses the two rationales for gender diversity in corporate boardrooms – *first,* equality and *second,* the business case. Thereafter, Part II of the paper provides a critical overview of the Indian experiment with diversity quotas on corporate boards. Moving onto the interface of gender diversity with institutional investors, Part III of the paper studies the emerging phenomenon of institutional investor activism in India, and Part IV goes on to examine the incentives of institutional investors to push for gender diversity in boardrooms. Part V of the paper recommends policy measures to facilitate the push for meaningful gender diversity by institutional investors. Part VI concludes. To our knowledge, the relationship between fiduciary law and institutional shareholder activism vis-à-vis gender diversity is yet to be examined in the Indian context, and to that extent, we seek to further research in this regard, and frame questions for further study.

[17] For an overview of the academic literature, *see* Rudresh Mandal & Ashwin Murthy, 'CSR in the post pandemic era: the dual promise of ESG investment and investor stewardship' (2021) 5(2) Indian Law Review 225; Anik Bhaduri, 'Fostering socially responsible stewards: CSR and investment funds in India' (2023) 23(2) Journal of Corporate Law Studies 567.

[18] Azman Usmani, 'ESG Mutual Funds in India are having a reality check', *BQ Prime* (3 October 2022) <https://www.bqprime.com/business/esg-mutual-funds-in-india-are-having-a-reality-check> last accessed on December 26, 2022.

II. GENDER DIVERSITY IN CORPORATE GOVERNANCE – WHY DOES IT MATTER?

The fundamental question in the gender diversity debate is its rationale – why is it important to appoint more women to the board of directors? In India, as in most other parts of the common law world, the board of directors is responsible for a wide variety of managerial decisions.[19] The board of directors in modern corporations historically emerged as a means to mitigate the agency costs arising out of asymmetries between shareholders and the management.[20] Particularly in the Indian context, the board is also expected to protect the interests of the minority shareholders against the promoters (controlling shareholders) who hold a majority of the stock.[21] While the board itself meets only around 8-12 times a year, directors serve on a variety of board committees that are tasked with specific functions. The specific number of board committees may vary across companies but the statutory framework stipulates that all publicly traded companies are required to have specific committees for audit, nomination and remuneration, corporate social responsibility, stakeholder relationship and risk management (where applicable).[22] These committees meet separately from the board, and are crucial in the governance of the company. Accordingly, the board of directors is a keystone institution of corporate governance, and changes in its composition affect the way in which the company is run.

The literature on boardroom gender diversity presents two key reasons behind the argument for increasing gender diversity in corporate boardrooms. The first is premised on the idea of equality and non-discrimination, while the latter is based on the (contentious) argument that having more women on board improves the quality of corporate decision-making. This part of the paper iterates and evaluates the academic literature discussing these two rationales, and locates them in the Indian corporate governance framework.

A. Equality and social justice

The first argument for the inclusion of women in corporate boards is based on the constitutional principles of gender equality, antidiscrimination and fairness. Rooted in the feminist movement, the social cause for gender diversity in boardrooms is premised on its

[19] Jill Fisch, 'Taking Boards Seriously', (1997) 19 Cardozo Law Review 265.

[20] ibid; Henry Hansmann & Reinier Kraakman, *The Anatomy of Corporate Law* (OUP 2004) 21.

[21] Umakanth Varottil, 'Evolution and Effectiveness of Independent Directors in Indian Corporate Governance' 6 Hastings Business Law Journal 284 (2010).

[22] The Companies Act, 2013 mandates all companies to have the Audit Committee (s 177), Nomination and Remuneration Committee (s 177), Stakeholder Relationship Committee (s 178(5)) and the CSR Committee (s 135).

intrinsic moral appeal – it simply is *"the right thing to do"*.[23] Taking into account the long history of women being excluded from positions of power, the push for gender diversity is aimed at remedying the lingering effects of discrimination on women. A variety of socio-cultural factors and prejudice at various levels and in various forms hinder the ability of women to reach the top rungs of management, and the push for gender diversity is seen as an attempt to alleviate the disparity between the genders in top roles.[24]

In some European countries like Norway and France that introduced quotas for women in corporate boardrooms, the equality rationale has been articulated in terms of democracy - in a democracy where men and women are placed equal, decision-making by a corporate board should also reflect the equality between the genders. Julie Suk has argued that such a move enhances the legitimacy of the democratic state.[25] Similarly, Peta Spender has noted that the involvement of women in the leadership of public companies is *'a measure of their democratic leadership because these corporations are critical actors in the public sphere and their directors influence public debate and access to resources'*.[26]

In India, which was ranked 140 out of 156 countries in the Global Gender Gap Report 2021,[27] women face a variety of systemic barriers that prevent their entry into the workforce in the first place, while the patriarchal and sexist culture of the work environment hinders their ascent to leadership positions. The Indian constitution imposes a duty on the state to take steps to mitigate discrimination against women and empowers the state to formulate regulations that would allow women to overcome social and political hurdles to their employment.[28] An emphasis by the state as well as by companies on gender diversity in boardrooms brings to light the social reality that impedes the professional development of women and seeks to remove prejudices against the appointment of women to decision-making roles.

[23] Lisa Fairfax, 'Board Diversity Revisited: New Rationale, Same Old Story?', (2011) 89 Northern California Law Review 854, 856-57.

[24] Jean du Plessis, Ingo Saenger & Richard Foster, 'Board diversity or gender diversity? Perspectives from Europe, Australia and South Africa' (2012) 17(2) Deakin Law Review 207; Darren Rosenblum, 'Feminizing Capital: A Corporate Imperative', (2009) 55 Berkeley Business Law Journal 80.

[25] Julie Suk, 'Gender parity and state legitimacy – from Public Office to Corporate Boards', (2012) 10(2) International Journal of Constitutional Law 449.

[26] Peta Spender, 'Gender diversity on boards in Australia – Waiting for the great leap forward?' (2012) 27 Australian Journal of Corporate Law 22.

[27] World Economic Forum, 'Global Gender Gap Report: Insight Report' (World Economic Forum, Mar 2021) <https://www3.weforum.org/docs/WEF_GGGR_2021.pdf> last accessed on 30 May 2024

[28] Indian Constitution (1950), art 15(3).

B. The 'business case'

In recent years, arguments behind gender diversity have shifted their focus from moral justifications to a more instrumental one. The 'business case' for gender-diverse boardrooms rests on the premise that diverse boards lead to better decision-making and governance. The argument has been proffered on the basis of numerous empirical studies that highlight a causation/correlation between diversity in boardrooms and the value of the company, but still remains highly debated.[29]

A key part of the debate stems from the absence of consensus on what reflects the 'success' of a firm. Empirical studies have attempted to correlate diversity in boardrooms with a range of variables such as stock value, profitability, market capitalization etc., but there is no economic basis yet to decide which of these is the most accurate measure of a firm's performance.[30] Some studies have shown a positive correlation between the gender diversity of boards and the value of the firm,[31] but there are also numerous studies to the contrary,[32] making it difficult to reach a conclusion. Moreover, almost all studies in this respect suffer from an inadequacy of causal inference. The studies suggest that companies with more women on their boards see an improvement in their stock value, while the reverse may also be true – female directors tend to join companies with strong financial performance, so the increased gender diversity may be *a result* of increased financial performance, and not *its cause.*[33] The 2007 McKinsey study[34] that shows a correlation between gender diversity and indicators of firm performance like average ROE and EBIT relies on a comparison of diverse firms to the industry average without controlling for variables like firm size, age, recent performance or

[29] Ernest Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP, 2020) 106-108.

[30] Thomas Hazen Lee, 'Diversity on corporate boards: Limits of the Business Case and the connection between supporting rationales and the appropriate response of the law' (2011) 89 North California Law Review 887.

[31] Kevin Campbell & Antonio Minguez-Vera, 'Gender Diversity in the Boardroom and Firm Financial Performance' (2008) 83 Journal of Business Ethics 435; Cristian L. Dezso & David Gaddis Ross, 'Does Female Representation in Top Management improve Firm Performance? A Panel Data Investigation' (2012) 33 Strategic Management Journal 1072; Paul Gommers & Silpa Kovvali, 'The Other Diversity Dividend' (Harvard Business Review Magazine, July-August 2018); Maurice Levi, Kai Li & Feng Zhang, 'Director Gender and Mergers and Acquisitions' (2014) 28 Journal of Corporate Finance 185 (observed that female directors correlate with increase in stock value because they are overestimate the gains from a merger less than their male counterparts, and accordingly pursue fewer acquisitions and if they do, pay lower bid premia).

[32] *See* for instance David A Matsa and Amalia R Miller, 'A Female Style in Corporate Leadership? Evidence from Quotas' (2013) 5 American Economic Journal: Applied Economics 136; Øyvind Bøhren and Siv Staubo, 'Mandatory Gender Balance and Board Independence' (2016) 22 European Financial Management 3.

[33] Renée B Adams, 'Women on Boards: The Superheroes of Tomorrow' (2016) 27 Leadership Quarterly 371.

[34] McKinsey, 'Women Matter: Gender Diversity, a Corporate Performance Driver' *McKinsey* (2007) <https://www.mckinsey.com/capabilities/people-and-organizational-performance/our-insights/gender-diversity-a-corporate-performance-driver> last accessed on 30 May 2024.

growth opportunities, and do not test the statistical significance of the results, so the results could have been driven by lucky outliers.[35] More recently in 2023, another McKinsey study again found that companies with 30% or more women on their boards are substantially more likely to outperform companies with less than that percentage.[36]

However, the empirical evidence is relatively clearer when diversity is measured against other indicators of firm performance. It is generally agreed that diversity in terms of gender, life experiences, ethnicity and so on, will counteract groupthink,[37] and will enhance deliberation in decision-making. A study of the Norwegian quota regime found that female directors *"may be particularly adept at critically questioning, guiding, and advising management without disrupting the overall working relationship between the board and management"*,[38] making companies with gender-diverse boards more vigilant than those with all men. Similarly, a study of Israeli boards observed, *"[b]oards with at least 3 directors of each gender are found to be at least 79% more active at board meetings than those without such representation"* and that *"[g]ender-balanced boards are also more likely to replace underperforming chief executive officers (CEOs) and are particularly active during periods when CEOs are being replaced."*[39] Recent studies have also indicated that the presence of women on the corporate board and in other key managerial positions substantially reduces the likelihood of white-collar crimes,[40] and can reduce the possibility of the company joining a cartel.[41] In modern corporate law and theory, one of the predominant purposes of the board of directors is to monitor the management and to diligently scrutinize the decisions of the

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[35] Alex Edmans, 'Response to FRC Pre-consultation on Corporate Governance' <https://www.frc.org.uk/getattachment/6f272e83-79e3-4397-a327-6e98549a4ae5/Edmans,-Professor-response;.aspx> last accessed on 21 January 2022.

[36] Mckinsey, 'Diversity matters even more: The case for holistic impact' (2023) <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-matters-even-more-the-case-for-holistic-impact> last accessed on 30 May 2024.

[37] Groupthink is defined as "A mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' striving for unanimity overrides their motivation to realistically appraise alternative courses of actions." See Irving L. Janis, *Victims of Groupthink: A Psychological Study of Foreign Policy Decisions and Fiascoes* (Houghton Mifflin Company, 1978) 78.

[38] Aaron A Dhir, *Challenging Boardroom Homogeneity: Corporate Law, Governance and Diversity* (CUP 2015) 35.

[39] Miriam Schwartz-Ziv, 'Gender and Board Activeness: The Role of a Critical Mass' (2017) 52 Journal of Finance and Quantitative Analysis 751.

[40] Ido Baum, Dalit Gafny & Ruthy Lowenstein Lazar, 'Gender and Corporate Crime: Do Women on the Board of Directors reduce corporate bad behavior?' (2022) Michigan Journal of Gender and Law, forthcoming <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4045490> last accessed on 30 May 2024.

[41] Carolina Abate & Alexis Brunelle, 'Cartel Behavior and Boys' Club Dynamics: French Cartel Practice through a gender lens' (2022) 13(7) Journal of European Competition Law and Practice 473.

management.[42] Drawing on case law from Delaware[43] and Australia,[44] Akshaya Kamalnath has argued that gender-diverse boards come closer to meeting the standard of scrutiny and monitoring expected by the court from corporate boards, and accordingly, if the success of a firm is understood in terms of corporate governance and decision-making, there is a clear case for gender diversity in boardrooms.

Nonetheless, the business case argument remains essentially contested, because in many cases it has been observed that increasing diversity leads to a decline in the value of the firm. Summarising existing literature on the business case, Katherine Klein notes that *"rigorous, peer-reviewed studies suggest that companies do not perform better when they have women on the board. Nor do they perform worse. Depending on which meta-analysis you read, board gender diversity either has a very weak relationship with board performance or no relationship at all."*[45]

III. DIVERSITY QUOTA IN INDIA: THEORY AND PRACTICE

In 2013, the Indian government overhauled the Companies Act, 1956, and the new Companies Act, 2013 included a provision which made it mandatory for all companies above a prescribed size to have at least one female director on their boards.[46] Soon afterwards, the SEBI amended the Listing Agreement and required all listed companies to appoint at least one female director. Subsequently, the SEBI adopted the recommendations of the Kotak Committee which suggested that at least one female director on the board of a company be an independent director.[47] It required the top 500 listed companies to have at least one female director by April 1st, 2019, and the top 1000 listed companies to fulfill the requirement by April 1st, 2020.[48]

A. Rationale behind the quota policy

[42] Fisch (n 10).

[43] Akshaya Kamalnath, 'Corporate Governance Case for Board Gender Diversity: Evidence from Delaware Cases', (2018) 82 Albany Law Review 23.

[44] Akshaya Kamalnath, 'Are gender diverse boards better for Corporate Governance? Evidence from Australian Judicial Decisions', 30 (1) Australian Journal of Corporate Law 58.

[45] Katherine Klein, 'Does Gender Diversity on Boards really boost Company Performance?' *Knowledge at Wharton* (18 May 2017) <https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance/> last accessed on 30 May 2024.

[46] Companies Act, 2013, sec 149(1). Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 stipulates the classes of companies that are required to have at least one woman director.

[47] Medha Srivastava & Adamya Vikrant, 'Analysis of Kotak Committee Recommendations on Corporate Governance', (*Mondaq*, 3 January 2018) <https://www.mondaq.com/india/corporate-governance/875864/analysis-of-kotak-committee-recommendations-on-corporate-governance#:~:text=In%20its%20meeting%20held%20on,8%20to%20other%20regulatory%20bodies> last accessed on 26 December 2022.

[48] SEBI Listing Obligations and Disclosure Regulations, 2015, reg 17(1).

The rationale behind the mandatory quota of female directors in India can be traced to an eclectic mix of both equality and business case arguments. Section 166(2) of the 2013 Act broadened the scope of directors' duties and stipulated that their duties were owed not just to shareholders but also to various stakeholders (including employees, the environment and the community),[49] sparking the debate on corporate purpose in India. It has been argued that the introduction of the female directors quota reflects the stakeholder-centric corporate purpose sought to be ushered in by the Act, which envisaged companies as agents of social change.[50] Explaining the rationale behind the gender quota in boardrooms, the Standing Committee on Finance expressed its hope that such *'indicative provisions'* would *'make the companies more alive to giving salience to the female gender in the realm of corporate governance'* and observed that the provision was *'also in line with the Government policy to encourage women's participation in decision making at every level in the society'.*[51] The equality rationale was therefore clearly at the heart of the quota which formed a part of a larger policy movement aimed at incorporating social development and the welfare of stakeholders within the corporate governance framework.

Taking a drastically different approach, the SEBI justified the necessity of women in corporate boardrooms predominantly with the business case argument. A 2013 SEBI consultation paper on corporate governance norms noted that the board of a company should be *'diverse in thought, experience, knowledge, understanding, perspective, gender and age'*[52] and that *'[d]iversity, in all its aspects can widen perspectives while making decisions, avoid similarity of attitude, and help companies better understand and connect with their stakeholders'.*[53] In 2017, the Kotak Committee, instituted by the SEBI to study the working of independent directors, recommended the appointment of at least one woman independent director in every listed company, on the grounds that a diverse board could provide '*guidance and direction*' to the company.[54] The suggestions were accepted by SEBI in 2018, and led to the introduction of Regulation 17 in the SEBI LODR Regulations, which required the top 500

[49] Companies Act, 2013, sec 166(2).

[50] Kamalnath & Masselot (n 23).

[51] Ministry of Corporate Affairs Standing Committee on Finance (2011-12) *The Companies Bill Report 2011*, (Lok Sabha, June 2012, 57th Report).

[52] SEBI, *Review of Corporate Governance Norms in India for Listed Companies* (2014) 10.

[53] ibid 21.

[54] Kotak Committee, *Report of the Committee on Corporate Governance*, (October 2017) https://www.nfcg.in/KOTAKCOMMITTEREPORT.pdf 15.

listed companies to have at least one female director by April 1st, 2019, and the top 1000 listed companies to fulfill the requirement by April 1st, 2020.[55]

B. Poor design, poorer implementation – the many drawbacks of the Indian diversity quota

Over the last 10 years since its introduction, while the number of women directors in Indian boardrooms has risen up, substantive gender equality in Indian boardrooms still remains a far cry. By September 2019, all Indian companies comprising the BSE200 Index had at least one woman director on their board.[56] In 2020, all private sector companies in the NIFTY50 had fulfilled the requirement of appointing at least one female director to their board but two public sector companies, the National Thermal Power Corporation and the Bharat Petroleum Corporation Limited, did not have any female directors on their board.[57] However, the percentage of women directors on the board remains low – only 96 of the 541 directors in the 50 companies were women.[58] On average, only 18.4% of the directors in private companies are women, while the percentage of female directors in PSUs was only 13.9%.[59] Despite the increase in the number of female directors in absolute terms, their role in decision-making and their effect on corporate governance remains minimal. The failure of the gender quota in Indian law to bring about meaningful gender diversity in the boardroom may be attributed to a number of factors, both in the design of the policy and its implementation.

First, the Indian quota requirement by design is vulnerable to tokenism. Unlike the diversity quotas in countries such as Norway which require a certain percentage of the board to comprise women, Indian companies are required to have one woman irrespective of the total number of directors, implying that a company with more than 10 directors that has one woman on the board would still be in compliance with the law. Numerous empirical studies posit that the inclusion of women in corporate boardrooms can make a difference *only if* the number of women is above a critical mass of three women, otherwise, the single woman is silenced by

[55] SEBI LODR (Amendment) Regulations, 2018 (May 9 2018).

[56] Gagandeep Singh, 'Corporate Governance: An insight into the Imposition and Implementation of Gender Diversity on Indian Boards', (2020) 13(1) Indian Journal of Corporate Governance 99.

[57] Furquan Moharkan, 'Gender Diversity| Women Scarce in India Inc Boardrooms', Deccan Herald, October 18, 2020 <https://www.deccanherald.com/business/gender-diversity-women-scarce-in-india-inc-boardrooms-903480.html> last accessed on 9 February 2022.

[58] ibid.

[59] ibid.

her male colleagues and is unable to add significantly to the discussion.[60] The Indian requirement does not require a diversity policy and is often fulfilled by tick-box compliance without any meaningful effort towards ensuring equality between the genders or involving women in the decision-making.

Second, boardroom appointments in India are often based on family ties and affiliations, compromising the integrity of the appointments in a system based on nepotism.[61] Many Indian companies seek to fulfil the quota requirement by appointing the promoter's wife or other family members to the board. Such appointments, although abiding by the legal requirement, do not add much to the monitoring ability of the board, since such a director is usually unlikely to question, let alone criticise, her husband or other male members of the family in a country where patriarchy is so rampant.

Third, it has been observed that diversity quotas often lead to stigmatization of the beneficiaries, and may also jeopardize their confidence and self-esteem.[62] Individuals benefitting from a diversity quota, including those with adequate experience and qualifications, are often perceived as *token appointees* who are unsuitable for the post.[63] In the context of gender diversity quotas in the board of directors, such stigmatisation of female directors is likely to undermine workplace collaboration and make the female directors feel unwelcome. The resentment generated by diversity quotas may also discourage male directors from mentoring or networking with their female counterparts, enhancing the isolation and exclusion of women on the board.[64] As a result, while diversity quotas may be effective in ensuring the formal inclusion of women on the board of directors, they fail to ensure that women directors are treated at par with their male counterparts.

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[60] Sumru Erkut, Vicki W Kramer and Alison M Konrad, 'Critical Mass: Does the Number of Women on a Corporate Board Make a Difference?' in: Susan Vinnicombe and others (eds), *Women on Corporate Boards of Directors: International Research and Practice* (Edward Elgar Publishing 2008) 350.

[61] Ernest Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP, 2020) 116; Diksha Madhok, 'India's Effort for More Women on Boards in backfiring in the Worst Way', *Quartz India* (19 June 2014) < https://qz.com/india/223405/indias-effort-for-more-women-on-boards-is-backfiring-in-the-worst-way> last accessed on 30 May 2024.

[62] Angela Ognuwachi-Willing, Emily Houh & Mary Campbell, 'Cracking the Egg: Which came first – Stigma or Affirmative Action?' (2008) 96 California Law Review 1299; Kasper Lippert-Rasmussen, *Making Sense of Affirmative Action* (OUP 2020) 173.

[63] Lisa M. Leslie, David M Meyer & David A Kravitz, 'The Stigma of Affirmative Action: A Stereotyping-Based Theory and Meta-Analytic Test of the Consequences of Performance' (2013) 57 Academic Management Journal 964.

[64] Akshaya Kamalnath, 'Legal and Market Initiatives to increase diversity in corporations – A Cross-Jurisdictonal Analysis' (2022) 46 Seattle University Law Review 115.

Fourth, corporate regulations in developing countries, such as the gender diversity mandate in India, generally tend to allow the subjects of these regulations (i.e., the companies) wide powers of discretion within a *zone of conformity*[65] – in this case, while the regulations mandate companies to include women as independent directors on the board, the responsibilities of these directors remain at the discretion of the company. The company management is often able to retain the status quo by complying with the law to the extent that may be scrutinized by external actors such as the media and institutional investors, yet maintaining the status quo and retaining their control over the affairs of the company through practices that are unlikely to be scrutinized by the external monitors and are outside the purview of the regulations. This attempt to seek legitimacy in the eyes of external monitors while preserving the power dynamics in its internal decision-making leads to symbolic compliance that meets the letter of the law but deviates far from the intent behind the regulation. It has been observed that in India, this buffering takes place through the appointments to key board committees. Kuppuswamy et al[66] observe that while a large number of companies appointed independent women directors to their boards, these women were far less likely than their male counterparts to sit on prominent board committees such as the audit committee, the remuneration and compensation committee or the nomination committee. For instance, the probability of an independent female director being appointed to the audit committee is 40% lower than that of a male independent director.[67] Indian companies tend to engage in *pinkwashing,* or appointing women to the board with a view to enhancing their legitimacy and complying with the legal mandate, but in effect excluding women from substantive decision-making.[68]

Fifth, while there seems to have been no empirical study of the impact of the diversity quota on the value of firms in India, studies from Norway and California indicate that the introduction of a diversity quota usually leads to a decline in firm value. Three out of the four

[65] RV Aguilera, QW Judge & SA Terjesen, 'Corporate Governance Deviance', (2018) 43(1) Academy of Management Review 87-109.

[66] Venkat Kuppuswamy, Rahul Anand & Ruth V. Aguilera, 'Symbolic Management in Symbolic Markets: The Case of Board Diversity' <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3764169> last accessed on 30 May 2024; Ruth V. Aguilera, Venkat Kuppuswamy & Rahul Anand, 'What happened when India Mandated Gender Diversity on Boards', (*Harvard Business Review*, 5 February 2021) <https://hbr.org/2021/02/what-happened-when-india-mandated-gender-diversity-on-boards#:~:text=Corporate%20governance-,What%20Happened%20When%20India%20Mandated%20Gender%20Diversity%20on%20Boards,t%20necessarily%20change%20company%20cultures.&text=Gender%20quotas%20on%20corporate%20boards,gender%20equality%20in%20the%20workplace> last accessed on 30 May 2024.

[67] ibid.

[68] ibid.

studies on the Norwegian quota have found that the requirement of comprising 40% of the board with non-male members led to a sharp decline in the value stock value of firms,[69] while the other study found no correlation between diversity and stock value.[70] The decline in value has been explained by a variety of factors such as the hasty implementation of the law that made companies switch their experienced male directors who had insider knowledge of the business with younger inexperienced *female independent* directors who had no prior knowledge of the firm. It may be argued that the Indian requirement will not precipitate a similar decline in policy – the Indian law requires the presence of a single woman on the board, and it is unlikely that they will replace experienced male directors. However, the 2018 California law requiring all publicly traded companies headquartered in the state of California to have at least one female director by the end of 2019 also led to an abnormal decline in share prices.[71] Von Meyerinck et al have argued that this decline in share prices comes from shareholder's aversion to government intervention towards protecting stakeholder interests – even though many shareholders are committed to the cause of diversity and would be willing to include women as directors on the board, they are sceptical of any government intervention that forces a company to change its organizational structure as they fear that such interventions in the future may be adverse to their own interests.[72] Rather surprisingly, however, stock markets in the EU reacted positively to the proposed introduction of the boardroom gender diversity quota in EU law earlier this year, but it is too early to discern why the EU response to the gender quota was so radically different from the stock market reactions in Norway or California to similar quotas.[73] It is, however, evident that the top-down imposition of gender diversity norms does not necessarily lead to an increase in stock value.

[69] Kenneth R Ahern and Amy K Dittmar, 'The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation' (2012) 127 Quarterly Journal of Economics 137–97; David A Matsa and Amalia R Miller, 'A Female Style in Corporate Leadership? Evidence from Quotas' (2013) 5 American Economic Journal: Applied Economics 136; Øyvind Bøhren and Siv Staubo, 'Mandatory Gender Balance and Board Independence' (2016) 22 European Financial Management 3.

[70] B Espen Eckbo, Knut Nygaard and Karin S Thorburn, 'Does Gender-Balancing the Board Reduce Firm Value?' (CEPR Discussion Paper No. DP11176, March 2016).

[71] Sunwoo Hwang, Anil Shivdasani, Ele Anil and Elena Simintzi, 'Mandating Women on Boards: Evidence from the United States' (Kenan Institute of Private Enterprise Research Paper No. 18-34, 13 October 2018).

[72] Felix von Meyerinck, Alexandra Niessen-Ruenzi, Markus Schmid & Steven Davidoff Solomon, 'As California Goes, So Goes the Nation? Board Gender Quotas and Shareholders' Distaste of Government Interventions' (ECGI Finance Working Paper No. 785/2021).

[73] Carlos Fernandez & Shams Pathan, 'The Valuation Impact of Gender Quotas in the Boardroom: Evidence from the European Markets' (2022) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4266971> last accessed on 30 May 2024.

It is evident that the diversity quota as introduced in 2013 Act has failed to achieve both its objectives of promoting gender equality and improving corporate governance. The percentage of women on India's corporate boards is one of the lowest in Asia, and falls far behind that of Hong Kong, which does not have a diversity quota or Malaysia, which has a comply-or-explain regime.[74] Although the number of women directors in Indian boardrooms has increased after in the last decade, the various inadequacies in the design as well as the implementation of the mandatory quota show that it is clearly not enough to bring about substantive gender equality in the boardrooms, and more is needed.

IV. INSTITUTIONAL INVESTORS IN INDIAN CORPORATE GOVERNANCE

One of the foundational issues plaguing the modern corporation that has worried corporate law scholars from the early 20th century is the issue of agency costs between the shareholders who own the company and the managers who run it.[75] For a long time, shareholders dissatisfied with the governance of a company would sell their shares instead of engaging with the management, and shareholder activism was unheard of.[76] Since the 1980s, however, the rapid rise of institutional investors drastically transformed the corporate governance landscape – shareholders were no longer passive, but were now actively involved in corporate governance through the exercise of their votes and their voice.[77] The ongoing debate on corporate purpose also focusses on institutional investors, who have taken the lead in promoting the inclusion of stakeholder concerns within corporate governance, and have, in many cases, voted with a view to push the management into incorporating ESG goals within the business of the company.[78] While the ability and incentives of large institutional investors (including banks, hedge funds, mutual funds, etc.) to monitor their portfolio companies remains

[74] Ernest Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP, 2020) 103-141.

[75] Adolf A. Berle and Gardiner Means, *The Modern Corporation and Private Property* (1st ed, Transaction publishers, 1932); Reinier R Kraakman, Paul Davies & Henry Hansmann, *The Anatomy of Corporate Governance* (OUP 2004) 21.

[76] Edward B. Rock, 'Institutional Investors in Corporate Governance' in Jeoffrey N. Gordon & Wolf-Georg Ringe eds., *The Oxford Handbook of Corporate Law and Governance* (OUP 2018).

[77] Jennifer G. Hill, 'Good Activist/Bad Activist: The Rise of International Stewardship Codes', 41 Seattle University Law Review 497 (2018).

[78] Barzuza et al (n 3); Lucian A Bebchuk & Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance', (2020-21) 106 Cornell Law Review 91.

a matter of intense debate,[79] there is no doubt that institutional investors are the new titans of corporate governance.[80]

In India, institutional investors had always held stakes of large public companies, but they have historically been passive, and have not voted against the management except in exceptional circumstances.[81] However, this passivity reduced over the last decade, due a variety of changes – driven by both regulation and market forces. In 2010, SEBI issued a notification to mutual funds requiring them to "*play an active role in ensuring better corporate governance of listed companies*", and heralded an early form of shareholder stewardship.[82] The increasing emphasis on disclosure impelled mutual funds to play an active role in exercising their voting rights. Section 108 of the Companies Act, 2013 furthered the ability of shareholders to participate in meeting virtually and engage in e-voting, providing a further impetus to activism.[83]

In their attempts to encourage shareholder activism, the regulators in India introduced a number of stewardship codes that require institutional investors to intervene actively in the management of their portfolio companies. In 2017, the Insurance Regulatory and Development Authority of India (IRDAI) issued a stewardship code for insurers,[84] and the next year, the Pension Fund Regulatory and Development Authority (PFRDA) introduced a stewardship code for pension funds.[85] In 2019, SEBI followed with a stewardship code for mutual funds and alternative investment funds (AIFs), effectively bringing most large institutional investors under the ambit of the stewardship codes.[86] In 2023, SEBI also amended the REIT and InvIT regulations requiring unitholders to formulate stewardship policies,[87] but did not outline the provisions of the policies/codes themselves. While there are broad similarities between the three codes (all of which track the UK Stewardship Code of 2012), the SEBI Code seems to

[79] Lucian Bebchuk, Alma Cohen & Scott Hirst, 'The Agency Problems of Institutional Investors' (2017) 31 Journal of Economic Perspectives 89-102; Eric C. Chaffee, 'Index Funds and ESG Hypocrisy' (2021) 71 Case Western Reserve Law Review 1295.

[80] Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, 'The New Titans of Wall Street: A Theoretical Framework for Passive Investors' (2020) 168 University of Pennsylvania Law Review 17.

[81] Umakanth Varottil, 'The Advent of Shareholder Activism in India', (2012) 6 Journal on Governance 582.

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

[83] Companies Act, 2013, sec 108.

[84] IRDAI, *Guidelines on Stewardship code for Insurers in India* (2017).

[85] PFRDA, *Common Stewardship Code,* PFRDA/2018/PF/01, May 4, 2018.

[86] SEBI, *Stewardship Code for all Mutual Funds of all categories of AIFs, in relation to their investment in listed entities,* Circular No: CIR/CFD/CMD1/ 168 /2019, December 24, 2019.

[87] SEBI (Infrastructure Investment Trusts) (Second Amendment) Regulations, 2023, reg 3(II), 3(IX); SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2023, reg 3(II), 3(VI).

have been influenced by the PFRDA more than the IRDAI. Both the SEBI and the PFRDA Codes require institutional investors to incorporate ESG concerns in their decision-making, and also explicitly mandate institutional investors to monitor the ESG risks facing their portfolio companies.[88] While the stewardship codes promulgated by the IRDAI, the PFRDA and the SEBI stipulate that the obligations imposed on institutional investors are 'mandatory', they do not prescribe any sanctions for failure to comply with the requirements, and remain soft-law codes that are not yet enforceable.

The emergence and rapid growth of the proxy industry in India has also contributed to the rise of institutional investor activism in India.[89] From 2008 to 2019, the percentage of shares held by institutional investors in India rose from 24% to 34.6%, accompanied with a concomitant increase in their engagement with corporate governance decisions.[90] Varottil observed that since 2014, institutional investors have defeated 105 different proposals put forward by the management of different companies on crucial issues like appointment and remuneration of directors, employee stock option plans, related party transactions and raising capital.[91] While promoter families and controlling shareholders still exert considerable influence on the affairs of the company, institutional investors are often able to hold the management accountable through their activism. More specifically, 2020 and 2021 saw an uptick in instances of shareholder activism, and often in combative form. In August 2021, the shareholders of Eicher Motors rejected a proposal for the reappointment of their managing director with a massive pay hike. Although the shareholders later reinstated the MD at the helm, his remuneration was capped at 1.5% of the profits.[92] Invesco, an investment fund holding 18% stock in Zee Telefilms called for an extraordinary general meeting seeking the removal of the CEO and the induction of six new independent directors over corporate governance concerns.[93] While the issue is now pending in courts, it clearly shows the active (and somewhat aggressive) participation of institutional investors in the governance of the company.

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[88] PFRDA Stewardship Code, Principle 3; SEBI Stewardship Code, Principle 3; IRDAI Stewardship Code, Principle 3.

[89] Umakanth Varottil, 'Shareholder Stewardship in India – the Desiderata', in Dionysia Katelouzou & Dan W. Puchniak (eds.), *Global Shareholder Stewardship: Complexities, Challenges & Possibilities* (CUP, 2022).

[90] ibid.

[91] ibid.

[92] Suresh P Iyengar, 'How Shareholder Activism has hit a high in India' (*Business Line*, 8 September 2021) <https://www.thehindubusinessline.com/companies/how-shareholder-activism-has-hit-a-high-in-india/article36540272.ece> last accessed on 30 May 2024.

[93] Harshvardhan Korada & Vasanth Rajasekaran, 'Rising Shareholder Activism in India' (*Business Line*, 23 January 2022) <https://www.thehindubusinessline.com/business-laws/rising-shareholder-activism-in-india/article64910251.ece> last accessed on 30 May 2024.

V. INSTITUTIONAL INVESTORS AND THE DRIVE FOR GENDER DIVERSITY: INCENTIVES AND (IN)ABILITY

Institutional investors in India, like their counterparts in the US and other jurisdictions, have a number of strong incentives to push for gender diversity in the boardroom. However, in India, institutional investors face a number of impediments arising from the legal framework as well as from the business environment, which severely hinders their ability to advocate for gender diversity and the quest towards boardroom gender diversity in India Inc. This part of the paper outlines the business reasons that incentivize institutional investors to push for diversity in the C-Suite, and the factors that affect their ability to do so. The next part of the paper provides some suggestions towards remedying these issues such that institutional investors can successfully steer their portfolio companies towards substantive gender equality in the boardroom.

A. Incentives of institutional investors to push for gender diversity

1. Business case for diversity

The first and the most frequently discussed incentive behind institutional investor activism aimed at gender diverse boardrooms stems from the business case. Although the empirical data on the causal relationship between boardroom gender diversity and stock performance remains debated, institutional investors across the world routinely justify their campaigns towards gender equality in boardroom on the grounds that a gender diverse boardroom leads to better financial returns. For instance, Vanguard notes that *"..(t)he business case is compelling. Diverse boards make better decisions, and better decisions lead to better results over the long term."*[94] Similarly, BlackRock has justified its push towards diversity on the ground that diverse boards are better at taking decisions,[95] while State Street has based its campaign gender diversity campaign on the ground that gender diversity leads to higher returns.[96]

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[94] Vanguard, *Board Diversity* (Vanguard Investment Stewardship Perspectives , 2019) <https://intl.assets.vgdynamic.info/intl/australia/documents/invest-stewardship/persp_board_diversity.pdf> last accessed on 26 December 2022.

[95] Sarah Krouse, 'BlackRock: Companies should have at least two female directors', (*Wall Street Journal*, 2 February 2018) <https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407> last accessed on 26 December 2022.

[96] Joann S Lublin & Sarah Krouse, 'State Street to Start Voting Against Companies That Don't Have Women Directors' (*Wall Street Journal*, 7 March 2017) <https://www.wsj.com/articles/state-street-says-it-will-start-voting-against-companies-that-dont-have-women-directors-1488862863?mod=article_inline> last accessed on 26 December 2022.

Although the effect of boardroom gender diversity on stock value remains questionable, there is ample evidence to suggest that gender diversity on the boardroom improves the ability of the board to monitor top executives and reduces the possibility of self-seeking by managers.[97] Further, since gender-diverse boards are more likely to scrutinize and question any substantial changes in the management or capital structure of the company, the likelihood of minority shareholders being mistreated by the controlling shareholders is reduced.[98] Accordingly, gender diverse boards are far better suited than homogeneous ones to protect the rights of the institutional investors (and other minority shareholders). In India, institutional investors are generally minority shareholders with limited rights, and are often at risk of being squeezed out or otherwise mistreated by the promoters who own an overwhelming majority of the equity capital.[99] The precarious position of institutional investors in the company provides them a natural incentive to push towards gender diverse boards that are better suited to safeguard the rights of minority shareholders and to minimize the self-seeking behaviour of the promoters or the top management.

2. Reputational effects

The second reason why institutional investors are likely to push for gender diversity (and other ESG issues) is the increasing pressure from their millennial clientele to incorporate broader social concerns into investment strategies. Investment funds cater to the the individuals who trust these funds with their money, and there is a growing change in the attitude of individual investors towards investments and profits. A number of studies show that millennials are more interested in social and environmental issues than in earning profits,[100] and accordingly, in order to appeal to a millennial client base, investment funds necessarily have to engage in ESG investing.[101] Besides the change in outlook, there are also a number of tangible economic and social reasons why the individuals investing in these funds would prefer gender diversity in boardrooms – for instance, it is quite reasonable for an average employee

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[97] Kamalnath (n 23).

[98] Ido Baum and ors (n 33).

[99] Umakanth Varottil, 'Minority shareholders' rights, powers and duties: the market for corporate influence' in *Comparative Corporate Governance* (Afra Ashfaripour & Martin Gelter eds, Edward Elgar, 2021).

[100] Ernst & Young, 'Sustainable Investing: The Millennial Investor' (2017) 1 (*"*Demand for sustainable investments is being driven, in part, by millennials who prefer to invest in alignment with personal values"*);* Barzuza et al (n 3).

[101] Barzuza et al (n 3).

to forego returns from her investments in the hopes of a gender diverse board that improves corporate culture and reduces the possibility of getting embroiled in corporate legal violations.

B. Impediments to gender diversity activism by institutional investors

1. Collective action problems

Shareholder activism on most issues is often plagued by a pertinent collective action problem. Different groups of shareholders often have different priorities – since no individual investor can unilaterally outvote the management, it is not rational for any particular investor to invest in monitoring and/or engaging with the management unless the other investors take a similar initiative.[102] While a number of investment funds, both Indian and foreign, have made a public commitment to engage on ESG issues, the precise issues on which these funds seek to engage with their portfolio companies remains unclear. The proxy industry in India is still in its nascent stage and confine their advice predominantly to financial issues – accordingly, although collaborative efforts by institutional investors have been successful in limiting managerial entrenchment and self-dealing,[103] successful instances of ESG activism are yet to be seen in India.

2. Incompatibility with fiduciary duties

The second problem stems from the apparent clash between ESG principles and the fiduciary duties of institutional investors. As trustees of their investors, investment funds are legally obliged to act solely for the benefit of their investors, and the legality of including non-financial factors in investment decisions remains questionable.[104] The purpose of fiduciary law is to ensure that the trustees in accordance with the wishes of their beneficiaries, and accordingly, the conflict between ESG investing and fiduciary duties is eliminated if the investors expressly consent to, or preclude the incorporation of ESG factors in investment decisions.[105] However, the Scheme Information Documents of most investment funds do not

[102] Frank H Easterbrook & Daniel R Fischel, 'Voting in Corporate Law' (1983) 26 Journal of Law and Economics 395; Paul H Edelman, Randall S Thomas & Robert B Thompson, 'Shareholder Voting in an Age of Intermediary Capitalism' (2014) 87 Southern California Law Review 1359.

[103] *See* Part III above.

[104] For an overview of the conflict between ESG principles and fiduciary duty, see Ernest Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP 2020) 196-204.

[105] ibid.

expressly specify whether non-financial factors may be taken into account in investment decisions, and how a trade-off between financial benefit and ESG is to be decided. In the absence of express instructions from the beneficiaries on the governance of their funds, the incorporation of ESG factors into investment decisions rests on how a particular investment fund interprets and understands its fiduciary duties.

Under one view of fiduciary duties applicable to institutional investors (and supported by the US Department of Labour), institutional investors are prohibited from taking into account ESG/non-financial factors, with their fiduciary obligations being geared towards solely maximising the financial returns of their beneficiaries.[106] A *second* interpretation of fiduciary duties suggests that institutional investors may consider ESG factors in their investment decisions if (i) they have a valid basis for thinking that their beneficiaries prefer them to take into account these matters; and (ii) the decision does not result in any significant financial detriment to the beneficiaries.[107] A *third* interpretation of fiduciary duties holds that institutional investors are not only permitted but required to take into account ESG factors and/or the socio-political preferences of their beneficiaries.[108] Unlike investor activism on issues like climate change action that may enhance long-term financial performance of the portfolio companies,[109] the shaky correlation between gender diversity and financial returns makes it difficult to argue that the inclusion of diversity concerns in investment decisions is solely in the benefit of the beneficiaries. The uncertainty in the interpretation of fiduciary duties leaves open the possibility that Indian courts may hold that the incorporation of ESG principles into investment decision-making breaches the fiduciary duties, and the threat of prosecution may deter some funds from considering issues like boardroom diversity in their investment decisions.

[106] Max M Schanzenbach and Robert H Sitkoff, 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 Stanford Law Review 381; *Cowan v Scargill* [1985] Ch 270.

[107] UK Law Commission, Fiduciary Duties of Investment Intermediaries (Law Commission No 350) (1 July 2014).

[108] Susan N Gary, 'Best Interests in the Long Term: Fiduciary Duties and ESG Integration' (2019) 90 University of Colorado Law Review 731; Susan N Gary, 'Values and Value: University Endowments, Fiduciary Duties, and ESG Investing' (2016) 42 Journal of College and University Law 247; Anat Alon-Beck, Michal Agmon-Gonnen and Darren Rosenblum, '"No More Old Boys' Club: Institutional Investors' Fiduciary Duty to Advance Board Gender Diversity' (2021) 55 UC Davis Law Review 102.

[109] Graham Steele, 'Confronting the 'Climate Lehmann Moment': The Case for Macroprudential Climate Regulation' (2020) 30 Cornell J. L. & Pub. Pol'y 109; Anik Bhaduri, 'Taking the Heat: (Non)Disclosure of climate change risks in India (2021) 41 Business Law Review 152.

VI. THE WAY AHEAD: REFORMING THE STEWARDSHIP CODES

The problems that plague shareholder activism can be mitigated, at least in theory, through the introduction of shareholder stewardship codes. The codes set out a list of issues on which all institutional investors are expected to engage with their portfolio companies, and therefore resolve the collective action problem by aligning the preferences of institutional investors and mandating them to engage with the portfolio companies. Since stewardship codes form a part of statutory law, they take precedence over the fiduciary duties of institutional investors, and therefore set out whether institutional investors can take into account issues like gender diversity in their investment decisions. In India, however, the stewardship codes fail in both these purposes and the challenges to shareholder activism persists.

A. Enforcement of shareholder stewardship codes

Although the three Stewardship Codes issued by the IRDAI, the PFRDA and the SEBI clearly indicate a regulatory impetus towards ESG and sustainable business practices, in the absence of an enforcement mechanism, there is nothing to align the incentives of all firms or to prevent some funds from engaging in pursuit of short-term profits. The IRDAI Code is premised on a *comply-or-explain* model,[110] the PFRDA and SEBI Stewardship Codes are couched in mandatory terms,[111] but do not explain the consequences of failing to adhere to the principles laid down in the Code, and therefore despite appearing to be mandatory in nature, remain soft law guidelines without any sanctions for their breach. All the three Stewardship Codes are premised on the UK Stewardship Code which also relies on soft law and voluntary compliance by companies to promote stewardship by institutional investors,[112] but the Indian experience in the past seems to indicate that soft law does not bring about any practical change in the manner Indian companies operate.[113]

In the three years since the promulgation of Stewardship Codes in India, there has not been any substantial difference in the activities of institutional investors or the quality of disclosure of such activities. Although there is no consensus regarding the best way to enforce

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

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

[112] Umakanth Varottil, Desiderata (n 25).

[113] Umakanth Varottil, 'Corporate Governance in India: The Transition from Code to Statute' in Jean du Plessis & Chee Keong Low (eds.), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Springer 2017).

shareholder duties such as engagement and stewardship, the necessity of an enforcement mechanism is increasingly being recognized across jurisdictions. While some jurisdictions have already introduced mechanisms for the enforcement of shareholder duties, their success has been rather questionable,[114] and the search for the best way to enforce shareholder stewardship is still underway.

The experiences of other jurisdictions make it evident that public enforcement of stewardship duties is not a viable regulatory alternative since the *quality* of disclosures or the *degree* of disclosure that is expected from an investment fund is often impossible to lay down in the form of bright-line rules. The adjudication of whether a certain investment fund meet the threshold anticipated in the stewardship code involves the vesting of broad discretionary powers in the regulator, which brings about uncertainty in the law and unpredictability in the functioning of capital markets.[115] Private enforcement through legal action by individual investors is equally unlikely to succeed in India, since it is almost impossible to demonstrate before a court that the fund did not engage with the management of its portfolio companies.[116]

A third alternative, which has been put into practice in some jurisdictions and is catching increasing attention in academic literature, envisages the enforcement of shareholder stewardship codes through social sanctions emerging from the reactions of market participants.[117] Regulatory procedures such as public warnings, naming and shaming, and public tiering of institutional investors based on the extent of their compliance with the principles of the stewardship code are premised on the assumption that non-compliance with the shareholder stewardship codes will lead to a decline in reputation for institutional investors, and may therefore result in significant financial losses.[118]

A characteristic example of such a reputational sanction mechanism is the approach followed by the UK Financial Reporting Council. In 2016, the FRC classified the signatories of the UK Stewardship Code into three tiers, based on the quality of their disclosures and their engagement with the principles of the UK Stewardship Code. The FRC gave the funds in tier

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[114] Dionysia Katelouzou & Konstantinos Sergakis, 'Shareholder Stewardship Enforcement' (European Corporate Governance Institute, Law Working Paper No. 514/2020).

[115] ibid.

[116] Christopher Van der Elst, 'Shareholder engagement duties: The European move beyond stewardship' in *Enforcing Shareholder Duties* 60,79 (HS Birkmose & Konstantinos Sergakis eds., Edward Elgar, 2019).

[117] Konstantinos Sergakis, 'Legal vs social enforcement of shareholder duties' in Hanne S. Birkmose & Konstantinos Sergakis (eds), *Enforcing Shareholders' Duties* (Edward Elgar, 2019); Konstantinos Sergakis & Dionysia Katelouzou, 'Shareholder Stewardship Enforcement' in Dionysia Katelouzou & Dan W. Puchniak (eds), Global Shareholder Stewardship (CUP, 2022).

[118] ibid.

3 some time to improve their standing, and warned that if they failed to do so they would be removed from the list of signatories to the Stewardship Code. Accordingly in 2017, 20 funds were removed from the list of signatories.[119] Although the tiering of investment funds has recently been discontinued in the UK,[120] there are a number of reasons why public tiering of investment funds can be effective in the enforcement of shareholder stewardship codes in India.

First, social enforcement is easier to accomplish and involves lower administrative costs than the *command-and-control* model of hardline rules backed by administrative sanctions.[121] Under a market-based enforcement mechanism, the sanctions flow naturally from the market participants without any regulatory intervention. Since there is little (or no) adjudicatory activity being undertaken by the securities regulator, the possibility of delays in enforcement and administrative expenditure arising out of prolonged litigation and multiple appeals is also minimal.

Second, social enforcement strategies allow a wide degree of flexibility to the institutional investors in designing and implementing their visions of shareholder stewardship. In a regulatory framework backed by inflexible rules and penalties for non-compliance, the immediate objective of institutional investors inevitably is to meet the regulatory requirements so as to avoid penalties, but social enforcement policies allow investors to craft and execute long-term stewardship policies so long as they can assure their ultimate beneficiaries (and other market participants) that they are not ignoring their stewardship duties. The top-down imposition of inflexible rules in such a novel context risk deterring innovative attempts at long-term stewardship and business entrepreneurship by imposing on institutional investors stringent requirements to comply with a pre-defined checklist of stewardship duties.[122]

Third, social enforcement provides an educational opportunity to both the market participants as well as the regulator to better understand the scope of stewardship duties expected by the Indian investors. At the moment, it is difficult to understand the extent and manner of shareholder stewardship expected by Indian investors, making it difficult to frame

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[119] Financial Reporting Council, *Tiering of Signatories to the Stewardship Code,* 14 November 2016 <https://www.frc.org.uk/news/november-2016/tiering-of-signatories-to-the-stewardship-code> last accessed 30 May 2024.

[120] Financial Reporting Council, *FRC encouraged by investors embracing the spirit of the UK Stewardship Code,* 10 March 2022 <https://frc.org.uk/news-and-events/news/2022/03/frc-encouraged-by-investors-embracing-the-spirit-of-the-uk-stewardship-code/> last accessed on 30 May 2024.

[121] Robert M. Baldwin, Martin Cave & Martin Lodge, *Understanding Regulation* (2nd ed, OUP, 2011) 151-152 (observing that regulatory strategies relying on third parties or the regulatees themselves to enforce corporate regulations are cost-efficient).

[122] Sergakis (n 104).

hard rules in that regard. The introduction of a social enforcement mechanism allows institutional investors as well as the SEBI to analyze the reaction of the investor community to various institutional investors based on the degree of their commitment to various principles of the stewardship codes with a view to understanding the preferences of the investors. Once the preferences of the investors become somewhat clear and the institutional investors become familiar with the levels of stewardship and disclosure expected by the market, perhaps the regulatory framework can move towards clear rules backed by financial sanctions.

Despite its expected benefits, policymakers must also take into account that the extremely low financial literacy in India may jeopardize the success of a social enforcement mechanism. Less than one-third of Indians are financially literate,[123] and accordingly, may not be able to adequately monitor or understand whether the investment funds are meeting the standards laid down in the Stewardship Codes. However, with the growing awareness of ESG issues[124] and the financial literacy programs introduced by various government agencies,[125] some degree of social sanctions for funds failing to engage in stewardship is extremely likely. Social enforcement of shareholder stewardship, therefore, seems to be the most viable regulatory alternative in India despite its limitations.

B. Resolving the fiduciary duties conundrum

Although the stewardship codes expressly mandate various institutional investors to monitor the ESG performance of their portfolio companies, they do not expressly refer to gender diversity, leaving open the question whether activism towards diverse boardrooms is consistent with the fiduciary duties of institutional investors. While the UNPRI and the Law Commission of England and Wales have issued guidance regarding the interface and (possible) clash between ESG and fiduciary duties, Indian regulators have been surprisingly quiet in this regard. In the absence of clarity regarding the fiduciary duties of investment funds, the encouragement provided to investor activism through the stewardship codes is unlikely to materialize in practice.

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[123]Anand K Rathi, 'Why financial literacy is key for millennials' (*Mint*, 7 December 2021) <https://www.livemint.com/money/personal-finance/why-financial-literacy-is-key-for-millennials-11638811574912.html> last accessed on 30 May 2024.

[124] Chandril Chattopadhyay, 'Importance of New ESG Rules in India', (*BW Legal World,* 14 September 2022) <http://bwlegalworld.businessworld.in/article/Importance-Of-New-ESG-Rules-In-India/14-09-2022-446622/> last accessed on 30 May 2024.

[125] Asian Development Bank, *In India, Financial Literacy Programs are Lifting Families out of Debt and Fueling New Prosperity* (8 March 2022) <https://www.adb.org/results/india-financial-literacy-programs-lifting-families-out-debt-fueling-new-prosperity> last accessed on 30 May 2024.

Therefore, we recommend that the Indian regulators (or courts) also clarify the position of the law in this regard, and expressly mandate institutional investors to campaign towards greater gender diversity on the boardrooms of their portfolio companies. Such a mandate would further the legislative intent of incorporating stakeholder considerations in corporate law, as well as provide a greater representation to women in Indian corporate governance. The express reference to diversity in the stewardship codes would also mitigate the collective action problem between various investors by ensuring that every investor is legally obligated to monitor and work towards gender diversity in the boardrooms of their portfolio companies.

VII. CONCLUSION

The tick-box approach generally followed by Indian companies in fulfilling the statutory diversity quota is radically at odds with the growing emphasis on the need for gender diversity in corporate boardrooms. Despite the drastic rise of ESG investments over the last few years, ESG activism on the issue of gender diverse boardrooms is yet to be seen in India Inc. While the shareholder stewardship codes indicate a regulatory impetus towards ESG and sustainability, there is little clarity on whether (and to what extent) ESG activism is in consonance with the fiduciary duties of investment funds. Further, in the absence of an enforcement mechanism for the stewardship codes, collective action problems are likely to persist. Accordingly, it is imperative to clarify the compatibility of ESG obligations with fiduciary duties, and to introduce an enforcement mechanism for stewardship obligations. Until there is more clarity on the precise content and contours of stewardship duties expected from the investment funds, it is difficult to frame bright-line rules and an enforcement mechanism relying on reputation-based sanctions seems the best way forward. Over the coming years, as the expectations of the regulator and the investors from investment funds become clearer, it might be pertinent to move towards a system of hardline rules backed by penal sanctions.