Improving corporate governance through shareholder activism

Shareholder activism is rare in Asia due to the strong presence of controlling shareholders in listed companies, said David Webb, shareholder activist and founder of Webb-site.com, at the PNB Corporate Summit 2019. However, without the appropriate corporate governance frameworks, minority shareholders may lose out in a market dominated by the bigger players.

Families who are controlling shareholders, for instance, tend to be conservative in the way they manage balance sheets and may have competing interests. "In the worst case scenario, they may engage in mispriced connected transactions, extracting value by transferring assets to the listed company at higher than fair value or buying assets from the listed company below fair value," said Webb in his presentation, "Shareholder activism in Asia — what more can be done?"

The government can also be a controlling shareholder. In this case, it may push for objectives and policies that it wants to implement. "It may be concerned about capping consumer prices for things like electricity, petrol or telecommunications. Or it may see national security as something companies should be focusing on," he said.

When there are controlling shareholders, the minority shareholder does not have much say, unless they are voting on issues when controlling shareholders are not allowed to vote, such as related-party transactions.

But if there are no controlling shareholders, activists can play a more direct role in pushing for change in companies. "They can add shareholder value by keeping companies on their toes and lobbying for reforms and seats on the board. Otherwise, they can [push for change] via gentle persuasion [for example]," said Webb.

In his view, regulators and governments have a role to play in facilitating shareholder engagement. This will benefit investors and companies.

"Imagine two identical companies. One operates in a market with no real corporate law or investor protection and the other has those rights and protections. Investors will rationally pay more for the second company because they can expect to get a fairer share of returns from the business," said Webb.

"Paying more for a stock lowers the cost of capital and when you do that, you tend to improve corporate performance because you can undertake projects with lower target rates of return and still expect to make a profit."

Institutional investors can also play a part. Since they tend to have large stakes in companies, selling the shares of companies that do not practise good corporate governance is not always viable.

"[They can] influence policymakers and lobby for reforms to the framework. If the eyes and ears of policymakers are closed, then they can simply vote with their feet. They will say, 'We will pay a price for your stocks, but it will be lower because of the poor corporate governance framework that does not give us the rights we expect', or they will allocate capital to other markets," said Webb.

SUHAIMI YUSUF/THE EDGE

UPHOLDING GOOD CORPORATE GOVERNANCE

There must be good rules in the framework for corporate governance, such as in the election procedures for board members or in the mechanism of shareholder voting, said Webb. He cites the example of electing independent non-executive directors. These directors protect the interests of shareholders by examining related-party transactions or if the executive director's pay is fair and reasonable. They also review the accounts and internal controls of the company as part of the audit committee.

"But the problem is that although most markets require independent directors, they also allow controlling shareholders to vote on the elections [of independent directors.] If there is a shareholder with a 51% stake, even if the rest do not like the so-called independent director candidates put forward by the board, they can do nothing about it if the major shareholder votes for the candidate," said Webb.

These controlling shareholders could then pick candidates whom they believe would not question them. "The whole system breaks down because independent directors are only as independent as the controlling shareholders want them to be. All the checks and balances that have been established fall away," he said.

This is a problem in Hong Kong that Webb has tried to tackle, especially when he was elected as an independent director of Hong Kong Exchanges and Clearing Ltd in 2003. Through his research, he found that 90% of Hong Kong-listed firms have a controlling shareholder who elects the entire board into practice. Some of his findings have prompted Hong Kong authorities to investigate the companies for breaking the rules.

"The solution is to look at an accountability system. If you have the important role to consider transactions where the controlling shareholder has an interest and has to abstain [from voting], you cannot be elected by the controlling shareholder," said Webb, adding that only independent shareholders can elect you to the board.

While the majority shareholder can propose candidates, "it has to be one that the independent shareholders say, 'I believe he or she will do a good job and look after my interests'," said Webb.

Each independent director should state in the annual report whether he or she is satisfied with the corporate governance of the company, he suggested. "If they say they are satisfied and subsequently, it turns out that the accounts were fake or there was a serious wrongdoing that they should have been aware of, or that they were aware of but felt pressured not to say so, they should be held accountable," he added.

Meanwhile, governments must avoid interfering in the free market through direct ownership of companies. They must resist the temptation to direct economic resources to certain sectors, said Webb. Good laws to encourage competition, including pre-merger controls, are also needed.

ENABLING RETAIL INVESTOR PARTICIPATION

Institutional investors often practise their voting rights, but the same cannot be said of retail investors. Low turnout by retail investors at shareholder meetings is dangerous, especially for smaller companies.

"At small companies, often there are not many institutional investors. That means bad proposals can get passed at shareholder meetings with low turnouts," said Webb.

So, it is important for regulators to facilitate retail investor voting. They could do so by changing their code of conduct and demanding intermediaries, who hold their retail clients' shares, to seek their clients' votes at every shareholder meeting.

"The intermediaries will then find the most cost-efficient way to do that, probably through an electronic system that is shared. In the US, the system works very well. If you open a brokerage account with a big retail broker, you will receive proxy materials in your email account," said Webb.

When all else fails, there must be a framework to allow investors to access justice. That is because it may be prohibitively expensive for individual minority shareholders to bring a court case.

One solution for this is the class action system, said Webb, which is available in Australia. This enables a group of people to merge their claims against an entity.

"They have litigation finance companies that will assess the case and say if it is a good or bad case. They will finance a good, strong case to cover damages and provide a deterrent to bad behaviour in the first place by suing the directors, auditors or whoever causes the company to fail beyond normal business reasons," he said. E

Becoming a shareholder activist

Shareholder activist David Webb moved to Hong Kong from the UK in 1991 to work as an investment banker and later as an adviser to a family-controlled conglomerate. He resigned in 1998 and established Webb-site.com, a platform that offers analyses and opinions on companies as well as economic and political affairs in Hong Kong.

"I wanted to give something back. I do not have expertise in many things, but I do know quite a lot about corporate governance and how companies can abuse their shareholders, as well as all the loopholes in laws and regulations. I wanted to make it systemically better and also do what I can at the individual company level," Webb said in a media interview on the sidelines of the PNB Corporate Summit 2019.

Over the years, he has succeeded in making some changes. One was a campaign in 2003 to advocate for a "one share, one vote" poll system, instead of voting by show of hands at shareholder meetings. The poll vote is fairer because it counts the votes of all shareholders, including those who send a proxy vote, and not just those of the attendees of the meetings, and the votes are proportionate to the value at risk.

"I pushed them to change the rules and they did so in 2006. Now, it is standard. [This system] is fairer," he said.

Other things he has pushed for include a competition law in Hong Kong, which was eventually introduced, although he would still like to see it reformed with a merger-control regime to cover all sectors.

Webb's investments are mostly in Hong Kong. In view of the upheavals in the city, he has been investing net cash for the past few months as the prices of small-cap stocks are depressed.

"Some fundholders who are not so familiar with Hong Kong and regard their Hong Kong equity fund as an exotic investment have been redeeming their units, forcing the fund to sell. So, there have been opportunities to top up some of my holdings. But obviously, the long-term outlook for Hong Kong business depends on what happens in this current situation," said Webb, referring to the ongoing street protests.