Shareholders Activism: Any Added Value to Governance?

Introduction

The recent financial crisis and enterprise collapse in Nigeria and across the globe again reinforce the need to check regulatory compliance, risk governance, transparency, accountability and ethical behaviour in corporate dealings. It is true that a company is an artificial entity, with all the rights and powers of a natural person of full capacity conferred on it by law. However, it was not the intention of Lord McNaughten in laying out this principle in the *locus classicus* of corporate personality in company law – the old English case of *Salomon v. Saloman Ltd*, that there should be a total extrication of the importance of human behaviour in the management of these entities created by law.

It was also not the intention of the Companies Act that codified the principle of artificial personality to eliminate the importance of human behaviour and accountability in the management of registered companies. Perhaps it was for this reason that certain statutory duties are imposed on the Directors who are primarily responsible for the governance of a company. Despite all of these, issues of insider dealings, fraud, and breach of director’s duties have continued to rear their ugly head which was evident from the 2009 crises in the Nigerian banking and financial sector.

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1 F. Ajogwu, *Corporate Governance & Group Dynamics* (CCLD 2013) 1

2 [1897] AC 22.

3 Ajogwu (n 1)


5 Ajogwu (n 1)
Any rationale for Shareholders Activism?

Placing the business of governance of a company’s affairs solely with the management without any form of interference from the shareholders, when occasion demands, may not necessarily guarantee sound corporate governance. The principle of checks and balances which operates in government circles can be applied in the governance of a company and the arm of the company that is best suited for performing this role of checking the excesses of the directors is the shareholders. This is because ultimate powers of control lie in the shareholders. Besides, the brunt or benefit of the governance of a company will ultimately be borne by the shareholders.

Shareholders Activism, what is it?

There are mainly two categories of shareholders in a company, the individual shareholder and the institutional shareholder. The former basically refers to individuals with shareholdings in the company (irrespective of the size of the shareholdings) whilst the latter refers to companies having stock in another company; typical examples are the trust companies, mutual, banks, investment houses, pension fund custodians, etc.

Shareholder activism is the way in which shareholders can assert their power as owners of the company to influence its behaviour.\(^6\) It is also known as relationship investing \(^7\) or shareholder advocacy.\(^8\) Activism includes “voting with one’s feet” (exit), private discussion or public communication with corporate boards and management, press campaigns, blogging and other e-ways of public “naming and shaming”, openly talking to other shareholders, putting forward shareholder resolutions, calling shareholder meetings and – ultimately - seeking to replace individual directors or the entire board.\(^9\) It is not in every situation that

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\(^6\) The European Corporate Governance Institute http://www.ecgi.org/activism accessed 20 August 2014


\(^8\) http://www.triplepundit.com/topic/shareholder-activism/ accessed 20 August 2014

\(^9\) (n 6)
shareholder activism is targeted towards the directors, sometimes it is against the majority shareholders.  

The concept of shareholder activism started in the USA through the influence of the California Public Employees Retirement System (CalPERS). This body in 1987 published a detailed statement of companies identified as poorest performers on corporate governance. In UK, the first activist structure was set up by Hermes Investment Management Limited in 1990. At present, shareholders activism is beginning to receive wide acceptance in other climes of the world. The Principle for Responsible Investment (PRI), an investor initiative in partnership with the UNEP Finance Initiative and the UN Global Compact, now counts among its signatories more than 450 asset owners and investment managers from around the world with approximately $18 trillion in assets under management. The PRI is essentially to drive institutional investors in pursuing responsible investments such as proxy voting and direct corporate engagement. The growth in shareholder activism has been spearheaded over the past decade primarily by groups falling into two categories: those whose motives are purely profit driven and those whose motives are to improve a company’s social and corporate responsibility.

Engaging in some form of activism is not the only option available to shareholders faced with a company’s behaviour. According to Albert O. Hirschman’s treatise, Exit, Voice & Loyalty, such shareholders can choose one of several options when confronted with corporate behaviour they find counterproductive. The Shareholders can choose to sell their stock, ‘voice’ their objections to the practices in question or hold onto their stocks and say

10 ibid  
11 Shareholder Activism and Corporate Governance  
12 Albert O. Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (Harvard University Press 1970)  
13 The Nathan Cummings Foundation, ‘Changing Corporate Behvaiour through Shareholder Activism: The Nathan Cummings Foundation’s Experience’  
nothing.\textsuperscript{14} Where the shareholders choose to sell their stock, or ‘exit’, they not only risk accepting a discounted value for bad management, but also effectively give up their ‘voice’ as owners.\textsuperscript{15}

Disposal of the stock of the company with bad practices may feel ethically satisfying for the shareholder and it is unlikely to bring about the much desired change in corporate behaviour, since the ability to sell the stock simply connotes that there is a ready and willing buyer.\textsuperscript{16} There are many reasons why shareholders may adopt the ‘exit’ option rather than ‘voice’. First, their intervention may draw the public’s attention to the difficulties being faced by the company.\textsuperscript{17} This is likely to be perceived as a bad omen by the financial market players, resulting in a fall in share price and a reduction in the value of their investment. The shareholders if involved in the management of the ‘problem companies’ become privy to inside information and may be unable to trade in those shares, potentially compounding their losses. Furthermore, effective monitoring is costly in terms of money, especially for institutional investors with diverse portfolios. Finally selling large blocks of shares in a ‘problem’ company is likely to be extremely difficult, particularly as the potential buyer is likely to be an alternative institution with knowledge of the potential problems which exist in the company.

Shareholders activism is said to be playing out where the shareholders decide to ‘voice’ their objections to the bad practices of their company. There is so much support for shareholders advocacy. This is more so when one views corporate governance as a process by which corporations are governed and controlled with a view to increasing shareholder’s values and

\textsuperscript{14} ibid.
\textsuperscript{15} (n 13) 5
\textsuperscript{16} ibid
\textsuperscript{17} H. Short & K. Keasey, ‘Institutional Shareholders and Corporate Governance in the UK’ in K. Keasey, S. Thompson, M. Wright (edns), Corporate Governance Accountability, Enterprise and International Comparisons (John Wiley & Sons, Ltd 2005)
meeting the expectations of other stakeholders. Therefore if part of the objectives of corporate governance is to increase shareholder values, no other stakeholder can help promote this objective better than the shareholders themselves who are the ultimate beneficiaries. As a result of the free rider problem, it has been argued that only a large shareholder has the incentive to undertake monitoring or other costly control activities, as it is more likely that the large shareholder’s increased return from monitoring is sufficient to cover the associated monitoring costs.

Critics of shareholder activism argue that shareholders often lack the expertise to advise corporate management. They also maintain that shareholder activism detracts institutional shareholders such as the pension funds, mutual funds, etc from their primary role of managing money for their beneficiaries. It has also been argued that “shareholder activism” is a euphemism for disruptive, uninformed, populist ranting or “take the money and run”. In its extreme forms, activism is said to be an extortion scheme that weakens strong companies. Nevertheless, the very process by which companies are targeted entails closer monitoring of management which is beneficial to all investors in the firm. Another reason for advocating shareholder activism is based on the belief that it focuses on the long-term goals of the company and in so doing helps management improve long-term performance.

Shareholder Activist Weapons

There are many tools available for the activist shareholder. He may requisition or call for a meeting or may propose that certain directors be removed thereby dissolving the ineffective

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18 Olu Awolowo, ‘Shareholder’s Association and Promotion of Good Corporate Governance in Nigeria’ (2012) 4 Journal of Corporate Governance 491
20 (n 7) 279
21 (n 7) 280
22 ibid
23 (n 6)
24 ibid
25 (n 20) 280
26 ibid
board. John E. Parkinson opined that the ability to remove the directors, and the threat of being able to do so, are the principal means provided by company law for ensuring that directors acts in conformity with shareholder interests.\textsuperscript{27} In addition to the power to dismiss directors, the members of companies also have the powers in general meeting to alter the company’s memorandum and articles of association, to authorise an increase or a reduction in the company’s capital and the purchase or redemption of the company’s shares, to issue of new shares, to sanction the payment of dividends, to resolve that the company be wound up, private discussion or public communication with corporate boards and management, press campaigns, blogging and other e-ways of public “naming and sharing”,\textsuperscript{28} talking to other shareholders, putting forward shareholder resolutions and calling shareholder meetings.\textsuperscript{29}

Publication is another means employed by shareholders to influence changes.\textsuperscript{30} In the USA, from 1989 through 1993, the United Shareholders Association published its Shareholder 1000Report, which ranked 1,000 firms on several dimensions of corporate performance, including shareholder rights and management compensation.\textsuperscript{31} Generally, shareholders also lobby the parliament to pass policies that are favourable to them and that promote the health of companies.\textsuperscript{32} Shareholders consent is required for the acquisition of another company.\textsuperscript{33} In the United Kingdom for example, the rules of the London Stock Exchange require the consent of the general meeting to be given for the acquisition or disposal of assets where their value exceeds 25 per cent of the company’s assets.

\begin{footnotes}
\item \textsuperscript{27} TB Pickens, ‘Impact on Corporate America’ \url{www.boonepickens.com/impact} accessed 21 June 2011
\item \textsuperscript{28} The European Corporate Governance Institute (n 15)
\item \textsuperscript{29} Ajogwu (n 1) 129
\item \textsuperscript{30} ibid
\item \textsuperscript{31} D Manry & D Stangeland, ‘The United Shareholders Association Shareholder 1000 and Firm Performance’ (2003) 9 Journal of Corporate Finance 353
\item \textsuperscript{32} Ajogwu (n 1) 129
\end{footnotes}
In US, increase in the deposits made by investors into activist funds has brought a new dimension to the strategy used by activists. The generation of media interest by activists (albeit with relatively small stakes) in the affairs of their company is also part of the weapon used. For instance, ValueAct’s with its shareholding of 0.8% position in Microsoft, Pershing Square’s with its 1% position in Procter & Gamble, and Barington’s small stake in Darden Restaurants were able to effectively use the media as one of their activist weapons. Other docile shareholders are beginning to partner with the activist shareholders having lost the stigma they had for activist shareholders as disruptive influences acting contrary to the long term interests of the company. Lastly in instances where a wrong has been committed by the company, the law gives an aggrieved shareholder access to court to challenge the wrong.

**New face of Shareholder Activism – Board Engagement**

With the recent trends in shareholder activism that demonstrates both an increase in activist activity in large companies and a widespread acceptance by institutional investors of activist tactics, companies no longer view activists in a negative light but as catalysts for positive changes in the company. This has made companies to explore the options of engaging their shareholders in carrying out important decisions of the company. Different companies have different strategies or methods in achieving this. Coca-Cola Company delegates engagement to its director of corporate governance, who serves as the mediator between shareholders and the board. This approach is to sieve out important shareholder concerns worthy of the management time. Other companies engage their shareholders via online platforms such as webcasts, podcasts, video, virtual meetings, and board blogs. These

35 ibid
36 ibid
37 ibid
39 (n 34)
methods afford companies with the ability to communicate with a large group of institutional and retail investors and enable them record such meetings for subsequent replay via companies’ websites.40

Approximately 40 companies, including Microsoft Corp., Applied Materials, Inc., Rambus, Inc., JetBlue Airways, Intel Corp., and Dynegy, Inc., held virtual annual meetings in 2011 using tools that enable online voting and participation.41 Coca-Cola and Best Buy Company, provide shareholders with an opportunity to ask questions via the internet.42 Berkshire Hathaway, Inc. also allows shareholders to email questions to the company prior to the annual meeting.43 In addition, Pansoft Company Ltd., a China-based software developer, supplemented its 2012 annual shareholders meeting, held in China, with a virtual meeting accessible to shareholders around the world.44

**Pros of Board Engagement**

Effective board engagement would help avoid an unexpected or unbudgeted expense that is likely to arise from court disputes. Shareholders can serve as a source of independent advice as managers often rely on internally generated information to make business decisions without realizing that, over time, their view of the world may become skewed in one direction.45 Shareholders’ engagement therefore provides an external but factual perspective on the company’s performance. Shareholders’ engagement can help companies increase investor trust.46 A board that is willing to hold shareholder meetings outside of the annual general meeting is likely to build a long-term relationship with shareholders, which is thought to be strategically advantageous for many companies.47
Conclusion

The modern day shareholder has evolved from the traditional passive shareholder who is just satisfied with getting dividends to the sophisticated shareholder who is not only concerned with the dividends but the long term sustenance of the company. This he does by effective monitoring of the company, active engagement in the governance of the company and if need be, enforcing rights assigned to him under company law. Vigilant shareholders are said to play the role of fire alarms and their mere presence can alleviate managerial or boardroom complacency.\(^{48}\)

\(^{48}\) (n 6)
REFERENCES


6. F, Ajogwu, Corporate Governance & Group Dynamics (CCLD 2013) 1


11. Olu Awolowo, ‘Shareholder’s Association and Promotion of Good Corporate Governance in Nigeria’ (2012) 4 Journal of Corporate Governance 491


14. The European Corporate Governance Institute http://www.ecgi.org/activism