Shareholder activism and how directors can respond

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Introduction

The global corporate landscape has seen a growing trend of "shareholder activism", a facet of corporate governance which broadly encompasses the notion of shareholders taking on a more active role in a company's affairs.

While Singapore has seen its share of tugs-of-war between companies and shareholders, albeit on a smaller scale compared to its U.S. counterpart, generally the objective of shareholder activists remains the same regardless of jurisdiction, which is to effect changes in the way a company is managed in order to enhance its value. Establishing a fruitful and enriching relationship between companies and such shareholders is therefore advantageous to the companies' long-term growth.

This article aims to examine the extent of dialogue companies should have with their shareholders and how directors should go about engaging shareholders.

Common Shareholder Concerns

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It is observed that as shareholder activism in Singapore is still in its developing stages, the major concerns of shareholders revolve around standard issues such as financial performance, executive compensation and return of cash to shareholders. Most questions raised by shareholders at annual general meetings centre on the company's general business and performance, such as whether the company has sufficient cash and capital resources to meet budget requirements and whether the board and management can execute its stated strategies, as well as the quantum of executive compensation, particularly where this is not considered to be in tandem with the amount of dividend declared, if at all, to shareholders.

Shareholder Engagement and Shareholder Groups

The shareholder base of a company typically includes a wide range of shareholders, and the manner in which directors should relate to each group of shareholders should be adapted accordingly. Some of these shareholder groups are explored below.

Institutional investors and hedge funds

Institutional investors tend to be the "big boys" in the market, being typically leading domestic and international banks. Boards are traditionally more receptive to the views of such investors as it is recognised that they may have extensive exposure to business strategies in a particular sector.

Institutional investors in Singapore have yet to reach the levels of activity demonstrated by their counterparts in Western capital markets. This may be because institutional investors here face a unique barrier to shareholder engagement, namely the limitation on proxies under section 181 of the Companies Act, Chapter 50 of Singapore (the "Companies Act"). However, the Ministry of Finance has accepted the recommendation of the Steering Committee for Review of the Companies Act to amend the relevant provision by allowing custodian banks and nominee companies to appoint more than two proxies, thereby better enfranchising beneficial shareholders and encouraging more active participation at general meetings.

Hedge funds similarly feature prominently as shareholder activists in the U.S. but significantly less so in Singapore. A judgement call is required by management and the board in each case to determine whether the activist hedge fund is looking for short-term gains at the cost of the company's long-term health.

Retail investors

In the past, directors in Singapore typically approached the engagement of retail investors warily, as it was thought that such shareholders were just being difficult. However, three factors suggest that a shift from limited engagement to welcoming interaction may be due.

First, the investor base has matured considerably over the last five to 10 years as Singapore grew in status as a global financial and commercial hub. As retail investors have evolved on the whole to be more interested in the way companies are run and more appraised of the corporate decision-making process, legitimate views expressed by retail investors should be welcomed.

Second, a bottom-up approach to corporate governance is emphasised in the revised Code of Corporate Governance issued by the Monetary Authority of Singapore in 2012 (2012 Code). The 2012 Code underscores the role of shareholders as guardians of corporate governance and the importance of effective communication between companies and their shareholders, recommending more strongly that companies "actively engage their shareholders and put in place an investor relations policy".

Third, the dynamics between companies and their shareholders have shifted with the advent of technology. Social media has made it much easier for shareholders to disseminate their views publicly and join together for lobbying purposes. Engagement could go a long way towards resolving any unhappiness before any negative publicity which may depress long-term shareholder value arises.

Considerations Relating to Shareholder Engagement

The following paragraphs set out three considerations for directors which aim to strike a balance between promoting discourse while maintaining certain lines which shareholders should not cross.

Setting boundaries

The boundaries which directors should bear in mind are twofold, namely (i) the amount of say shareholders should have in company matters, and (ii) the extent of information which may be disclosed to shareholders.

(i) Separation of powers in companies

As the doctrine of separation of powers in companies dictates that management and board matters remain exclusively within the purview of the company which shareholders are not allowed to interfere with, the ensuing question is where the line for shareholder engagement should be drawn. It is considered that while shareholders' feedback and views on corporate policies and business strategies which have been adopted are welcomed, certain matters relating to the future direction of the company fall under the board's authority to manage the company's business and affairs as delegated to management and should be precluded. This is supported by Singapore's current statutory framework.

Section 157A of the Companies Act provides that "the directors may exercise all the powers of a company except any power that this Act or the memorandum and articles of the company require the company to exercise in general meeting". Under section 152 of the Companies Act, shareholders of public companies are also vested with the power to remove directors by ordinary resolution, while section 176 of the Companies Act provides for the right to requisition an extraordinary general meeting. These rights collectively signal that there is a separation between ownership and management, with shareholders' protection being derived from ownership rights which are distinct from the actual management of the company.

(ii) Disclosure of information to shareholders by directors

While directors should be diplomatic when engaging shareholders, they should err on the side of caution when it comes to offering material information or promises relating to future corporate opportunities, direction or strategies. This is to avoid any selective disclosure of sensitive information, which is prohibited by Appendix 7.1 of the Listing Manual of Singapore Exchange Securities Trading Limited.

Companies could have in place corporate disclosure policies which are communicated to directors, together with guidelines on what constitutes material information which may not be disclosed to shareholders. A tight relationship between management and directors would also help to ensure that the same messages are passed to shareholders.

Engagement with a view to fostering shareholder goodwill and confidence

The immediacy of interaction and enclosed setting at general meetings mean that directors should be particularly tactful when engaging shareholders at such occasions. The general guiding

principle is to seek to cultivate shareholder goodwill and confidence, which may be achieved by being respectful, approachable and patient to shareholders.

As a starting point, directors should not give dismissive answers when shareholders ask what appear to be legitimate questions. Directors should also possess a sufficiently in-depth understanding regarding the company's business, as shareholders expect directors to actively evaluate alternative financial and business strategies for the company. Finally, directors are also recommended to remain cordial throughout when answering questions raised by shareholders in order to avoid appearing cavalier.

Conducting general meetings objectively and being prepared

In relation to the actual conduct of general meetings, directors should aim for these to be held in a manner which is procedurally regular and fair in both appearance and fact.

While general meetings will always retain an element of unpredictability, directors can ensure such meetings run smoothly by formulating appropriate and proportionate responses beforehand. The formulation of response plans for as many contingencies as possible would help directors to avoid being caught on the wrong foot when facing shareholders.

Conclusion

Through constructive engagement of shareholders, directors will be able to convey the inputs of shareholders on governance and other matters to the company, in effect helping companies to attain higher standards of corporate governance and optimise shareholder value. It is hoped that the considerations set out in this article would help to elucidate the thought process for directors seeking to deal with shareholder activists, so that more companies would realise the benefits of engaging their shareholders. ■

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