SHAREHOLDERS: RECLAIMING THEIR POWER AND RIGHTS

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The theory is that the shareholder is king. The reality is however, often the CEO rules the roost. Investors across the world are increasingly willing to reassert their rights and defend the checks and balances that protect their interests. Such greater investor engagement is sometimes catalysed by new codes on shareholder stewardship and corporate governance.

Power lies at the very heart of corporate governance. That is because corporate governance, at its core, is concerned with the allocation, balance, management and accountability of power within companies.

It is clearly in the interests of shareholders, who entrust capital to companies under the stewardship of other people, to identify where power resides. Rules and regulations may set the boundaries, but power relations, along with things like culture, can have a big effect on corporate performance.

In theory, shareholders must approve a board of directors to oversee their interests and so, shareholders wield power over directors; the board has power over management because executives are accountable to board members; the chief executive may formulate strategy, but if performance fails to meet shareholders' expectations, his job is at risk. In theory, the shareholder is king.

In reality, it is often the chief executive officer (CEO) who is the undisputed boss in the corporate power structure. When this happens, the board may struggle to perform its oversight role, especially if there are divisions within its ranks. Board members may also be too close to the CEO. The board may be structurally independent, but it is meaningless if the CEO helped recruit some of its members.

Meanwhile, shareholders may fail to exercise control over boards because they are too fragmented and cannot coordinate their actions. In the US, staggered boards and plurality voting have made it difficult to remove under-performing directors. In Asia, minority shareholders may find themselves emasculated by a majority shareholder who controls the recruitment, nomination and election of directors.

When power is too concentrated

Too much power in the hands of an individual is bad news. In the case of an imperious CEO, the desire to have total control can sometimes result in a single person filling the roles of chairman and CEO. The job of the chairman is to manage the board, while the CEO is supposed to run the company. A combined chairman-CEO can be a dominant, autocratic figure who discourages discussion and suppresses dissent.

A strong chief financial officer (CFO) can act as an important counter-balance to this chief executive's more aggressive instincts. For example, he ought to be empowered to tell the CEO if the company cannot afford a project, before it is too late. However, a weak CFO may not be able to stand up to the demands of a powerful CEO.

The dysfunction caused by the concentration of power can be felt even within the ranks of independent directors. Directors appointed to the board from outside the company represent one of a number of checks and balances designed to prevent abuses. However, what are the power relationships at work here? Is there a dominant individual who overshadows proceedings? Does

this person foster a culture of open discussion and robust debate, or is there a culture of passive obedience?

Since it is in the interests of shareholders to invest only in companies where governance arrangements are observed in such a way that prevents the flagrant abuse of power, what are investors doing when these checks and balances come under threat?

Investor responses to distortions in power

Investors are increasingly prepared to challenge the company's management to seek redress when their interests are threatened. This is a reassertion of rights that aims to put power back into the hands of the people who own the company – the shareholders.

Asia has traditionally seen less shareholder "activism" than other parts of the world, but this has been changing in recent years with high-profile campaigns in markets such as Korea, Japan and Hong Kong.

For example, Japan's Financial Services Authority has issued its "Principles for Responsible Institutional Investors" document – better known as the Stewardship Code – which serves as a framework of obligations to ensure investors play a bigger role engaging with listed companies.

Modelled on a set of guidelines released in the UK in 2010, the Stewardship Code encourages investors to challenge management on broader issues of governance and strategy, rather than focusing on shorter-term questions relating to financial performance.

So what are some of the things that shareholders push for? In cases where one person is chief executive and chairman, they increasingly seek the separation of those roles. Where this is impractical, for example at smaller firms, the appointment of a lead independent director is an acceptable alternative. If the board is too cozy with the CEO, shareholders ask to see new faces on the board.

How shareholders can assess power

To hold management accountable there must be regular engagement – the frank discussions with a company that take place before and after the initial investment.

Meetings can be held with the management team, non-executive directors and the chairman – in fact anyone in a position to provide deeper insights into issues that affect the firm. However, even though shareholders approve the board of directors, they are seldom given access to the individuals who serve on them. This is one area where there is much room for improvement.

Investor engagement is sometimes catalysed by new codes (on stewardship, corporate governance). Many investors have an increasingly Environmental, Social and Governance (ESG) brief, as opposed to one that is focused on governance alone.

On governance matters, discussions may be around transparency and disclosure, checks and balances, composition of the board and management, remuneration and capital management.

Shareholders should be at the apex of power structures that control listed companies. Unfortunately, this is not always the case. Misallocation and abuse of power happen far too often.

While it is the responsibility of every stakeholder to ensure adherence to governance "best practices", shareholders have the most to gain by defending the checks and balances that have been designed to protect their interests. ■