

Shareholder ACTIVISM

HOW IT WORKS IN NZ'S "VILLAGE" ECONOMY What is shareholder activism, does it produce anything of economic value, and how is it done in New Zealand? Are the outcomes measurably different to what is being achieved in other countries? by Bruce Sheppard

I've been asked to comment on the above questions which is perhaps a little unfair as I can only talk as a shareholder activist (as chair of the New Zealand Shareholders' Association) – so I'd like to think it's a useful activity. I'd also like to think that what is being achieved in New Zealand is measurably differently – and possibly better than anything else done under the banner of shareholder activism elsewhere in the world.

But to understand shareholder activism, it has to be put in context. It's important to understand the framework in which it operates and the global environment out of which it has sprung, as shareholder activism is a global phenomena.

THE ROT

- Shareholders as a matter of law are the owners of companies, which in turn run businesses. Businesses in turn are the combination of an idea or opportunity with managers and capital. Companies are the front line in the partnership of capital and labour.

- In practice, however, shareholders are not able to operate as owners, due to the fragmentation and mobility of ownership. For decades small shareholders in practice have had no say in the governance or operation of the companies in which they own shares. They have been disenfranchised.
- Boards are, in effect, the representatives of shareholders and as a matter of law are accountable to shareholders. In practice, boards self perpetuate and elections tend to be a farcical process.
- As boards that were supposed to be the representatives of owners in practice were not accountable to owners, over time the mentality of boards migrated to the mentality of the paid servants, the managers. If you like, it was management capture of boards. At this point shareholders were disenfranchised and their representatives served the interests of managers rather than shareholders in many of the decisions that were made. Boards saw shareholders as cheap non-recourse bankers.

- As a result CEOs increased their power and influence and consequently their rewards, mostly at the expense of shareholders as the growth in executive pay, performance based or not, has not been mirrored by an increase in shareholder returns.

Out of this elitist executive culture and the disenfranchisement of the "electorate" a popular revolution occurred and this is what may be described as shareholder activism.

THE REVOLUTION The activism has taken many forms internationally, including organised proxy wars, campaigns to remove directors, and fights on major transactions. Activists have used the meeting process, media and shareholder lobbying campaigns to raise the profile of particular issues. Successes have been limited. Few directors are removed, few issues are defeated, and virtually never is a shareholder-initiated item of business passed at a meeting against board opposition and an entrenched major shareholder.





THE NZ REVOLUTION? In New Zealand, we have taken a considerably different approach to many elsewhere in the world. Our approach has been to change the way boards think about shareholders, their role and business, rather than to extract 'wins'. This said we have had the occasional win, just as have our compatriots overseas.

The real difference in New Zealand, however, is the evolution of thought on the role of shareholders, boards and the governance process among those who control the means of production.

Initially we were highlighting issues that we thought were morally wrong, or downright stupid. We did it with humour; we engaged with the media and the objective was to humiliate those who did immoral or dumb things so that they would not relish the prospect of making the same mistakes again.

However, we also did try to maintain a rational underlying position on such matters. Progressively we softened our stance to encourage companies to engage with us on key issues and we set up processes to engage

with companies in non-confrontational ways to ensure that they knew what we were about and what our principles were.

We now meet regularly with many chairmen and CEOs and we organise shareholder visits to most prominent companies for our members thereby increasing the dialogue between company managers, boards and small shareholders. The end outcome of this is a better engagement between ownership and management and a better understanding of each other's position on issues.

This approach works well in New Zealand as, relative to other countries, we are a village economy.

The New Zealand Shareholders' Association has published thought pieces on the interface between owners and workers, the functioning of shareholder democracy, the role of boards, CEO rewards and board composition and selection.

We also engage in regular lectures at leading universities and routinely address professional groups on issues relevant to shareholders. Over time this seeps into the minds of those who are or will be making decisions about others' wellbeing.

Progressively, institutional shareholders have taken up these and other issues. While their approach may be different, their objective is the same and when combined with voting power the outcomes have seen useful board evolution in thought and process.

THE UNIQUE COMBINATION? The combination of confrontation, humour, corporate and community engagement and participation in leading the debate on shareholder and governance issues is probably a world first in approach. In addition we also engage in shareholder education and political advocacy. In short we are both activists and lobbyists.

A VALUE PROPOSITION? Has it made a difference? It seems to our Association that directors now regard shareholders

as owners and give them, both large and small, the respect owners deserve. It seems also that boards now take more care with remuneration than they did, and that they tend to scrutinise major decisions with more care.

Option packages, never much used in New Zealand, are now almost gone entirely. Performance-based pay is given more than lip service. Annual reports on executive reward and selection processes for boards are becoming more transparent.

The issue, however, is whether any of this makes more money. Well, the simple answer is no, what makes money is taking risk against a sensible strategy properly executed while managing the downside risk. In other words, it is business process that makes money, not governance process. Shareholders have little to do with the business process and the only real interface is on major transactions, which are rare.

The counter to shareholder activism, is that if it is done badly and the effect is to increase the reputation risk to decision makers to an unacceptable level, then they will alter their risk taking and shareholder returns will be reduced.

WHAT IS IMPORTANT? It is all about the right balance of action and the right thinking. Get the thinking right and most issues disappear. It is about corporate and community values, morality and fairness. If these principles are adopted and applied, the cake is bigger and all share in an equitable manner.

Trouble is, such an egalitarian world exists only in fantasy and in reality human greed ruins it for the rest. We thus remain committed to exposing those whom we perceive to be villains so that those of us who don't wish to deal with such people know who they are and can avoid them. **M**



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