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Shareholders: Investors or Activists

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Shareholders: investors or activists

An investor commits capital with an expectation of a financial return

- Equity investor, shareholder: owner not a lender
- Holds the riskiest type of security, at the back of the queue of creditors in an insolvency
- Ownership implies control but only over the shares owned; with some rights e.g., a vote
- To control the company, you need a majority of the shares – risk of being in a minority, wishes ignored

Don't forget: debt may convert to equity in a crisis

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Some shares are more equal than others

Most investors prefer one share, one vote

- Dual class shares: one class (A or B) has more voting rights; economic interest separated from say in governance
- A way for founder to keep control

  > eg Snap sold shares with no voting rights in its IPO

  > eg Ken Moelis has 10 votes per share
- As with small free floats, can mean exclusion from indices
- France's Florange Law: double voting rights for long-term (two-year) holders – a reward or protectionist?

  < a way for the state or national champions to keep control

  < puts off other investors as they will be diluted

Should incur a discount but high growth induces leniency

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Different Types of Shareholders - Passive Investor

- You own a basket of shares that mirror an index
  e.g., 100 pieces of the FTSE 100; automated choice
- An economic interest only, no direct vote
- Voting and stewardship delegated to fund manager
- The fund manager has few resources for governance
- It may delegate voting to a proxy
  e.g., Institutional Shareholder Services – ISS
- ISS says it is a leader in corporate governance *and responsible investment*

Minimum thought, no direct engagement

No Interest in Governance?

- Even a passive investor relies on company law and corporate governance rules and codes
- Compliance with CG codes may be part of a stock exchange's listing requirements
- In 2013 Alibaba decided against listing in Hong Kong because of the one share, one vote principle
- Passive investors may avoid markets where governance rules are lax; or demand a higher return
- Indices also have rules e.g., Snapchat's exclusion

A weak governance regime raises the cost of capital

Case for Active Engagement by Passive Investors

- They cannot sell: so what to do about a problem?
- Talk to the board, "engage"
  e.g., on succession, pay, choice of auditors, or other governance issues
- Large providers of index funds
  e.g., BlackRock invests in governance
- Increased use of ESG – environmental, social and governance screens in "passive" investment

Concept of stewardship, responsible ownership, applies

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Active Investors

- Active choice to buy, sell or hold shares
- Incorporate governance and other non-financial factors into valuation; discount for poor governance
- Sometimes fund managers, other buyers of shares have different views to the governance experts
- Incentive to engage e.g., in a turnaround, or over strategic issue, but can signal just by selling
- Special interest investors e.g., focus on climate change

  > Avoid or engage?

Active is not the same as "ACTIVIST"

Activist Investors

- Buy a (small) stake with a view to effecting change
- Company is vulnerable e.g., poor share price performance; management has failed to deliver
- Activist will often push for board changes, may get a seat on the board
- Aim is to change strategy or improve performance

<u>Examples</u>

➢ Easy win at GE

➢ Rebuff at P&G, BHP, ADP

➢ In between at Credit Suisse

Stewardship – What does it mean?

- A person / firm employed to manage and look after another's property – the principal / agent issue
- UK Financial Reporting Council's Stewardship Code:

  "Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole."

- Holding executive management to account: applies to non-executive (independent) directors and shareholders

Stewardship may be linked to public policy – interests other than shareholders e.g., staff, suppliers, environment

Different Ownership Models; Different Pressures

- **<u>Companies with a dominant shareholder:</u>**

➢ Founder-owner-manager

➢ Family dominance

➢ State control / influence

➢ Private equity involvement

➢ Cross-holdings e.g., by big company in suppliers

- Different time horizons: long-term versus short-term
- Different motives : improve company's performance; enrich self; maintain family control; social impact

Pass on assets in a better state than when you entered

Involvement in decision-making

- Voting – what is a protest vote?
- UK: companies receiving 20%-plus vote against must explain how they addressed concerns
- Pressure 'behind closed doors' by big shareholders
- Public calls for change from governance teams, e.g., on exposure to climate change risk
- Limits: fragmented shareholder base, small stakes; limited resources – which issues to pick?

Investors don't want to run the company but to be confident in the agents they have chosen to do so

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Q&A Session