



Capital Markets

MindTree Consulting Ltd.

Volume 1, Issue 4, 05 Feb 07

Shareholder Activism- is it hurting the long term prospects of listed enterprises?

By Dr. Ashok Hegde

“ SEC law passed in the 1930s limited the role of financial institutions in corporate governance and operations... However rules passed in 1942 allowed shareholder participation.

Shareholder activism dates back to the 1930s. It is recorded that when Henry Ford decided to cancel a special dividend and spend that money on social objectives, for the first time in the history of corporate America, shareholders objected and took the matter to court. Though it appears that Ford's intention was influenced by his desire to help society at large, the court saw merit in the shareholders' view that 'an economic entity' needs to have its owners' (shareholders) economical return at the core of its business philosophy. Social responsibility, though appealing to the masses, may not be in the best interest of investors who put their money to realize higher returns. With that view the court made way for shareholders to receive their special dividends. The SEC law passed in the 1930s limited the role of financial institutions in corporate governance and operations. However, rules passed in 1942 allowed shareholders to submit proposals for inclusion of shareholders' agenda in the ballot. It was T Bone Pickens who organized the 'United Share Holder of America', a grass root group that forced policy makers to ease restrictions on shareholder activism.

The Ford incident is considered to be the genesis of shareholder activism. Since then, on regular intervals, markets have witnessed continuous rise of different types of activism. In the late 1980s, it were people like Paul Getty, known for his rider qualities, who took on corporate America and focused on hostile takeovers and leveraged buyouts of undervalued and non-performing companies. In the 1990s, the activism of managers at CaLpers, one of the largest pension funds of yesteryears, contrasted with that of Paul Getty. They withheld votes on important proxy issues and forced many boards to re-look at their strategies and operations.

Today it is estimated that about 57 million people in American household own stock either directly or through mutual funds. With increased information on company operations being made public and the streamlining of the proxy voting process, both pushed by regulatory authorities such as stock exchanges and SEC/FSA, the way in which shareholders have organized their views on the proposed agenda of a listed company has undergone structural changes. The following 3 issues have consistently figured in a majority of 'shareholder activism' events. It is interesting to note that issues such as 'corporate social responsibility', approach towards environmentally safer products, and approach towards 'gender diversification' have all moved southward in the list. Three im-



Capital Markets

MindTree Consulting Ltd.

Volume 1, Issue 4, 05 Feb 07

portant issues which are taking center stage now are:

- Company's acquisition and M&A strategy
- Inappropriate remuneration levels and termination packages
- Company's operations and performance

It appears now that the focus is more on the dilution of control span and return on equity/investment in the short to medium term. More often we are seeing a greater alignment of funds' views on business influencing corporate policies. Often, this activism is forcing companies to compromise on their strategic intent as is seen in the pending decision of Northern Rock.

“ we are seeing a greater alignment of funds view on business influencing corporate policies. Often these activities are forcing companies to compromise on their strategic intent as in the pending decision of Northern Rock

Northern Rock, bowing to pressure, agreed to hold a shareholder meeting as demanded by RAB Capital and SRM Global. It is understood that RAB and SRM, who have spent significant amounts to accumulate their stake in Northern Rock, are now demanding that shareholders have the right to vote on any plan by Rock involving the sale of more than 5 percent of its assets. The meeting was called to block Rock from issuing new shares worth more than 5 percent of the bank's assets. Bryan Sanderson, Chairman of Rock, described the move by RAB and SRM as “unnecessary” and said that “they would restrict the bank's ability to be flexible during an unprecedented period in its history” (Times Online December 22).

Increasingly, hedge fund activities, disguised as shareholder activism, are forcing many new policies among listed companies. What we are witnessing in the market today is structurally different from past experience. Hedge funds often invest in the growth of a company with a 3-5 year view. It is a concern that these hedge funds are increasingly taking proxy routes to force boards and management to re-look into their long term view.

Hedge funds argue that they represent ‘like-minded’ shareholders’ view about the companies and their operations cannot be taken at face value. The intrinsic truth is that their own trading strategies often conflict with the company's philosophy of building sustainable competitive advantage in the long run.

With increasing hedge fund activism and other like-minded groups which are using proxy as a tool to achieve their own political and financial objectives, it may be time for a regulator to re-look into the way proxies are managed. It is also important that authorities the world over look into the so called Investor Service organization which is increasingly voting on behalf of investors. It is interesting to note that increasingly these agencies are advising both corporates as well investors at the same time. The inherent conflict in their approach is



Capital Markets

MindTree Consulting Ltd.

Volume 1, Issue 4, 05 Feb 07

“ Fund which invest in stocks primarily to gain through market volatility can not be viewed as a custodian of shareholder interest.

quite glaring. It is apparent that funds, hedge funds and other interest groups which are mushrooming every day are using proxy as a tool to achieve their own political and financial objectives. It may be time for a regulator to understand the various dimensions of the proxy voting process. It is evident that often the voice of small and retail investors is not taken into consideration. Funds which can organize themselves can exercise pressure on proxy voting which is aligned to their own business model or trading strategies. Often these activities further depress the overall return and derail many plans which may help the company and investors in the long run.

Funds which invest in stocks primarily to gain through market volatility cannot be viewed as a custodian of shareholder interest. There is no significant study which provides statistical evidence (my search to find the same did not result in any meaningful outcome) suggesting that ‘shareholder activism’ really helped companies to perform better—though they addressed certain executive compensation issues and forced regulators to improve the disclosure guidelines. It is important that we make the distinction between various types of investors and their role in the proxy process. A general consent obtained by Proxy Analysis Agencies from the end investors needs to be viewed as proxy by intermediaries. In many cases, investors may not even be aware of how his right of proxy has been used by the representative agencies.

Inherent conflicts between funds’ views and managerial responsibility, in addition to the long term interest of an investor in the well being of a company he/she invests in, calls for a reexamination of this issue in detail. Shareholder activism, influenced by vested interests can be disruptive in the operations of a company and may limit the company’s ability to adapt in the ever changing business landscape to remain competitive, or at least survive.

Dr. Ashok Hegde|Vice President & Head - Capital Markets|
MindTree Consulting Ltd. | Global Village, RVCE Post, Mysore Road, Bangalore
560059 India |Voice + 91 80 26265294|Mobile +91.9986030987 |Fax +91 80-
26264100 | email:ashok_hegde@mindtree.com|www.mindtree.com|

ABOUT MINDTREE

MindTree Consulting is a global IT and R&D Services Company co-headquartered in the U.S. and India. With a passion for customer satisfaction, MindTree partners with its clients to create a transparent, value-based relationship. Our domain experts deliver business-enabling solutions by leveraging a consulting led, framework based and IP-driven approach. MindTree’s IT Services business provides a range of services to CIOs across a variety of industry segments. Our R&D Services business works with Technology companies to help build innovative products by providing Product Realization services.

USA | India | United Kingdom | Singapore | United Arab Emirates | Sweden | Germany | Japan | Australia