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Asian Corporate Governance Association (ACGA)

"Shareholder Activism in Asia: Four Years On"

Presentation by
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HKU Faculty of Law, LLM class
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Agenda

1. Why is shareholder activism important for economic development in Asia?
2. Degrees and types of activism.
3. Key players and examples.
4. The future: implications for legal systems and lawyers in Asia.

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1. Activism & economic development

- From the bottom up:
  - Institutional investors have a fiduciary duty to manage client assets honestly and with professionalism. This implies assessment of risk and (some degree of) engagement with investee companies on governance as well as business issues.
- Trust is critical for the development of capital markets:
  - Trust that your assets will be safeguarded.
  - Trust that your fund manager has your best interests at heart.

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Capital market development

Activism aids the development of corporate governance. Better governance means stronger securities markets. Stronger markets play a more productive economic role:

- Greater investor confidence + more stable, longer term investors (eg, pension funds)
- Deeper liquidity
- Reduced “market discounts”
- Less extreme volatility

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Achieving substance

- Three catalysts for sound governance:
  - Regulatory discipline: rules and enforcement
  - Market discipline: investor and creditor pressure
  - Corporate self-discipline: voluntary improvements in disclosure and to internal checks and balances
- What if market discipline is absent? You have sub-optimal governance:
  - Financial regulators cannot bear the entire enforcement burden: they lack resources and have no ownership clout.
  - Self-discipline: vital for the development of substance, but not always consistent; and companies often need external pressures before acting.

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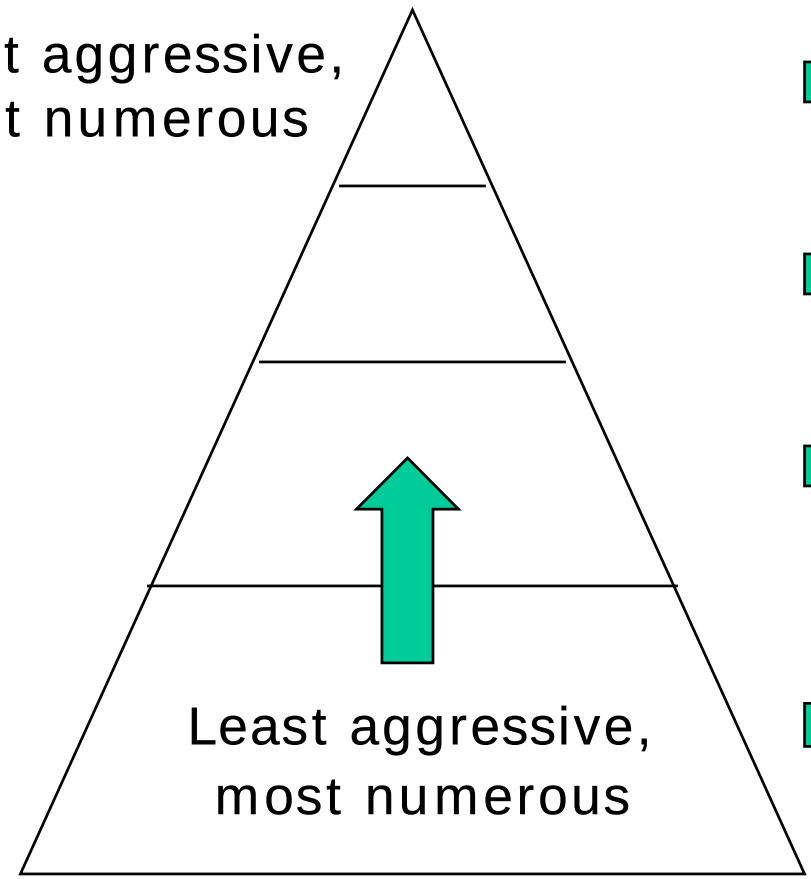
2. Degrees and types of activism: 2000

How we saw investor activism in 2000:



"Focus funds", dissident proposals, law suits

Public activism, alliances, private CG codes

Private pressure on management

Voting, information sharing

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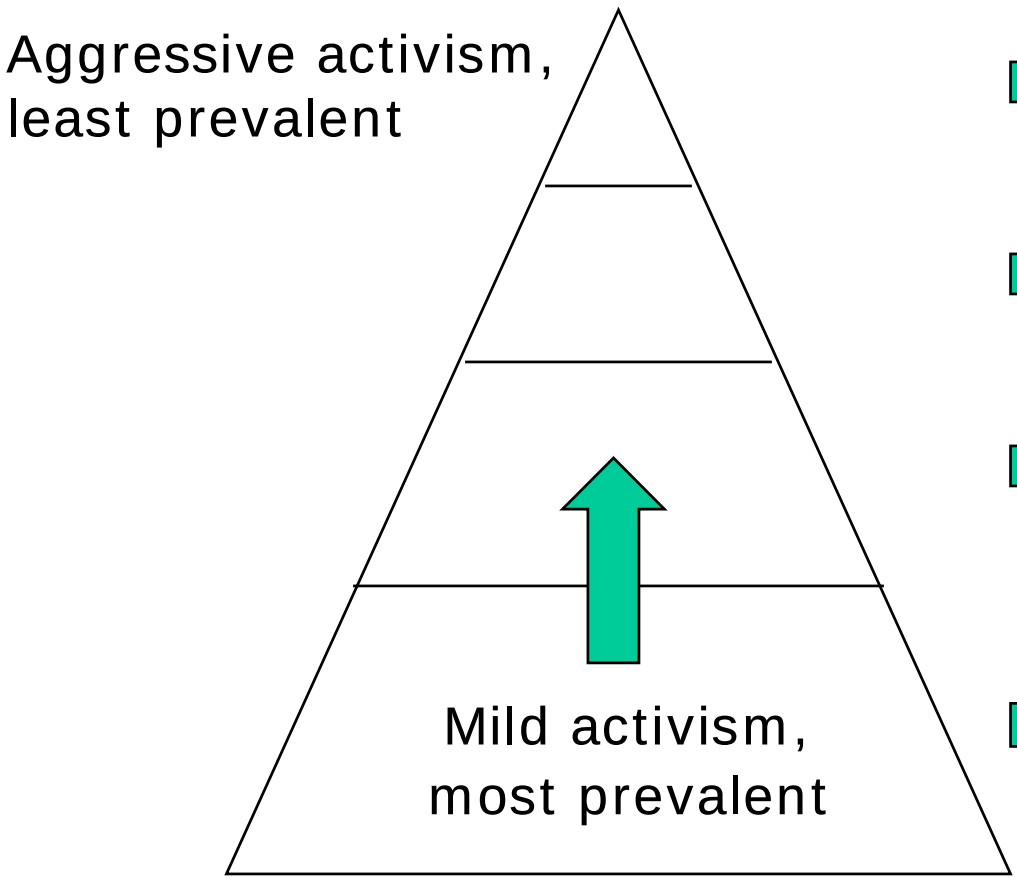
Degrees and types of activism: 2004

How we see investor activism in Asia today (with changes highlighted in red):



Public criticism, law suits, proxy battles

Public engagement, attending AGMs

Voting, "focus funds"

Private engagement with management

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An expanding universe

Type of activism	2000	2004
Public criticism, law suits, proxy battles	A handful of outspoken activists.	Still very limited, but on the rise.
Public engagement, attending AGMs	A small number of committed retail investors + 1-2 institutional.	Retail groups more established. Steady growth in institutional involvement.
Voting, focus funds	Voting seen as a “tedious duty”. No focus funds existed.	Voting becoming more serious. Focus funds in Japan & Korea.
Private engagement with management	Only a few private or public equity funds were active.	Though hard to measure, the numbers are clearly increasing.

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Private engagement

- The first step for most of the largest and/or most established institutional investors:
  - Most seek an open and constructive dialogue with management. Effective engagement often requires diplomacy—especially if your stake is relatively small and you have little leverage over a company. Or if you are a private equity investor and cannot easily sell.
  - Many investors believe they can achieve more through private negotiation than public criticism—especially if they wish to maintain access to management or a low profile.
  - Channels of communication: writing letters; meetings with management (note role of “investor forums”).
  - For public equity investors, there is always the option of selling if management won’t listen or does something egregious.

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Voting, focus funds

- Voting is on the rise, but statistics hard to come by.
- Voting is not an automatic function—it requires a sustained investment of time and money:
  - Assessing company meeting agendas and circulars.
  - Taking advice from “proxy consultants”.
  - Organising your voting systems and voting within deadlines.
- Focus funds:
  - Unlike US focus funds, those in Asia take a more moderate, gradual and less public approach to governance activism.
  - Governance recommendations made very tactfully!

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Public engagement, AGMs

- Public engagement has traditionally been the domain of retail shareholder activists:
  - They seek to leverage their influence through public debate and media coverage.
  - Less belief in the value of private negotiation, but most will engage in it from time to time.
  - Involvement driven more by public-interest motives—being a “watchdog”—than private self-interest.
- A new breed of activist institution is becoming engaged in Asia:
  - They develop their own governance guidelines and proxy voting policies.
  - They seek to make their principles publicly known, as well as their views on specific company issues.
  - They attend AGMs as well as vote their shares.

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Public criticism, law suits, proxy battles

- Still a fairly rare occurrence in Asia:
  - Cultural taboos against public finger pointing.
  - Political and social constraints/penalties for individuals or groups taking aggressive positions.
  - Going to court extremely expensive and time consuming in most countries.
  - Restrictions on types of legal action impede litigation.
  - Proxy battles are equally expensive, time consuming and difficult to organise.
- Nevertheless, more aggressive activism is coming:
  - Cultural attitudes are slowly changing, especially among younger professionals.
  - Political systems becoming more pluralistic and media more open.
  - Development of a “consumer protection” sensibility.
  - Legislation governing legal action is slowly being reformed.

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3. Key players and examples

- Maverick individual and minority activists in Asia:
  - Hong Kong: David Webb (www.webb-site.com)
  - Korea: Professor Hasung Jang and his colleagues at PSPD-PEC. For more, go to: (http://eng.peoplepower21.org/contents/actionbody_economy.html)
  - Japan: Yoshiaki Murakami, M&A Consulting, Inc.
  - Malaysia: Minority Shareholder Watchdog Group (a group undergoing transition; no website).
  - Singapore: David Gerald and his colleagues at the Securities Investors Association (Singapore). For more, go to: (www.sias.org.sg)

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Key players—institutional

- Selected activist institutional investors (including pension funds) engaged in Asia:
  - Aberdeen (www.aberdeenasset.com.sg)
  - BCIMC (www.bcimc.com)
  - CalPERS (www.calpers-governance.org)
  - Hermes Pensions Management (www.hermes.co.uk)
  - Pension Fund Association, Japan (www.pfa.or.jp)
  - Standard Life Investments (www.uk.standardlifeinvestments.com)
  - State Street Global Advisors (www.ssga.com)
  - Templeton (www.templeton.com.sg)
  - TIAA-CREF (www.tiaa-cref.org)

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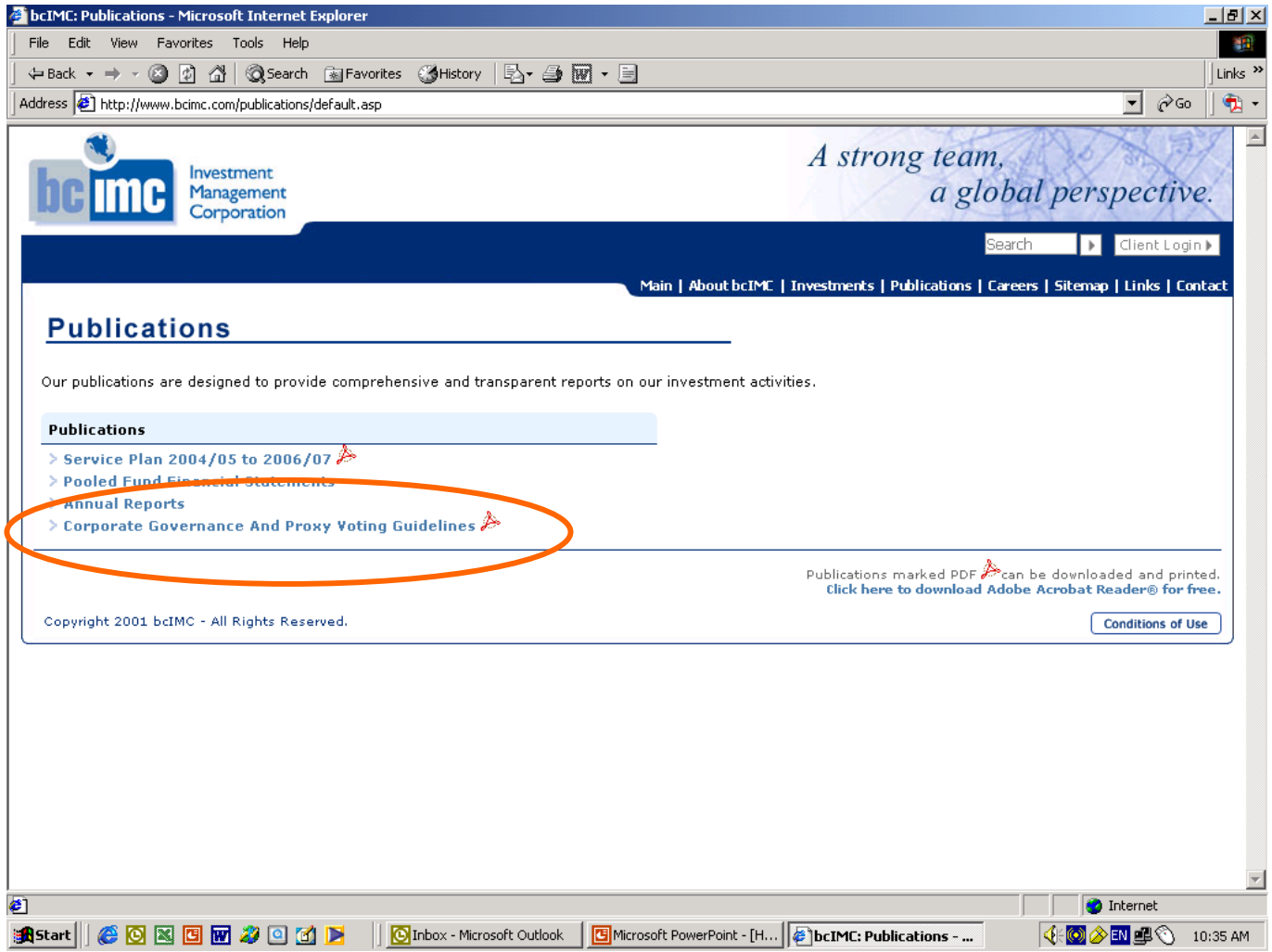

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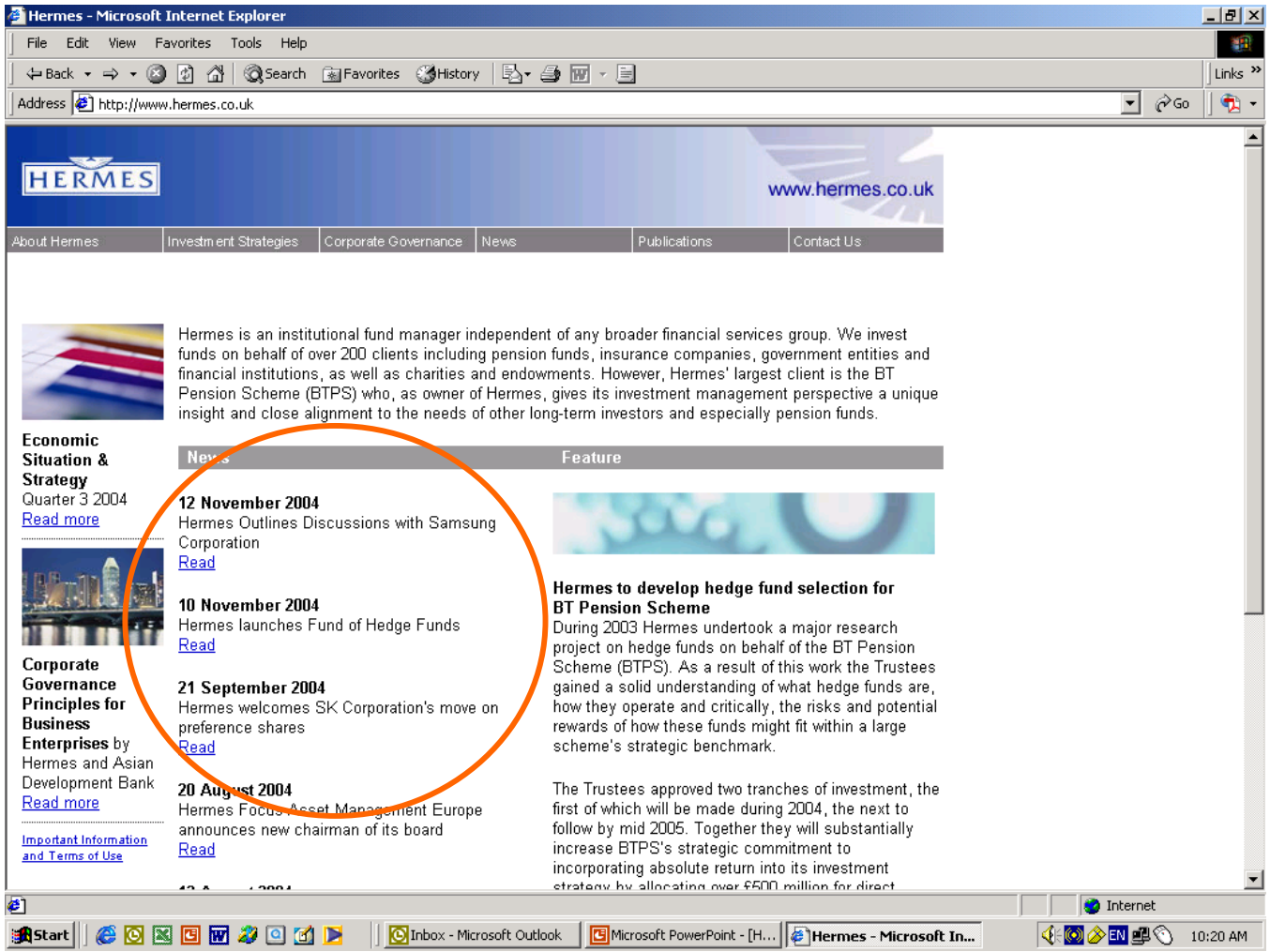
www.hermes.co.uk



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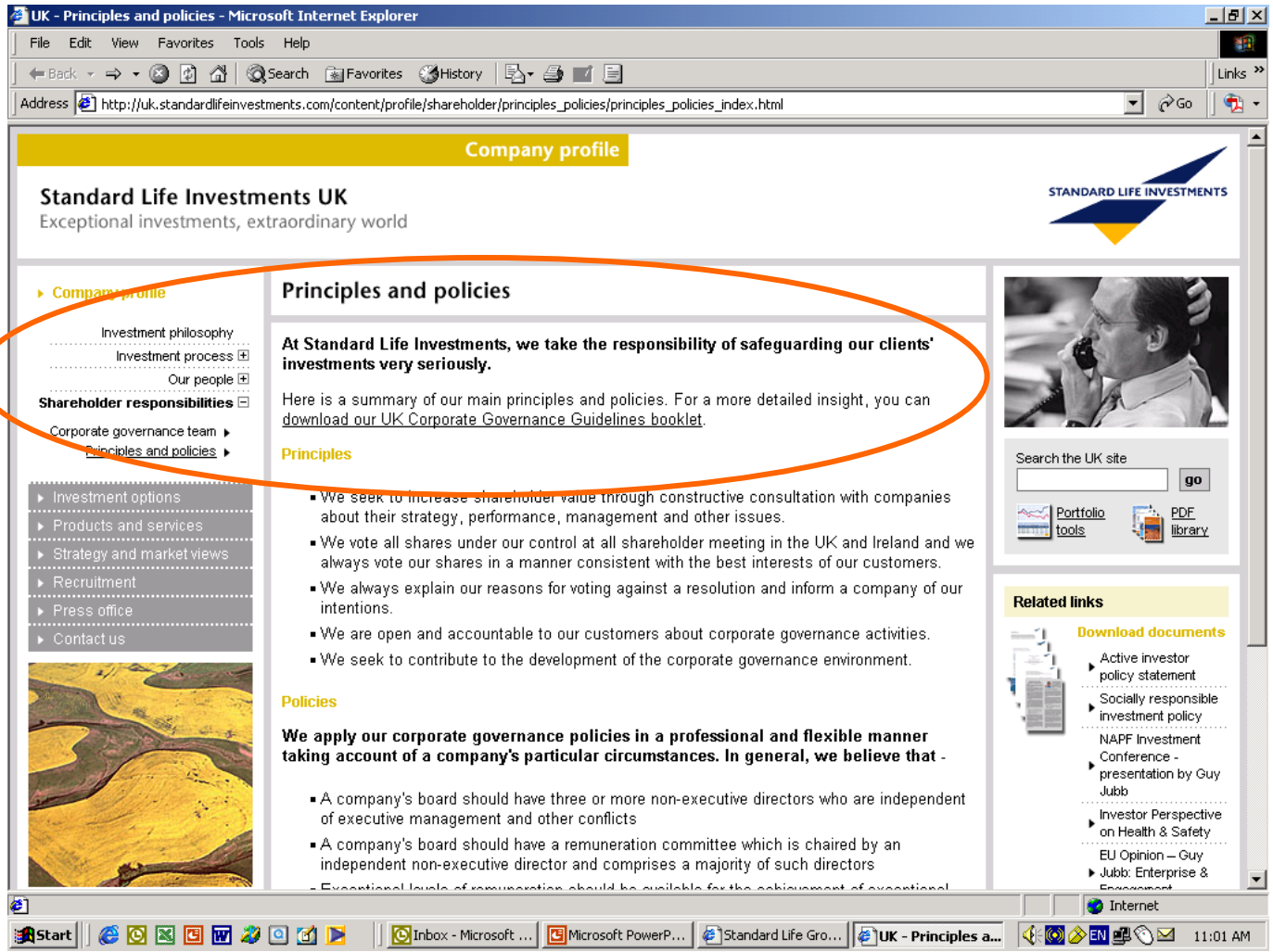
www.uk.standardlifeinvestments.com



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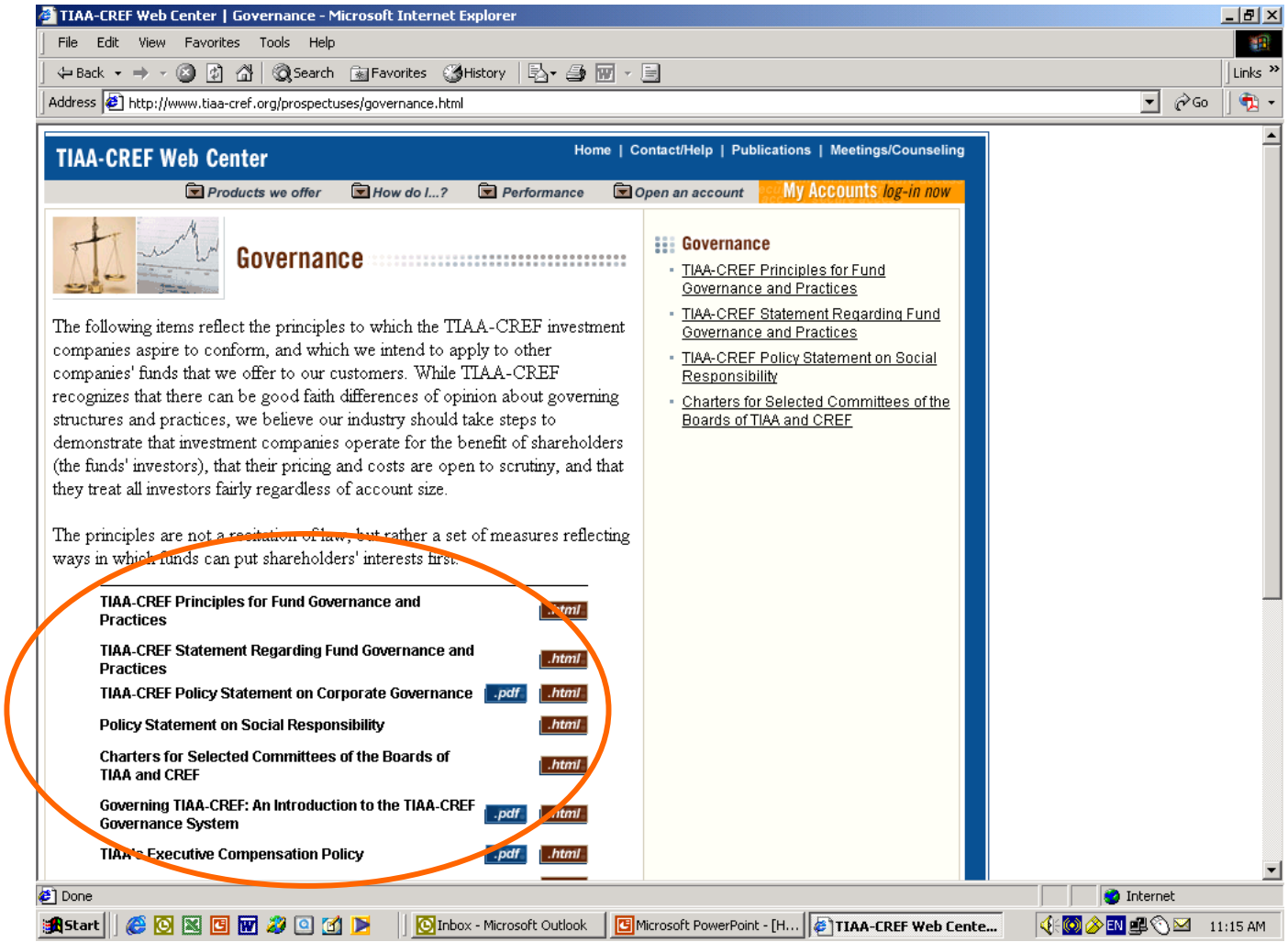
www.tiaa-cref.org



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Examples

- Private engagement:
  - Letter writing campaigns (eg, Arisaig Partners (Asia), a Singapore-headquartered boutique fund manager, often writes to Asian firms)
- Voting:
  - Most large international institutional investors and committed boutique investors have become more systematic in their voting. Case of Japan.
  - This process is assisted, to varying degrees, by proxy voting advisors such as Institutional Shareholder Services (ISS), Georgeson Shareholder Communications, etc
- Focus funds:
  - Japan: CalPERS invested US$200m in one managed by SPARX in 2002 and another called The Taiyo Fund in 2003.

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More examples

- Public engagement:
  - A number of institutional investors, including Hermes and Templeton, joined the campaign to effect change in the governance and board of SK Corporation, Korea, in late 2003/early 2004.
  - Hermes outlines its discussions with Samsung Corp (see its website).
  - Aberdeen a keen participant in company AGMs in Singapore—if it can get in! It is still quite rare for institutions to attend such meetings.
  - CalPERS has published its assessments of the investment environment in Asian countries.

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And more examples

- Public criticism/proxy battle:
  - Again, the SK Corp case is one of the main examples over the past year. A hard-fought proxy battle over board seats and amending the company's Articles took place at the SK Corp AGM in March 2004 (which Sovereign and other minority investors narrowly lost).
  - Sovereign requested an EGM in late October 2004 to try again to amend the Articles. The SK board rejected this request and Sovereign has now mounted a legal challenge.
  - Another proxy battle likely at the next AGM in March 2005.
  - Much domestic criticism of Sovereign has been strident and some media reporting extremely misleading.

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4. The future—implications for the law

- Regulatory implications:
  - In order for "market discipline" to function effectively in Asia, regulators need to revise procedural rules governing the exercise of shareholder rights (eg, voting & custodial processes, attending AGMs, voting by poll, and so on). Significant impediments exist.

    See: "Time to Take Stock", CG Watch 2004, pp 4-7. CLSA/ACGA

- Legal system reform:
  - The number of legal challenges being mounted by investors is increasing around Asia. Yet litigation remains extremely expensive and difficult; there is a need to simplify and make it more cost effective. Case of Taiwan: (www.sfipc.org.tw)
  - Going to court may be a measure of last resort, but it is an option that should be available. Also strengthens the rule of law.

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New legal avenues

- Derivative actions:
  - Not popular or effective in most countries. But there has been some attempt to make them more efficient (eg, statutory derivative action now permitted in Hong Kong).
- Class action:
  - Korea the first country to pass a bill (which takes effect from January 2005). Thailand reviewing one.
- Arbitration:
  - Becoming more popular as a way to resolve disputes between shareholders of private companies. Not as valid for public company disputes. But use of mediation evident in some places (eg, the Hongguang Industrial case in China in November 2002).

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Conclusion

- Shareholder activism has an important role to play in Asia's economic development:
  - Greater trust in fund management companies
  - Deeper, strong capital markets
  - Better governed companies
- Activism comprises a diverse range of activities; the universe of activists is expanding in Asia; and the range of tools available is growing fast.
- Activism is here to stay and will have significant implications for regulatory and legal system development in Asia.

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