

DO NOT TRUST THE MANAGEMENT: SHAREHOLDER ACTIVISM AND ITS CHALLENGES IN MALAYSIA

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ABSTRACT

Shareholder activism is one of the corporate governance mechanisms introduced in the process of improving corporate governance practices within companies. The aforementioned governance allows shareholders to check management behaviour, safeguard their interests and reduce conflict of interests. In the course of protecting their rights via shareholder activism, there is a wide range of actions available to the shareholders, such as filing proposals, meeting with management including the board of directors, taking legal action to voice out their dissatisfactions, providing suggestions or recommendations to their investee companies. In Malaysia, as in other emerging countries in the South-East Asian region, shareholder activism is on the rise, and there has been greater recognition of corporate governance since the devastating Asian Financial Crisis (AFC 1997-1998). The companies have become more receptive to engagement and open dialogues with their shareholders. This paper focuses on the trends and factors that may impede the shareholder activism as one of the corporate governance mechanisms being implemented, as an effort to reduce agency problems in Malaysia through the implementation of high performance corporate governance practices. The cases of shareholder activism were collected through newspaper reports from 2006-2017. The findings of this article indicate an upward trend of shareholder activism, and surprisingly from individual shareholders. The agency and constituency theory are used to discuss shareholder activism. On the aspect of the challenges, the existing local corporate governance characteristics have been identified in the literature, they are such as political connection government influence and specific organisation policy among many others. In order for the shareholder activism to be effective, it must be treated as a mechanism to improve current practices rather than as a mean for shareholders to find faults or provocations.

Keywords: Shareholder Activism, High Performance Corporate Governance, Malaysia, Agency problems, Public listed Companies

1.0 INTRODUCTION

The high number of corporate scandals being reported all over the world has definitely been a topic of discussion on the current condition of corporate governance. At the height of these corporate scandals, if these issues remain unresolved, the issues may escalate to become the main catalyst for the downward spiral of the corporations. The classic examples of corporate scandals are such as Parmalat, Enron, Barings Bank, just to name a few. Accordingly, shareholders changed their investment approaches. This change has led to shareholder activism. Currently, shareholder activism is gaining momentum including in Malaysia.

According to Allen (2011), shareholder activism in Malaysia is the result of foreign institutions entering the local capital market. In Malaysia, shareholder activism are led by institutions such as government agencies, including sovereign wealth, pension fund, pilgrimage and trust funds. Even though their participation and involvement is relatively not as vigorous as compared to their counterparts in the developed nations (Musa and Ismail, 2015). In this paper, shareholder activism is defined as the action of shareholders expressing dissatisfaction in order to change the status quo of a company they have invested in without actually changing the control structure (Gillan and Starks, 1998). The objective of shareholder activism can vary from financial to non-financial aspects of the targeted companies (Bebchuk, Brav and Jiang, 2015; Sjöström, 2008).

2.0 THEORIES TO EXPLAIN THE SHAREHOLDER ACTIVISM MOVEMENT

The interventions and engagements in the areas, which are identified as strategic in the companies indicate that they are responsible investors as their lack of accountability may result in the divergence of interests (Gow, Shin and Srinivasan, 2016). The theories that are used for illustrating shareholder activism are Agency Theory and Constituency Theory. These three theories bring about shareholder activism by shareholders and the non-shareholders alike for the improvement of corporate governance practices. Through corporate governance, the companies may perform better and may prevent frauds. The agency theory is one of the main theories in corporate governance. These three theories are used as the theoretical framework to explain the phenomena of shareholder activism. The basic idea of corporate governance is to address the conflicts of interests, or potential conflicts of interest between shareholders, the board of directors as a whole and individual board members and possible also a number of other stakeholder groups. The conflict of interests that exist in the modern corporation is due to the separation of ownership and control in organisation (Fama and Jensen, 1983).

Many ways have been suggested to resolve the problem in order to reduce the agency cost. Shareholder activism, which means intervention from the shareholders is proposed as a way to solve the problem (Fama, 1983). However, the assumption made by the agency theory is that the shareholders are passive (will sell all the shares if they are not satisfied with the performance), geographically dispersed and have different standpoints concerning their investments (Rubach, 1999). The constituency theory is employed to explain shareholder activism in corporate governance. This management theory is used to explain how the shareholders who are diverse geographically, are grouped based on the common interest, which is their investments. Some of these shareholders even form an alliance to perform shareholder activism. To alleviate agency problems through the intervention of these institutional shareholders, the Constituency Theory is introduced to shareholder activism research (Rubach, 1999). The constituency model posits that the constituents of the organisation participate in organisational strategic decision-making if they deem necessary.

What makes it more relevant to this paper is that, the shareholders will not exit the companies if they are not satisfied with the performance of the company for instance, but stay and exercise their rights by voicing their dissatisfactions to the board of directors and the management of the companies. By including the constituency theory into the theoretical framework, it has made institutional shareholder activism possible in corporate governance

(Rubach, 2013). This type of shareholder activism may lead to the creation of the shareholders' wealth as they do not exit the company at the first sign of problem. Rather, the shareholders remain and correct the unacceptable corporate behaviours. By doing this, it shows that the shareholders are interested for long-term investment. Another theory used to explain the shareholder activism is the Social Movement Theory. This theory is used to illustrate the movement of shareholder activism, which is led by non-shareholder's formal organisation for instance the Minority Shareholder Watchdog (MSWG) in Malaysia, which was established as a government initiative to protect the interests of minority shareholders through shareholder activism. According to the theory, the convergence of interests of the organisations and the shareholders has created the movement in the society. Thus, shareholder activism is possible under the above theoretical framework. The shareholders collectively seek for their rights together with the MSWG. The section below explains the need of shareholder activism to achieve high performance corporate governance practices.

3.0 THE INFLUENCE OF SHAREHOLDER ACTIVISM ON THE HIGH PERFORMANCE CORPORATE GOVERNANCE PRACTICES

There are various types of control available for the companies to implement in the course of ensuring the effectiveness and the efficient of the operations within the company. The most common control mechanisms across all organisations consist of internal and external control. If internal corporate governance fails, an organisation may rely on external controls. One of the external control mechanisms available to companies is shareholder activism, which can act as a secondary governance mechanism in case of poor internal governance, but it can also serve the purpose of enhancing internal governance (Rose and Sharfman, 2014). Shareholders may choose to engage with the company and act as a second control mechanism to the board of directors and management, particularly when internal governance (control) is not functioning as expected (Lashgari, 2004). Indeed, many authors have argued that the involvement of responsible shareholders in monitoring or controlling activities can limit agency problems (Gillan and Starks, 2007; Fama and Jensen, 1983).

According to Bebchuk, Brav, and Jiang (2015), frequent and systematic engagement in shareholder activism towards high performance internal governance practices may result in high profits for stakeholders. Through shareholder activism, the shareholder activists may lobby for a prompt result on investment returns to improve the operations of the company or for a long-term improvement of shareholders' value (Dimson, Karakas, and Li, 2015). Another research conducted by Cuna et al. (2012) has shown that shareholders' efforts to improve corporate governance have delivered results that contribute to their wealth with a more positive share price reaction. The positive side of shareholder activism is the spillover effect. It can alert non-targeted companies to improve their practices, and may lead to the issue of free riders. The activists would spend an enormous sum of money and efforts to initiate shareholder activism (Clifford, 2008), but the ensuing benefits of the activism are enjoyed by all the shareholders.

These free riders also derive the benefits from any form of activism without spending any money or making the efforts invested by the activists (Admati and Pfleiderer, 2009). It is justified for the shareholder activists to depict that these free riders attain positive results of shareholder activism based on the hard work rendered. On the part of other shareholders, they

either wait for other shareholders to intervene and if there is no intervention from any shareholders, the best option for the adverse reaction is to withdraw their investments and identify other available options rather than striking out on their own due to the costs involved (Admati and Pfleiderer, 2009). It is logical and practical that shareholders with huge interest in a particular company are the first to intervene when returns from the shareholder activism outweigh the cost of engagement with the targeted companies. Apart from that, the shareholder activists are also under immense pressure from their beneficiaries for superior returns.

4.0 THE CURRENT TREND OF SHAREHOLDER ACTIVISM IN MALAYSIA

It is reported by a survey conducted by JP Morgan entitled "Shareholder Activism in Asia" (2018) that the Asian markets like China, Hong Kong, Japan, India, and Singapore have been experiencing the rise of shareholder activism among their local shareholders. Likewise, Malaysia may have also experience similar issue. The Malaysian market might benefits from it tremendously as foreign activists are always seeking for investment opportunities in Asia and are used to shareholder activism as a mechanism for monitoring their investments. Japan and Hong Kong accounted for the bulk of activist activities in 2017, at 32 per cent and 24 per cent of total activity respectively, followed by Singapore (14 per cent), China (10 per cent), India (8 per cent) and South Korea (6 per cent) (Shareholder Activism in Asia, 2018). According to the MSWG, the presence of shareholder activism is rather pertinent. From the observation during the shareholders general meetings, the shareholders are actively engaged at individual as well institutional level.

The Malaysian current corporate governance characteristics is the result of government policies, pattern of the shareholding, cross-holding of the major shareholders in the Malaysian Capital Market that comprise of government agencies or family-owned corporations, the nominee companies followed by non-financial companies and the government. (Rahman, Omar and Rahman, 2016). These characteristics are shared by many East Asian countries like Indonesia, Thailand, Korea, Hong Kong and Japan. With the above shareholding, to a certain extent, agency problem becomes irrelevant (Liew, 2007). However, in reality there is always a risk of misappropriation by controlling shareholders when they become too powerful, thus agency problems are still relevant to the countries with high concentration of ownership of corporate governance characteristics (Liew, 2007). Hence, shareholder activism in Malaysia is very much applicable to corporate governance mechanism. Shareholder activism requires the shareholder to intervene systematically and constantly with the management of the targeted companies's operations. Hence it is not an easy task and it involves a large amount of resources, time and costs (Manconi, Yassa and Yasuda, 2012). As such, institutional shareholders are often tasked with spearheading shareholder activism because they are an organised institution with huge amount of resources.

In Malaysia, domestic institutional investors are often subsidiaries of large banks and insurance companies or government sovereign funds, especially pension funds. As a result, the domestic institutional shareholders activism is restricted by the relationships that their parent companies have with listed companies (Claessens, 2002). They are among the substantial shareholders or the substantial shareholders of many public listed companies in

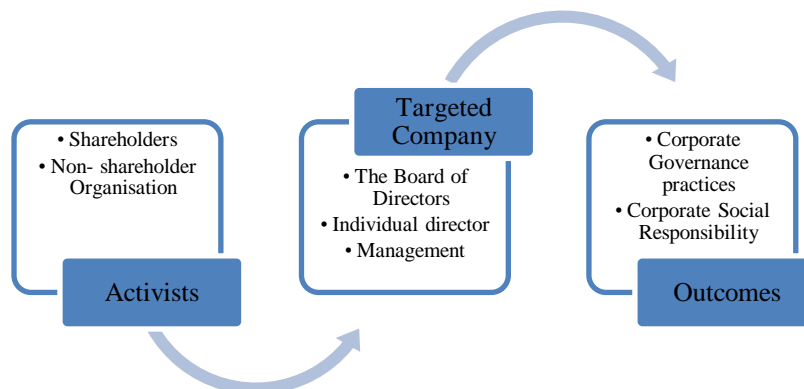
Malaysia at the moment. Throughout the years, the Employees Provident Fund (EPF) has transformed from a passive shareholder into a major enthusiast of sound corporate governance for the benefit of their investments. The EPF is a social security institution that provides retirement benefits for members through management of their savings. The EPF is the fifth largest pension fund in Asia and seventh largest in the world as of year 2018. In addition to that the EPF is the largest institutional fund in Malaysia with over RM730 (USD183) billion total investment assets (EPF, 2018).

Through proactive interaction and engagement with the board and management of investee companies, as well as on-going participation in companies' shareholders meetings, EPF aims to promote the best practices of corporate governance amongst its investee companies (Corporate Governance Principles and Voting Guidelines, 2014). In the latest shareholder activism EPF as an institutional shareholder for Sapura Energy Bhd president and chief executive officer. The remuneration amounted to RM71.92 million was equivalent to about 35 per cent of the company's net profit for the year ended January 31, 2017. Remuneration was considered "excessive" by the Employees Provident Fund (EPF) which had voiced its unhappiness over the issue and even mooted an idea to oppose the re-election as the company director at the annual general meeting. The new addition of the institutional shareholder activist is Kumpulan Wang Persara (KWAP). KWAP is the second largest pension fund in Malaysia more proactively involve with shareholder activism and responsible investing.

KWAP engagements are in the form of attendance of general meetings, company visits, and private discussions with the company management of the companies in its investment portfolio (Corporate Governance Principle and Voting Guidelines, 2014). The engagement performed by KWAP is more of non-traditional method of shareholder involvement. The traditionalist approach may confine to the annual general meetings through voting and submitting proposals to the registered office prior the general meetings (Corporate Governance Principle and Voting Guidelines, 2014). Apart from that, KWAP also issues letters to investee companies and annual shareholder letters whenever there are matters of their concern. KWAP chooses to be a believer of shareholder activism and learns from the experiences of international shareholder activist. The fund may appoint a representative on the board of the investee companies if the need arises.

They believe that regular intervention in the strategic areas may increase the shareholders wealth and reduce losses by reducing the divergence of interests. Having said that, the new regulatory developments in the Malaysian market such as Companies Act, 2016, have also driven the rise of shareholder activism in the country, including continued measures to implement new corporate governance principles to strengthen investor confidence. The characteristics should no longer be the challenges to move forward with shareholder activism. On the other hand, this may be used as an avenue to improve current corporate governance practices via shareholder activism.

Diagram 1: Shareholder Activism Process



Shareholder Activism and Malaysian Shareholders

In addition to the above point, the table below provides the list of shareholder activism in Malaysia from the year 2000 until 2017. The actions were brought forward by the shareholders who were mostly not satisfied with the ways the company was handled which resulted millions in losses as compared to other issues. Based on the table below, the numbers have increased tremendously throughout the years. It is remarkable to see that individual shareholders play more roles in the shareholder activism in Malaysia as compared to institutional shareholders. There are 20 activism cases that have been identified in 2006-2017. These cases were reported by the print media. At the moment, any official data has yet to be compiled by any authority pertaining to shareholder activism. Furthermore, any regulatory requirement and corporate governance best practices pertaining to the disclosure of any shareholder activism experienced by the public listed companies have yet to be ascertained. Thus, the acquisition of validated and official data is close to none.

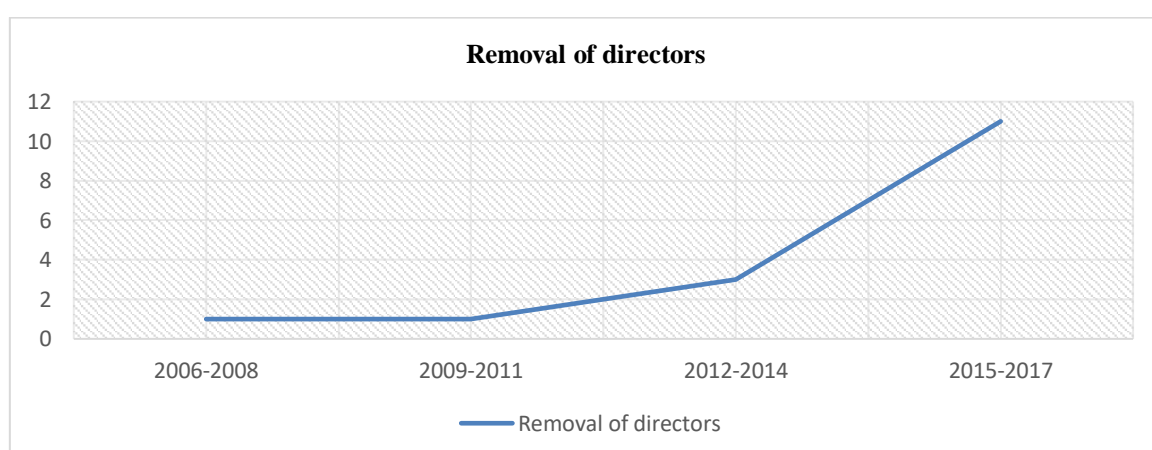
Based on the above cases, the 20 cases of the identified shareholder activism, industry wise, indicates that the shareholder activists do not target any specific industry or sector. By not focusing the shareholder activism in one specific industry, this means that the shareholder activists are not from one industry only, thus, all the shareholders use shareholder activism. This aligns with other Asian countries (J.P. Morgan, 2018). The percentage of the companies, which are being targeted, is even across the board. Table 1 below shows that the most frequent issue is pertaining board of directors with 16 out of 20 cases, which represents 80 percent of the reported cases. The attack centres on the board as well as the management teams. The concerns that have been put forward are mainly removal of the Chief Executive Officer (CEO), individual board members and even the entire board of directors in more dramatic cases. There is also a case where the director is reported to the authority for breach of trusts. However, according to the Shareholder Activism in Asia: Confrontation Gaining Momentum across Asia, the attack on the board of directors is not common (J.P. Morgan, 2018). Nevertheless, having said that, the cases reported targeting the board of directors has increased in 2017, four times higher than 2014. Therefore, the trend in Malaysia is similar with the pattern of shareholder activism in other countries in Asia. Based on the above scenario, the local shareholders are now more comfortable exerting pressure, thus, forcing the management team and board to adapt to a new investment method, where shareholders

demand their voice to be heard and enjoy the support from other shareholders to put forward their views.

The shareholder activists in the reported cases are the ones the shareholder representatives on the board of directors of the reported shareholder activism cases. This is usually the case with family business. Their shareholdings are substantial and most often than not they have family connection with each other. Thus, these shareholder activists are not ordinary retail individual shareholders. Their involvement with shareholder activism can be associated with information and the expertise that they possess; influential businessmen, hence are well versed with business strategies. This is normally not the case with other retail individual shareholders. Assistance and support is usually available to public individual shareholders that are usually provided by the MSWG. The shareholders are being thought to read the financial statements and the type of information need to be assessed before obligating to the investments.

Meanwhile for the above shareholder activism cases, the shareholders are on the board of directors and with full access of the information. From the data above, institutional shareholders' interventions, which are publicly known, are not many. From here, it is still valid to presume that the Malaysian shareholders are still lacking in championing their legal rights especially institutional shareholders with huge of investment and beneficiaries despite commendable efforts by some institutional shareholders such as EPF and KWAP. Unfortunately, the actions are not undertaken on time, as the company has suffered a huge amount of losses or have been classified by the authorities as under financial distress based on the reported cases. The recovery requires a longer duration in terms of financial performance and public image. Hence, a more pragmatic and systematic approach is required by the Malaysian shareholders.

Diagram 2: Removal of Directors by the Activists



The Malaysian Companies Act, like other legislations on company law around the world, specifies the rights of all shareholders in the country's companies. Among the rights given to shareholders is the right to requisition for, and convene, general meetings. The new act has expanded on this by giving members the statutory right to conduct a management review, where members may debate, challenge or make recommendations to the management of the

company, thus creating more opportunities for shareholder activism. To illustrate, under the new companies act, the shareholders at a general meeting shall approve the remuneration of directors of public companies and any benefits payable, unlike in the previous act, only the remuneration of directors. In addition to that, under the new act the service contract of a director of a public company should be made obtainable for review at the company's registered office. These provisions promote greater transparency and accountability of directors. In contrast, the board of directors may approve the remuneration of directors of private companies. However, the shareholders holding at least 10 per cent of the voting rights of the company may demand that a director's remuneration must obtain the shareholders' approval if the remuneration decided by the board of directors is deemed unfair. This has increased the right of the shareholders to oversee the directors' remuneration legally. To conclude, the new act gives more rights to the shareholders to be involved with the operations of the company. This marks the beginning of a potentially more rigorous level and aggressive shareholder activism, as there are more avenues for the shareholders to engage legally.

Intriguingly from the table above, there is only one case of removal of auditor and three cases out of the 20 cases identified, preventing the corporate exercises or demanding for better terms of the corporate exercise. In addition, there is a case on opposing on the change of the capital structure such as share split. This is a good indication that the shareholders are monitoring the important decisions made by the company, as these decisions have major impact on the companies and the interests of all the related stakeholders. Issues across Asia according to JP Morgan survey, 2018 (Shareholder Activism in Asia) capital structure related shareholder activism (equity, loan, share capital etc.) which amount to 24 per cent. Meanwhile the opposition to announce deal for instance the terms amount to 12 per cent and corporate strategy related issues which is 13 per cent.

5.0 CONCLUSION AND LIMITATIONS

Based on the above findings, shareholder activism in Malaysia is still very at the infancy stage and confine to a certain group of shareholders who have the luxury of access to knowledge and resources. The issues usually targeted by the shareholder is the similar and this indicate that there is no broad appreciation on the importance of overall corporate governance which may lead to the company performance. The shareholder activism is done when the problems are already at the stage of beyond redemption or difficult to recover. It is hope that shareholder activism is able to be exercised easily by all the shareholders regardless of their shareholding. Sincerely, positive view of shareholder activism from the both parties involved in the process is important in keeping the divergence of interests at bay and subsequently reducing agency costs. Shareholders in Malaysian companies are rather reluctant particularly when discussing on issues pertaining shareholder activism. Significantly, this can be attributed to the fact that shareholder activism is still considered a controversial issue, where activists can often be criticised as troublemakers or disruptive elements. The legal framework concerning shareholder activism must be strengthened to create value to shareholders and targeted companies as a whole. The legal framework empowers shareholders to be actively involved with shareholder activism. Lowering barriers in exercising rights, procedures and engagement costs are other possible ways to encourage the shareholders to be involved with shareholder activism. This study used only secondary data which is printed media as a source of information for the cases. Thus, verification on the

number of cases is rather uncertain. Certain cases may have been accidentally omitted from the list.

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