MINORITY SHAREHOLDER WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
(Incorporated in Malaysia – Company No. 524989-M)

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THE IMPACT OF SHAREHOLDER ACTIVISM

BY **TAN ZHAI YUN**

Shareholder activism has been on the rise in Asia since the 2008 global financial crisis, due in part to the greater push for good corporate governance and the protection of minority shareholders. This tide of activism brings with it various implications for investors, ranging from share price movements to corporate governance reforms.

Last year, four of the 10 most targeted countries (excluding the US) by activist investors were in this region, where campaign volume has seen a compound annual growth rate of 48% since 2011, according to a JP Morgan report in May. According to the report, activist assets managed by hedge funds reached a record US$125.6 billion in December last year, up 4% from 2016. Also, the number of international campaigns exceeded those in the US for the first time.

"Broadly speaking, activism has been on the rise since the global financial crisis as part of the circular change on how the wider investment world views its role in managing companies. There has been a view that the board may manage the company, but shareholders have a greater role to play in overseeing the board," says Josh Black, editor-in-chief of *Activist Insight*, a publication based in New York and London.

More activism campaigns could occur going forward due to the strong economic growth, he adds. "This creates more opportunities for activists to say they should do this or that, or point out underperforming companies that still have cash and can return it to shareholders, invest it or become a takeover target. There are far more options when companies are doing well, and I think you will start to see more activism whenever there is dilemma for management that stalls corporate decision-making."

According to the *Activist Insight Half-Year Review 2018*, most of the global activism centred on dual-class share structures, mergers and acquisitions (M&A) and gender diversity, along with a shift in attention towards environmental, social and governance (ESG) issues. In Asia, there was a rise in activism that targeted companies' business strategies and a decline in those seeking boardroom representation.

Foreign activist funds such as Third Point and Elliott Management Corp are increasingly targeting Asian companies as the US market has reached saturation point. But the bulk of shareholder activism in Asia is still undertaken by domestic activists.

"Shareholder activism is on the rise in Asia, but mostly in South Korea and Japan due to the maturity of their corporate governance frameworks. That said, other parts of the region are also seeing an increase in such activities," says Roland Jude Thng, who runs the Judah Value Activist Fund of the Singapore-based Swiss-Asia Financial Services Pte Ltd.

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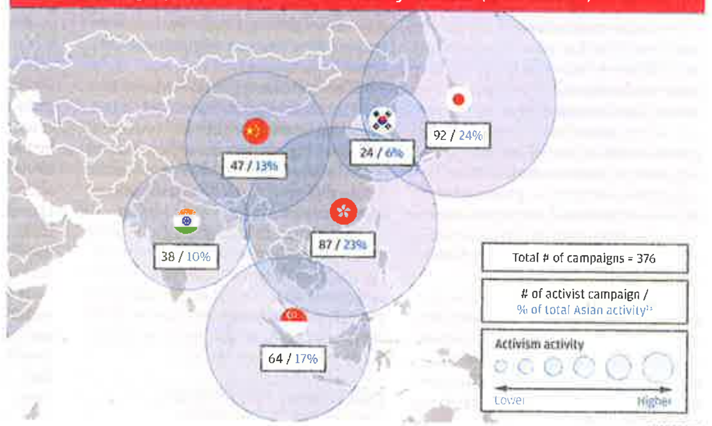
Primary geographies for activism activity in Asia (2011-2017)



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"These activities will only increase in the future due to the evolution of financial markets. The US and European markets serve as a precedence to what will happen in Asia."

The Judah Value Activist Fund invests in the Hong Kong and Singapore markets. It currently has US$44 million under management and targets annual returns of 20% to 30%.

Activism can be defined as any type of investor influence on a company's decisions, including institutional investors that recommend the other shareholders vote a certain way. However, some associate this more commonly with hedge-fund activism, where the funds acquire shares of the target company and issue various demands — at times using aggressive or controversial methods — to increase shareholder value.

A recent example in Malaysia was the Minority Shareholders Watch Group's vote against the re-election of two independent directors of Sapura Energy Bhd and payment of their benefits in July, due to excessive remuneration of the CEO. The Employees Provident Fund was reported to have backed this move.

Other issues often brought up by activists are the return of excess cash to shareholders, proxy fights to place a representative on the board or M&A suggestions.

"We do not draw a strict line here as everything from actively speaking to the board, shareholders and management to proxy fights is essentially 'activism'. Some activists like to work behind closed doors and nobody knows they are 'activists' while others are more vocal about their engagements and receive more media coverage," says Jan F Moermann, chief investment officer and managing director of Quarz Capital Asia (Singapore) Pte Ltd, an activist fund based in the city state.

Activist hedge funds usually acquire a significant amount of shares in a company that they think is undervalued. After acquiring the equity, they launch campaigns to force the company to adhere to their suggestions. Meanwhile, institutional investors could partner hedge funds or announce their intent to vote a certain way.

According to Moermann, activist campaigns will always be present as long as there are companies that are being run inefficiently. Quarz invests in companies around the world and includes the likes of Apple and Switzerland-based Coltene Holding in its portfolio.

"Activists are just shareholders who are willing to speak up and improve shareholder value. Many small shareholders invest their hard-earned retirement funds in companies that languish for a long time and do not increase dividends or grow their share price," says Moermann.

"We help investors by stepping up to the task, raising our concerns and making recommendations to increase shareholder value. Small shareholders, in my view, should always do their own research before making investment decisions, but they can also follow activists to see what they propose."

GROWTH FACTORS

There are several factors driving the growth of shareholder activism in Asia, including the demand for good corporate governance and the protection of minority shareholders. That is why most of the activity in the region occurs in developed markets such as Singapore, Hong Kong, South Korea and Japan, which have introduced corporate governance and stewardship codes in recent years.

Japan's Prime Minister Shinzo Abe has embraced shareholder activism as part of his economic policy. In the past, many activists avoided Asian markets due to their lack of transparency and weak corporate governance, according to various reports. But now, companies with these weaknesses have become attractive targets.

"Western investors are probably looking at countries with greater political momentum behind good corporate governance. In Japan, you have the Abe reforms and in South Korea, you have the anti-chaebol movements. They are also probably looking for countries with a looser monetary policy," says Black.

For instance, US-based giant activist fund Elliott Management urged automotive conglomerate Hyundai last year to adopt a holding company structure and implement a clearer shareholder returns policy. The South Korean company responded to this with a plan that addressed its concerns.

According to reports, there has been a change in culture, where retail investors are becoming more aware of their rights and accepting of activists' call for a move away from practices such as generational succession and nepotism.

"In a class of Asian students, the students are always shy to ask questions. That is just the Asian culture of subtlety. But the moment a few students speak up, the others are more open to talk. When there are fruitful discussions among the different participants, new ideas may be generated, which benefits everyone in the discussion. That is the reason I have always encouraged shareholders to speak up," says Thng.

"Investors should learn about their rights. After all, it is their hard-earned cash that they used to buy stakes in companies. Their share ownership entitles them to voice out their concerns. Fluctuations in share prices are not a guarantee and the key is to push for improvements in the fundamentals. Sooner or later, the share price will follow."

Both Moermann and Thng's funds focus on value investing, particularly among small and mid-cap companies that are seldom covered. The presence of undervalued companies and the dearth of information present an opportunity for activist funds.

"Especially in Singapore and Hong Kong, activists find undervalued, high-quality companies compared with those in the US and the European Union. We only invest and get active if the companies are very undervalued and inactive," says Moermann.

"In Asia, a lot of companies are kept undervalued so that the majority shareholder can take the company private at a cheap price, which hurts the small shareholders. We increase volume and liquidity, close information asymmetries and increase value for all shareholders."

Thng made his move to activist investing in 2014, when he noticed a number of undervalued investment opportunities in Singapore. That was when he founded activist hedge fund EVA Capital SP.

To Thng, the discrepancy between share price and value is a signal for investors to take a deeper look. "We primarily set our sights on companies in the small and mid-cap space with strong balance sheets. My focus are small and mid-caps typically majority-owned by families," he says.

"I would prefer to take a stake, sit on the board if possible and grow the company with the existing board and management team. The basis is always undervaluation. I can choose to sit on the undervalued stock or sell it immediately after the shareholder value increases."

Meanwhile, there is a growing emphasis on ESG principles among institutional investors, whose holdings are increasingly global. Many of them are now either engaging in activism themselves or partnering hedge funds to push for greater ESG performance. For example, prominent US-based hedge funds Jana Partners and ValueAct Capital have launched other funds to push companies to adopt ESG practices.

The world's largest asset manager, BlackRock, waged its first campaign against Hong Kong-listed G-Resources Group Ltd in February 2016, voting against its plan to sell its main asset. BlackRock stated that investors should be compensated if a company sells most of its main assets when it wants to move into another industry, according to Bloomberg.

BlackRock is an example of a prominent index fund provider engaging in shareholder activism. Index funds have an inherent inability to divest companies from the indices they track, thus they are incentivised to increase monitoring to improve performance.

"With index funds, it is more about the votes. They are doing it to win the votes of the top investors. Activists are working closely with pension funds, just like Jana and the California teachers' pension fund. They ran a campaign on Apple in January for more parental controls on the iPhone [for example]," says Black.

Much research has been done to determine

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View of shareholder activism is changing

Most people associate shareholder activism with hedge fund activist investors such as Carl Icahn, who has been called a corporate raider for his hostile takeovers; Paul Singer, whose Elliott Management fund uses many confrontational tactics, including public letters, presentations and litigation; and Dan Loeb of Third Point, who is notorious for writing harsh letters to companies.

Over the years, many of these prominent activist investors have launched nasty campaigns that last for years, fought with companies and forced executives to step down. But this view of shareholder activism is changing, say some reports. Many activists are switching strategies to be viewed more as engaged investors. Institutional investors are adopting activist tactics to push for change in their investee companies while hedge funds are taking longer-term horizons in their investments.

According to a JP Morgan report in February, direct public attacks on board members are not as common in Asia as in the US. Calls for corporate governance reforms and demands for direct shareholder representation in the boardroom are increasing. Return on capital, opposition to announced mergers and acquisitions (M&A) and interested-party transactions are some of the common demands in Asia.

Many of the activists around the world are shifting their campaign focus to operational issues. Rather than demanding for higher dividends or M&A, they are increasingly taking on longer-term issues by demanding the appointment of independent directors, joining the board or helping to execute a new strategy, according to a PwC report in February.

According to the global firm, companies that often become targets of activists have low market value relative to their book value, weak company performance compared with their peers, but are profitable with good operating cash flow, return on assets and excessive cash in hand. Companies with diverse businesses with one line that is underperforming or a line that has a different growth potential are also attractive targets, as well as those with board compositions that do not meet governance standards.

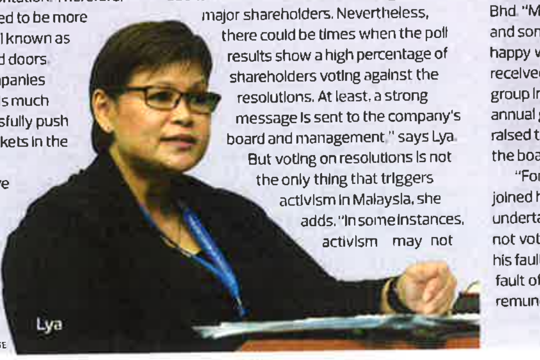
The Malaysian perspective

The Minority Shareholders Watch Group (MSWG) was established in Malaysia specifically to protect the interests of minority shareholders by engaging in shareholder activism.

General manager Lya Rahman says shareholder activism is rising in the country. "In the past, investor activism usually took the form of private engagements, especially in Asia, where there is cultural aversion to public confrontation. Therefore, investor activism seemed to be more suppressed and not well known as it was carried out behind doors. Moreover, as Asian companies are often tightly held, it is much more difficult to successfully push for change in some markets in the region."

The factors that have driven shareholder activism in Malaysia include a greater awareness of shareholder rights, the poor financial performance of companies and lower shareholder returns, Lya observes. The addition of more rules to Bursa Malaysia Listing Requirements, Malaysian Code on Corporate Governance and Sustainability Statement and Guidelines has also contributed to the trend.

"Vote 'no' campaigns are becoming more common even though in many instances, the resolutions could still be carried out due to the substantial shareholding of major shareholders. Nevertheless, there could be times when the poll results show a high percentage of shareholders voting against the resolutions. At least, a strong message is sent to the company's board and management," says Lya.



MOHD SHAHRIN YAHYA/THE EDGE

Lya

But voting on resolutions is not the only thing that triggers activism in Malaysia, she adds. "In some instances, activism may not necessarily be in regard to voting but more on the poor financial performance, no or very little dividends declared, excessively high cash holdings not deployed for better investments, unusually high gearing, high absenteeism of directors at board meetings and unusually long tenures of independent directors."

A recent example took place in July when MSWG opposed the re-election of two independent directors at Sapura Energy Bhd. "Many shareholders, including MSWG and some institutional investors, were not happy with the excessive remuneration received by the group CEO despite the group incurring substantial losses. At the annual general meeting, many shareholders raised their concerns and even bombarded the board with sharp criticism," says Lya.

"For the first time, institutional investors joined hands with retail investors to undertake shareholder activism. We did not vote against the CEO because it is not his fault for getting the high salary. It is the fault of the board and the members of the remuneration committee."

However, the independent director was still re-elected narrowly. "But a strong message has been sent by the shareholders that they are not happy with the directors' actions based on the concerns raised. Do not ignore the voice of the shareholders," says Lya.

Meanwhile, Pong Teng Siew, head of research at Inter-Pacific Research Sdn Bhd, says individual investors should do their own research and decide whether the activist investors' claims are justified. For instance, the call for companies to pay out excess cash as dividends may not be good in some circumstances.

"There are reasons why the company may be trying to conserve cash, either in preparation for a merger or acquisition or to tide it over in difficult times. If they feel strongly enough, then by all means attend the annual general meeting and make the votes count. But for individual shareholders, it may be more difficult to organise themselves as a group and gather enough shareholders for their weight of votes to count," says Pong.