

**The role of Shareholder Activism by Institutional Investors in
furthering Corporate Governance**

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Chapter 1: Introduction

1. Research problem

One of the issues that has attracted much discussion under corporate governance in South Africa and many other foreign jurisdictions has been the issue of shareholder apathy. Shareholder apathy has been attributed to the separation of ownership and control between shareholders and directors.¹ It is proposed that this separation between ownership and control has caused shareholders to become apathetic about how the company is managed thus giving directors unconstrained freedom to manage the company even contrary to the interests of shareholders.² As a result, shareholder activism has been championed as being the solution to the shareholder apathy dilemma. More specifically however, shareholder activism by institutional investors in South Africa has been identified as the key to curbing shareholder apathy and achieving greater corporate governance.³ In addition, institutional investors are regarded as being long-term shareholders by nature therefore it is argued that they have an incentive to encourage good corporate governance in companies.⁴ The need for shareholder activism by institutional investors has been further supported by experiences of market failures related to governance issues being caused by the absence of active institutional investors.⁵ After the 2008 financial crisis, there has been a shift in academic discourse with regard to the role of institutional investors in the governance of listed companies with many calls for “engaged” governance on the part of institutional investors.⁶

A recent example in South Africa is the KPMG auditing firm which was found to be allegedly involved in large-scale corruption. This has fuelled the call on shareholders to take a more proactive role as systemic failures in governance continue to rise.⁷ However, even though institutional investors are all highly specialised investors

¹ Cassim *Contemporary Company Law* (2012) 498.

² Bebchuk *et al* ‘The Agency Problems of Institutional Investors’ (2017) 31 *Journal of Economic Perspectives* 89.

³ Cassim (n 1 above) 499.

⁴ Harber ‘The role of institutional investors in promoting long-term value creation: A South African perspective’ (2017) 9 *African Review of Economics and Finance* 277.

⁵ Institute of Directors Southern Africa ‘King III Report on Corporate Governance for South Africa’ (2009) 7.

⁶ Kallifatides & Nachemson-Ekwall ‘Awakening giants? The politically contested modification of institutional investors’ (2016) 16 *Corporate Governance* 279.

⁷ Gossel & London ‘What the South African KPMG saga says about shareholder activism’

who invest on behalf of other people, there are differences that exist between different types of institutional investors which may affect their proactive role in corporate governance issues.⁸ Various reasons have also been identified as to why institutional investors tend to be passive shareholders. Therefore, a critical and comparative analysis is necessary to determine to what extent shareholder activism by institutional investors in South Africa can promote better and efficient corporate governance.

2. Research questions

- a) What is the current position in South Africa regarding shareholder activism by institutional investors?
- b) What is the state of shareholder activism by institutional investors in other countries?
- c) What lessons, if any can South Africa learn from foreign jurisdictions on the role of shareholder activism by institutional investors?

3. Methodology

The methodology adopted for this qualitative research consists of a critical and comparative legal analytic review of the relevant legislation and literature.

4. List of chapters

- a) Chapter 2: This chapter will entail a discussion of the current position of shareholder activism by institutional investors in South Africa. This will be done by firstly discussing the concepts of 'corporate governance', 'institutional investors' and 'shareholder activism'. The second section will give an overview of the corporate governance framework relating to institutional investors to determine whether it facilitates shareholder activism. This will be done by discussing the Companies Act, the King's Report, and the Code for Responsible Investing in South Africa. The third section will briefly look at the role that pension funds as a category of institutional investors, can play in corporate governance.

(2017) available at <https://theconversation.com/what-the-south-african-kpmg-saga-says-about-shareholder-activism-84540> (Date of use: 22 March 2018).

⁸ Chan *et al* 'Analyst coverage and types of institutional investors' (2013) 12 *Review of Accounting and Finance* 63.

- b) Chapter 3: This chapter will focus on a discussion on the position of the United Kingdom regarding shareholder activism by institutional investors. The United Kingdom is chosen as a relevant country to analyse for various reasons. The United Kingdom has the strongest tradition of active ownership by shareholders in all European countries and is recognized as a leader with the highest number of shareholder activist campaigns outside North America.⁹ In addition to the fact that institutional investors hold 70% of all listed equities in the United Kingdom, the positive effect of active institutional investors has also been well documented in the empirical literature.¹⁰ This chapter will firstly entail a discussion of the corporate governance framework in the United Kingdom with specific focus on comparing the 'UK Stewardship Code' which aims to assist institutional investors exercise their ownership responsibilities with the 'Code for Responsible Investing in South Africa' which also aims to assist institutional investors become active shareholders. The second section of this chapter will then look at the various challenges hindering shareholder activism by institutional investors in the United Kingdom. The last section of this chapter will discuss whether the fact that institutional investors in the United Kingdom are mostly pension funds,¹¹ has had any effect on the level of shareholder activism by these institutions. Institutional investors have different performance strategies and contribute diverse pressures on the company therefore it is important to differentiate among the types of institutional investors.¹²
- c) Chapter 4: This chapter will discuss how the legal framework that exists in a country can hinder or promote shareholder activism by institutional investors. The United States of America will be used as a reference point. Academic research indicates that legislation and legal systems are important factors that impact corporate governance and legislation can even encourage responsible behaviour from investors.¹³ The approach by the United States of America to

⁹ Ivanova 'Institutional investors as stewards of the corporation: Exploring the challenges to the monitoring hypothesis' (2017) 26 *Business Ethics: A European Review* 176.

¹⁰ Ivanova (n 9 above) 176-177.

¹¹ Aguilera *et al* 'Corporate Governance and Social Responsibility: a comparative analysis of the UK and the US' (2006) 14 *Corporate Governance* 149.

¹² Aguilera *et al* (n 11 above) 150.

¹³ Yamahaki & Frynas 'Institutional Determinants of Private Shareholder Engagement in Brazil and South Africa: The Role of Regulation' (2016) 24 *Corporate Governance: An International Review* 511.

corporate governance differs vastly from the South African corporate governance framework which is based on voluntarism.¹⁴ Corporate governance in the United States of America is regulated by legislation as well as the rules of the stock exchanges and in addition there are various voluntary codes.¹⁵ Legislation has been found to foster certain shareholder engagement strategies over others, for example, voting turnout is higher in the United States of America because private pension funds are mandated to vote by legislation.¹⁶ Therefore, this chapter will explore whether legislation as found in the United States of America such as mandating certain institutional investors to vote is an effective way to increase shareholder activism in South Africa.

- d) Chapter 5: This chapter will conclude this research by providing final conclusions and recommendations. These final conclusions and recommendations will be informed by the detailed review of the South African position and the comparative review of the United States of America and the United Kingdom.

5. Scope and limitations of study

This research will be limited to shareholders who are classified as institutional investors. The comparative analysis will only discuss the identified jurisdictions of the United Kingdom and United States of America due to the fact that prior research on shareholder activism is largely focused on these two countries hence there may be lessons to be learnt from these countries.¹⁷

¹⁴ Wiese *Corporate Governance In South Africa - With International Comparisons* (2016) 211.

¹⁵ Wiese (n 14 above) 207.

¹⁶ Yamahaki & Frynas (n 13 above) 512.

¹⁷ Chung & Talaulicar 'Forms and Effects of Shareholder Activism' (2010) 18 *Corporate Governance: An International Review* 255.

Chapter 2: Shareholder activism by institutional investors in South Africa

1. Introduction

A commonly held assumption has been that shareholders can best look after their own interests if they have sufficient rights and access to information.¹ Institutional investors are becoming increasingly prominent in the global financial markets. In 2012 alone, institutional investors controlled roughly 95 percent of the South African investment market.² The increased presence of large institutional investors has created the expectation that a new breed of highly skilled and well-resourced professional shareholders would make informed use of their rights thereby promoting good corporate governance in the companies they invest in. However, institutional investors are not like other shareholders but have a unique set of costs, benefits and objectives.³ Accordingly, they have not always behaved as desired. This chapter will explore shareholder activism by institutional investors in South Africa and their role in promoting good corporate governance. The first section of this chapter will briefly discuss the concepts of 'corporate governance', 'institutional investors' and 'shareholder activism'. The second section will give an overview of the corporate governance framework relating to institutional investors and how it facilitates shareholder activism. The third section will briefly discuss the role of pension funds.

2. Fundamental concepts

2.1. Corporate governance

The concept of corporate governance was born out of the agency problem that arose when the ownership of companies became separated from the control thereof. The agency problem has been aptly encapsulated as follows:⁴

“The directors of companies, being managers of other people's money, cannot be expected to watch over it with the same vigilance with which they watch over their own.”

¹ The Organisation for Economic Co-operation and Development (OECD) 'The Role of Institutional Investors in Promoting Good Corporate Governance' 9 (hereafter the OECD Report).

² Van der Ahee & Schulschenk 'The State of Responsible Investment in South Africa' (2013) A report by Ernst & Young Africa 3.

³ As above.

⁴ Snyman-Van Deventer & Thabane 'Pathological Corporate Governance Deficiencies in South Africa's State-Owned Companies: A Critical Reflection' (2018) 21 *Potchefstroom Electronic Law Journal* 6.

Therefore, at the heart of the agency problem is the self-serving nature of human beings. As owners of companies no longer controlled the management of companies, the responsibility for control shifted to the directors of the company.⁵ The problem created by this situation was that directors of companies could abuse their control function to their own advantage and to the detriment of the owners. Corporate governance was consequently introduced to ensure that the directors of companies control companies in ways that will serve the interests of the shareholders of the company.⁶ This responsibility of directors to shareholders usually implies four functions, namely direction, executive action, supervision and accountability.⁷

Corporate governance has been defined as 'the system by which companies are directed and controlled'.⁸ The purpose of corporate governance practices is to determine whether the directors have discharged their duties and to also assist them in the discharge of their duties.⁹ The benefits of good corporate governance include the capacity of companies to increase their ability to implement sustainable growth, the ability to limit their potential for liability and attract a better calibre of employees.¹⁰ The court in the *Minister of Water Affairs and Forestry v Stilfontein Gold Mining and others*¹¹ case highlighted the importance of having good corporate governance by stating that practising sound corporate governance is essential for the well-being of a company and is in the best interests of the growth of this country's economy especially in attracting new investments. Therefore, what makes corporate governance an important aspect of company law is that good corporate governance extends beyond merely providing greater shareholder returns but is essentially beneficial for society by ensuring more efficiently run companies thus contributing to the economy.

In 2014, the office of the South African Public Protector in a published report found developments at the South African Broadcasting Corporation (SABC), a state-owned company, to be "symptomatic of pathological corporate governance deficiencies" but

⁵ Malan *et al* 'Corporate Governance in South Africa' (2002) 37 *Journal of Business Ethics* 289.

⁶ As above.

⁷ As above.

⁸ Cassim *Contemporary Company Law* 473.

⁹ As above.

¹⁰ Cassim (n 8 above) 473.

¹¹ *Minister of Water Affairs and Forestry v Stilfontein Gold Mining and others* 2006 (5) SA 333 (W) para 16.7.

unfortunately, failure of corporate governance is in no way unique to the SABC.¹² Within the South African context, other examples where failed corporate governance has led to reduced shareholder value or even the total collapse of companies include Masterbond, CNA, Tollgate and many others.¹³ Therefore, it remains necessary to explore new ways in which corporate governance can be better promoted in South Africa. Little was known about the role that institutional investors can play in promoting corporate change before it was highlighted in 2002 in the King II report on corporate governance in South Africa.¹⁴

The King II report acknowledged that the apathy of shareholders and, more particularly, institutional investors is largely responsible for the non-enforcement of the breach of duties by directors and managers.¹⁵ It also highlighted the sentiment that institutional investors remain passive despite some obvious instances of poor or undesirable corporate governance practices by South African companies. On a way forward, the King II report referenced the National Association of Pension Funds and the Association of British Insurers Funds in the United Kingdom, which published a report recommending to shareholders how to vote at annual general meetings and suggested that similar bodies should be funded and established in South Africa.¹⁶ The King II report found it to be essential that support be given to the development of these bodies, as they will ensure the critical governance levels that are necessary.¹⁷ In addition, the King II report suggested that sanctions should be imposed upon institutional investors who fail to attend shareholders' meetings.¹⁸

The King III report in 2009 reiterated the notion that institutional investors should be encouraged to vote and engage with companies.¹⁹ According to the King III report, this will ensure that governance best practice principles are more consistently applied. The King III report was written from the perspective of the board as the main point of

¹² Snyman-Van Deventer & Thabane (n 4 above) 2.

¹³ As above.

¹⁴ Smit & Viviers 'Institutional proxy voting in South Africa: Process, outcomes and impact' (2015) 46(4) *South African Journal of Business Management* 24.

¹⁵ Institute of Directors Southern Africa 'King Report on Corporate Governance for South Africa' (2002) 149 (hereafter King II report).

¹⁶ As above.

¹⁷ King II report 150.

¹⁸ As above.

¹⁹ Institute of Directors Southern Africa 'King III Report on Corporate Governance for South Africa' (2009) 10.

corporate governance. However, the King Committee believed that a code should be drafted to specifically set out the expectations on institutional investors in ensuring companies apply the principles and recommended practices effectively.²⁰ The Code for Responsible Investing in South Africa which focussed on the role of institutional investors in corporate governance was then implemented in 2011.

The King IV report in 2016 through its 17th principle dictated that an institutional investor should ensure that responsible investment is practised to promote good governance in the companies they invest in.²¹ According to principle 17, this can be achieved by implementing the Code for Responsible Investing in South Africa. Institutional investors in South Africa are highlighted as being key role players in good corporate governance. To aid institutional investors fulfil their role in corporate governance, the Code for Responsible Investing in South Africa has been adopted. However, it's still important to determine how mechanisms such as shareholder activism by institutional investors can be used to promote better corporate governance.

2.2. Institutional Investors

Generally, institutional investors are financial institutions that accept funds from third parties for investment in their own name but on the third parties' behalf.²² More specifically, in South Africa an institutional investor means any legal person or institution referred to in the definition of "financial institution" in the Financial Services Board Act, to the extent that these legal persons or institutions own and invest in the equity of a company and have obligations in respect of investment analysis, activities and returns to ultimate beneficiaries.²³ The term 'institutional investor' is often loosely used to refer to asset owners and asset managers.²⁴ Asset owners, who own ordinary shares in a company, have the right to vote on certain matters. Asset owners typically delegate their voting power to asset managers (also called investment managers). Historically, major institutional investors include pension funds, mutual funds and insurance companies, while other forms such as sovereign wealth funds, hedge funds

²⁰ As above.

²¹ Institute of Directors Southern Africa 'King IV Report on Corporate Governance for South Africa' (2016) 33 (hereafter King IV report).

²² As above.

²³ Financial Services Board Act 97 of 1990 s1.

²⁴ Smit & Viviers (n 14 above) 23.

and private equity represent only a smaller share of the industry.²⁵ However, the relative importance of different types of institutional investors varies depending on the country.²⁶

A further distinction is made between institutional investors based on some institutional investors being 'traditional' institutional investors while others are labelled as being 'alternative' institutional investors. Hedge funds, private equity funds and sovereign wealth funds are labelled as 'alternative'. The main rationale for the label 'alternative' is that they are relatively new and have emerged as an alternative to more traditional types of institutional investors.²⁷ Another reason for treating them separately from traditional institutional investors is that reliable data for hedge funds, private equity firms and sovereign wealth funds is quite limited compared to what is available for traditional institutional investors.²⁸

When focussing on the South African institutional investment industry, it can be viewed as being mainly focused on providing investment management and consulting services to the retirement and life insurance industries.²⁹ Accordingly, the main institutional investors in South Africa comprise of pension and provident funds and insurers. There are approximately 7 dominant organisations in the South African retirement fund landscape.³⁰ These firms include the asset management arms of Old Mutual, Sanlam, Liberty Life and Momentum. The other managers are independent asset management firms such as Allan Gray, Coronation Fund Managers, and Investec. The main business and offerings of these managers is to provide a comprehensive range of investment products for differing client needs, for both the institutional and individual direct investor.³¹

The need to further focus on the behaviours of institutional investors in South Africa is fuelled by their increasing importance. In April 2015, South Africa became the first country to put in place comprehensive regulation for hedge funds. In South Africa

²⁵ The OECD report 26.

²⁶ As above.

²⁷ Celik & Isaksson 'Institutional investors and ownership engagement' (2014) *2013/2 OECD Journal: Financial Market Trends* 100.

²⁸ As above.

²⁹ Nhlapo 'Non-bank institutional investment behaviour in the South African market' South African Reserve Bank, Research Department 3453.

³⁰ Bhikha 'Corporate governance in South Africa: The role of Institutional Investors' LLM dissertation, University of Cape Town, 2014 28.

³¹ As above.

hedge funds have gone through various regulatory changes over the years culminating in the most comprehensive changes in 2015 when hedge funds were finally regulated.³² Following the financial crisis in 2008, the South African National Treasury and the Financial Services Board released a framework for regulating hedge funds in South Africa on 13 September 2012.³³ The regulators took industry comments into account and on 16 April 2014 published the new hedge fund regulations which were effected through the Collective Investment Scheme Control Act. Therefore, as institutional investors even 'alternative' forms such as hedge funds continue to gain prominence in South Africa, company law should take advantage of this by requiring institutional investors to use their shareholder roles to improve corporate governance.

2.3. Shareholder Activism

The global financial crisis of 2008 provided a new incentive toward rethinking the fundamental principles of corporate governance. It is now widely accepted that one of the causes of the downturn can be attributed to institutional investors' failure to monitor their investee companies.³⁴ This failure by shareholders to monitor companies has been attributed to shareholder apathy. According to Adolf Berle and Gardiner Means, shareholder apathy stemmed from the split between ownership and control.³⁵ The control and management of large companies are left in the hands of the board of directors while ownership of the shares remains with the shareholders. This split then creates a divergence between the interests of the shareholders and the interests of the directors whilst there is an absence of effective monitoring of the powers of directors. In addition, the disperse ownership of shares results in no single or group of shareholders being able to exercise effective control over the directors. Because of the above reasons, shareholders tend to be passive leaving the directors free to do as they please even if it is at the expense of good corporate governance practices and principles.³⁶

³² Fairtree Capital 'The South African Hedge fund industry: An ever evolving landscape' (2016) available at https://fairtree.com/wp-content/uploads/2016/12/sanne_connect_winter_2016_FINAL.pdf (Date of use: 20 October 2018) 8 (hereafter Fairtree Capital report).

³³ Fairtree Capital report 9.

³⁴ Ivanova 'Institutional investors as stewards of the corporation: Exploring the challenges to the monitoring hypothesis' (2017) 26 *Business Ethics: A European Review* 175.

³⁵ Cassim (n 8 above) 498.

³⁶ As above.

Shareholder apathy consequently denotes the situation where shareholders are passive despite legal efforts to facilitate shareholders active input on how the company is managed.³⁷ Shareholder activism on the other hand stems from the notion that since shareholders have certain rights that are enshrined in company legislation that strengthen their ability to hold the board of directors accountable, they should consistently and effectively engage with the company and ensure that it is managed well in areas such as corporate governance.³⁸ In order to ensure that company management conform to the principles of good corporate governance, many enforcement mechanisms exist. Shareholder activism is identified as a very important component of these mechanisms.³⁹ Shareholder activism therefore requires shareholders to not merely be shareholders in name only but that they utilise their ownership rights and ensure that the company meets the required standards of acceptable corporate governance.

Shareholder activism may be achieved through varies mechanisms as provided in the table below:⁴⁰

	Mechanism
Private (informal)	Writing letters
	Negotiating with management in private
	Divesting (i.e. selling some or all the shares owned in the investee company)
	Initiating legal proceedings to enforce shareholder rights
Public (formal)	Filing shareholder resolutions
	Asking questions at annual general meetings (AGMs)
	Opposing management and shareholder-initiated resolutions by voting against them
	Stimulating public debate on issues of concern (e.g. talking to the media and raising issues at conferences)
	Criticising a company on social media

³⁷ Black 'Shareholder Passivity Reexamined' (1990) 89 *Michigan Law Review* 523.

³⁸ King IV report 32.

³⁹ Rademeyer & Holtzhausen 'King II, Corporate Governance and Shareholder Activism' (2003) 120 *South African Law Journal* 767.

⁴⁰ Viviers 'Should South African companies be concerned about the rising tide of public shareholder activism?' Proceedings of the 28th Annual Conference of the Southern African Institute of Management Scientists 531.

The significance of having various private and public methods of carrying out shareholder activism makes shareholder activism a suitable concept that can be easily adopted by South African shareholders. The fact that a shareholder can choose from various public or private methods on how they prefer to engage with a company regarding dissatisfaction with issues such as the corporate governance practices of a company, means that shareholders and especially institutional investors, have no excuse as to why they remain passive when so many avenues are at their disposal. Institutional investors have been criticised as simply selling their shares when they are unhappy as opposed to first engaging with an investee company. Therefore, embracing shareholder activism will also force them to consider other less extreme measures on how they express their dissatisfaction.

Shareholder activists' preferences for specific mechanisms are strongly influenced by the prevailing business culture in a country.⁴¹ Size also matters in the choice of activism mechanism. Small institutional investors and individual investors seldom have access to management and are thus restricted to voicing their discontent through public activism mechanisms. In a study investigating the nature of shareholder activism by institutional investors in South Africa, it was reported that institutional investors in South Africa prefer to engage with investee companies behind closed doors.⁴² This was explained through the claim that institutional investors prefer a non-confrontational approach which protects the investor-investee relationship.

However, given the confidential nature of private negotiations, the frequency, intensity and outcomes of these engagements remain a mystery to all but those who were privy to the negotiations.⁴³ Outsiders (and this includes other shareholders) have no insight into the nature of concerns raised, directors' responses to shareholders' demands and whether shareholders have followed up on directors' promises to transform. Although it is difficult to determine the full extent of private activism in South Africa, some authors claim that it is increasing.⁴⁴ Since institutional investors have been identified in South Africa as having a key role to play in promoting sound corporate governance, it would be preferable if they utilised more public methods of shareholder activism. This would

⁴¹ As above.

⁴² Viviers (n 40 above) 533.

⁴³ As above.

⁴⁴ As above.

ensure that their engagement with investee companies can be measured and sets the standard for other shareholders to be able to understand that being an engaged shareholder is an important component for the success of the company.

The effectiveness or success of shareholder activism can be measured in several ways. In the United States of America, success is often evaluated in terms of the number of shareholder-initiated resolutions that have been withdrawn prior to a company's annual general meeting.⁴⁵ The higher the number of withdrawals, the more successful activists have been in influencing corporate policies and practices. However, some researchers warn that resolutions can be withdrawn for several reasons and that a more refined definition of success should be used.⁴⁶ Other researchers have focussed on the number of 'no' votes that a company attracts on certain resolutions. Although the empirical evidence is not overwhelming, several studies show that high levels of 'no' votes have resulted in companies taking concrete steps to appease disgruntled shareholders.⁴⁷

Shareholder activism could be instrumental in changing corporate practices, however, shareholder activism is still uncommon in South Africa.⁴⁸ The first academic study on shareholder activism by institutional investors in South Africa was conducted in 1995 and since then only limited research has been undertaken on the mechanisms used by local shareholder activists.⁴⁹ Since the King reports have highlighted the key role that institutional investors can play in maintaining acceptable corporate governance levels and shareholder activism can help institutional investors fulfil this role, further research should be done on the mechanisms used by institutional investors when it comes to shareholder activism.

3. The Corporate Governance framework

Institutional investors are recognised as having an essential role to play in achieving successful corporate governance in South Africa because they have the resources, capabilities and expertise to properly scrutinise company management. In addition, the King Report II pointed out that since institutional investors are the majority of

⁴⁵ Viviers (n 40 above) 534.

⁴⁶ As above.

⁴⁷ As above.

⁴⁸ Smit & Viviers (n 14 above) 23.

⁴⁹ As above.

shareholders in South Africa, more focus should be placed on their actions.⁵⁰ Accordingly, the corporate governance framework will be discussed to determine the extent to which it facilitates shareholder activism by institutional investors.

3.1. The Companies Act

One of the stated objectives of the Companies Act 71 of 2008, is to promote the development of the South African economy by encouraging transparency and high standards of corporate governance.⁵¹ In line with this objective there are various provisions in the Companies Act that encourage shareholders to be active in the affairs of the company.⁵² Such provisions include section 61 which empowers shareholders to call a shareholders meeting. Section 64(1) also increased the quorum requirements from those under the Companies Act 61 of 1973 by providing that the quorum at a shareholders meeting is 25% of all the voting rights that are entitled to be exercised in respect of a matter to be decided at that meeting. The quorum requirements under the Companies Act of 1973 required that at a meeting there be three members entitled to vote in the case of a public company and two members entitled to vote in the case of a private company.⁵³ The increased quorum is believed to ensure that more shareholders attend shareholders meetings because it will encourage companies to vigorously pursue and persuade shareholders to attend shareholders meetings so that quorum requirements are met.⁵⁴

The right to appoint a proxy in terms of section 58 of the Companies Act is an important and valuable one, especially in the case of companies whose members are numerous and widely scattered.⁵⁵ The shareholders of public companies are usually widely dispersed throughout the country and many shareholders do not attend the annual general meeting due to it being impractical to do so.⁵⁶ Section 63 has attempted to curtail this obstacle by allowing meetings to be conducted entirely through electronic communication.⁵⁷ The use of electronic communication encourages shareholder activism because it saves on travelling time and the expense of attending a

⁵⁰ Cassim (n 8 above) 499.

⁵¹ Companies Act 71 of 2008 s7(b)(iii) (hereafter the Act).

⁵² The Act s61 & s64.

⁵³ Companies Act 61 of 1973 s190.

⁵⁴ Cassim (n 8 above) 500.

⁵⁵ Delpont *Henocheberg on the Companies Act 71 of 2008* 226.

⁵⁶ Cassim (n 8 above) 370.

⁵⁷ The Act s63.

shareholders meeting in person. The concerns over shareholders right to information and participation have given rise to the inclusion of effective shareholders meetings as part of the best practices in corporate governance.⁵⁸ However, low shareholder attendance is a typical scenario in most general meetings, therefore one of the main issues hindering shareholder activism against corporate governance.⁵⁹ The advent of electronic meetings is a means to increase their participation because electronic meetings may offer a low cost and borderless medium of communication and in the process offer a solution to resolve shareholders passivism.

The Companies Act in line with its stated objective of encouraging transparency and high standards of corporate governance has overall created an environment in which shareholders are given the freedom to engage with companies. The increased focus on getting shareholders to attend meetings, the use of proxy voting and the movement towards allowing meetings to be conducted entirely through electronic communication are a few examples of the enabling environment that the Companies Act provides. If institutional investors utilise these rights they will be able to actively engage with companies and monitor the corporate governance practices that may be detrimental to the company.

3.2. King IV Report on Corporate Governance

The legal status of the King Report is a set of voluntary principles and leading practices. In South Africa a hybrid system of corporate governance has developed.⁶⁰ Some practices of good corporate governance have been legislated in parallel with the voluntary King codes of governance. The courts have also endorsed the principles laid out in the King codes of governance. In the *South African Broadcasting Corporation Ltd and Another v Mpofu*⁶¹ case, the court stated that companies and their board of directors are required to measure up to the principles set out in the King codes of governance.

The King IV report in its principles of good corporate governance includes a principle regarding the responsibilities of institutional investors. Principle 17 provides that ‘the

⁵⁸ Ali *et al* ‘Some Legal Uncertainties in Electronic Corporate Meetings’ (2013) 5 *International Journal of Computer Theory and Engineering* 284.

⁵⁹ As above.

⁶⁰ King IV report 35.

⁶¹ *South African Broadcasting Corporation Ltd and Another v Mpofu* (A5021/08) [2009] ZAGPJHC 25; [2009] 4 All SA 169 (GSJ) para 29.

governing body of an institutional investor organisation should ensure that responsible investment is practised by the organisation to promote the good corporate governance and the creation of value by the companies in which it invests'.⁶² This principle supports the contention that institutional investors have an additional responsibility to that of a normal shareholder due to their unique nature. This responsibility requires institutional investors to promote good corporate governance in their investee companies. In this regard the King Report has endorsed the Code for Responsible Investing in South Africa as a specific Code that will help institutional investors become more actively involved in the company and as result contribute to better corporate governance levels in South Africa.

3.3. The Code for Responsible Investing in South Africa

In an attempt to promote institutional shareholder activism in South Africa, the Association of Savings and Investments SA launched a Code for Responsible Investing in South Africa in 2011. The CRISA gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance.⁶³ The CRISA again highlights the fact that an institutional investor has by virtue of its share ownership and rights, including voting rights, the ability to influence and encourage investee companies to apply sound governance principles and practices.⁶⁴ Despite public support for the CRISA, a survey by the CRISA committee in 2013 revealed that few institutional investors seriously considered the principles.⁶⁵ Although compliance with CRISA is voluntary, the Minister of Finance hinted that more active involvement by the government could be expected if 'this voluntary code to promote more open and broadly beneficial investment proves ineffective'.⁶⁶

Principle 1 of the CRISA provides that an institutional investor should incorporate sustainability considerations, including economic, social and governance issues into its investment analysis and investment activities.⁶⁷ The CRISA requires institutional

⁶² King IV report 73.

⁶³ Institute of Directors Southern Africa 'Code for Responsible Investing in South Africa' (2011) 3 (hereafter CRISA).

⁶⁴ CRISA 6.

⁶⁵ Smit & Viviers (n 14 above) 25.

⁶⁶ Viviers & Els 'Responsible investing in South Africa: past, present and future' (2017) 9 *African Review of Economics and Finance* 133.

⁶⁷ CRISA 10.

investors to develop policies on how they incorporate sustainability considerations, including economic, social and governance, into investment analysis and activities. Institutional investors should ensure that this policy is implemented and establish processes to monitor compliance with the policy. Principle 2 provides that an institutional investor should demonstrate its acceptance of ownership responsibilities in its investment activities. The second principle requires institutional investors to demonstrate a responsible approach to shareholding by, among others, implementing a policy detailing mechanism of intervention and engagement with companies when concerns have been identified, as well as the means of escalation if concerns raised cannot be resolved. The CRISA requires such a policy to also detail the approach to voting at shareholder meetings, including the criteria to be used in reaching voting decisions and public disclosure of full voting records. These principles create an environment in which institutional investors can be shareholder activists because issues such as governance have to be considered in investment activities. In addition, institutional investors are required to take their ownership roles more seriously by engaging with companies.

Using a voluntary approach, the CRISA relies on public disclosure to encourage self-regulation. The CRISA expects all institutional investors and their service providers to implement the prescribed principles on an 'apply or explain' basis and disclose publicly their responsible investment practices. The public disclosure of these practices enables beneficiaries and other stakeholders to engage meaningfully with institutional investors and their service providers and hold them to account. Despite the efforts of the CRISA to help institutional investors become less passive shareholders, overall, the industry is still largely characterised by a passive and selective approach to responsible investment and strong differences exist amongst categories of institutions.⁶⁸ Broader progress is limited by a lack of clarity on what it means to integrate economic, social and governance considerations into investment decisions and the necessity of balancing short-term with long-term objectives.⁶⁹

⁶⁸ Institute of Directors Southern Africa 'Responsible investment research: CRISA disclosure by institutional investors and their service providers' A research report by the CRISA Committee and EY 1.

⁶⁹ As above.

4. The role of Pension Funds

To promote shareholder activism among institutional investors, Regulation 28 of the Pension Funds Act was amended in 2011. Regulation 28 of the Pension Funds Act aims to ensure that savings invested in South African retirement funds are prudently invested from an economic, social and governance perspective.⁷⁰ Trustees of local pension funds are now amongst other things, required to develop an investment policy statement which should describe their fund's approach to trustee education, Broad-Based Black Economic Empowerment and economic, social and governance issues. The largest pension fund in South Africa, the Government Employees Pension Fund, warned that they would use their financial might to 'force corporate South Africa to shape up in areas of good governance, social responsibility and environmental protection'.⁷¹

As the Government Employees Pension Fund controls almost half of all retirement savings in the country, they have the potential to exert enormous pressure on investee companies to reform their policies and practices.⁷² Therefore, pension funds and specifically the Government Employees Pension Fund should be further encouraged to take their ownership responsibilities seriously by embracing shareholder activism which will help them ensure that investee companies have sound governance. In the same year of 2011, the CRISA was launched to provide institutional investors with guidance on complying with Regulation 28 of the Pension Funds Act, as well as recommendations contained in King Report III and the United Nation's Principles of Responsible Investing. Although some analysts claim that these initiatives have been unsuccessful in promoting shareholder activism, all of them stress the need for more active engagement.⁷³

5. Conclusion

This chapter aimed to determine the role of shareholder activism by institutional investors in promoting corporate governance in South Africa. Shareholder activism is a valuable strategy available to responsible investors who want to monitor and influence corporate behaviour. South Africa has embraced the notion that institutional

⁷⁰ Viviers & Els (n 66 above) 132.

⁷¹ Viviers & Els (n 66 above) 129.

⁷² Viviers & Els (n 66 above) 133.

⁷³ Viviers (n 40 above) 533.

investors can no longer be passive shareholders but that for corporate governance to thrive, institutional investors will have to actively engage with their investee companies. This chapter found that institutional investors in South Africa are highlighted as being key role players in good corporate governance by the King reports. To aid institutional investors fulfil their role in corporate governance, the Code for Responsible Investing in South Africa has been adopted. In addition, the Companies Act has overall created an environment in which shareholders are given the freedom to engage with companies. The increased focus on getting shareholders to attend meetings, the use of proxy voting and the movement towards allowing meetings to be conducted entirely through electronic communication are a few examples of the enabling environment that the Companies Act provides.

Due to the efforts that are already in place that encourage institutional investors to be actively involved in the running of the company shareholder activism should be further embraced. Shareholder activism involves the notion that since shareholders have certain rights that are enshrined in company legislation that strengthen their ability to hold the board of directors accountable, they should consistently and effectively engage with the company and ensure that it is managed well in areas such as corporate governance. Various shareholder activism methods are available for shareholders to choose from which allow them to engage and monitor a company. Therefore, shareholder activism should be incorporated to further contribute to the agenda that already exists to eradicate apathy on the part of institutional investors.

However, this chapter also found that despite the corporate governance framework in South Africa creating an environment where institutional investors can improve corporate governance through shareholder activism, institutional investors have not taken full advantage of the enabling environment. The King reports and CRISA developed principles and practices to guide institutional investors to exercise their ownership responsibilities in their investee companies but research seems to suggest that institutional investors have not taken the principles seriously. When looking at shareholder activism in South Africa, research suggested that institutional investors prefer private negotiations with management when it comes to influencing corporate behaviour. The issue with this preference is that the success or impact of this form of shareholder activism cannot be measured.

This chapter also discussed the role that pension funds can play in corporate governance. Pension funds such as the Government Employees Pension Fund can exert enormous pressure on investee companies to reform their policies and practices. Therefore, pension funds should be further encouraged to take their ownership responsibilities seriously by embracing shareholder activism which will help them ensure that investee companies have sound governance. The corporate governance framework through legislation and codes of principles has created an environment where institutional investors can promote corporate governance through shareholder activism, but research seems to indicate that institutional investors have not embraced their role. Therefore, an analysis of how other jurisdictions have dealt with shareholder activism by institutional investors is necessary to determine what lessons South Africa can learn to improve.

Chapter 3: Shareholder activism by institutional investors in the United Kingdom

1. Introduction

This chapter will focus on a discussion on the position of shareholder activism by institutional investors in the United Kingdom. Institutional investors are the largest owners of United Kingdom listed companies but despite this they have also been accused by the Cadbury, Hampel and Newbold corporate governance committees of being too passive investors.¹ Therefore, this chapter will look at how the United Kingdom has attempted to create more active investors to determine what if any lessons South Africa can learn. This chapter will firstly entail a discussion of the corporate governance framework that is directed at institutional investors with specific focus on comparing the 'UK Stewardship Code' with the 'Code for Responsible Investing in South Africa'. The second section of this chapter will then look at the various challenges hindering shareholder activism by institutional investors in the United Kingdom. The last section of this chapter will discuss the role of pension funds as shareholder activists in the United Kingdom.

2. The UK Stewardship Code

One of the main shortcomings of the United Kingdom's system is thought to be the passiveness of institutional investors and the resulting high discretionary power of directors.² Although institutional investors control a large proportion of votes, they are often reported to abstain from voting at annual general meetings or rubber-stamp the management's motions. As a result, directors are left with substantial levels of discretion as to how they run the company. The introduction of the UK Stewardship Code³, in the United Kingdom therefore represented the long-awaited departure from the traditional acceptance of investor apathy. The Stewardship Code resulted from the recommendations of the Walker Report that were prepared in the aftermath of the financial crisis.⁴ The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders. This way, investors will be inspired to care more about what happens to

¹ Goergen *et al* 'Do UK Institutional Shareholders Monitor their Investee Firms?' (2008) 8 *Journal of Corporate Law Studies* 43.

² Goergen *et al* (n 1 above) 40.

³ Financial Reporting Council 'UK Stewardship Code' (2012) (hereafter the Stewardship Code).

⁴ Arsalidou 'Institutional investors, behavioural economics and the concept of stewardship' (2012) 6 *Law and Financial Markets Review* 410.

their companies. As with the UK Corporate Governance Code, the UK Stewardship Code is applied on a “comply or explain” basis.⁵ Where institutional investors choose not to comply with one of the principles they should deliver meaningful explanations that enable the reader to understand their approach to stewardship.⁶

The Stewardship Code came into effect immediately after its publication in 2010 and replaced the engagement principles for institutional investors contained in the UK Corporate Governance Code. It comprises of seven principles and of interest are principles 3, 4 and 5. Principle 3 requires institutional investors to monitor their investee companies.⁷ As part of this monitoring, they should satisfy themselves that the investee company’s board and committee structure are effective and that the independent directors do their jobs properly. They should also keep a clear audit trail that includes records of private meetings held with companies, records of the way votes were cast, records of reasons for voting against management, for abstaining or for voting with the management. Further, where appropriate and practicable, asset managers should make the effort to attend general meetings of companies in which they have a major holding. They should also consider carefully the explanations given for any departure from the UK Corporate Governance Code and should attempt to identify problems at an early stage to reduce any loss to shareholder value.

Principle 4 expects institutional investors to establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.⁸ They should set out the circumstances when they will actively intervene and regularly assess the outcomes of doing so. To begin with, they should hold discussions with the boards of the investee companies on a confidential basis, but if boards do not respond constructively, should resort to other means of intervention, such as holding additional meetings with management to discuss concerns, making a public statement in advance of the annual general meeting or submitting resolutions at shareholders’ meetings. Principle 5 provides that institutional investors should be willing to act collectively with other investors where appropriate.⁹

⁵ Stewardship Code 4.

⁶ As above.

⁷ Stewardship Code 7.

⁸ Stewardship Code 8.

⁹ As above.

2.1. The Stewardship Code and the Code for Responsible Investing in South Africa

The Stewardship Code and the CRISA have the same objective of namely attempting to make institutional investors more active shareholders who monitor and engage with their investee companies with the intention of improving aspects such as a company's corporate governance. Both codes apply on a "comply or explain" basis. The principles are largely similar. Both codes require institutional investors to accept and fulfil their ownership responsibilities, to actively manage any conflict of interests, to monitor the investee companies and both require institutional investors to be willing to act collectively with other institutional investors where appropriate. However, evidence suggests that, overall, the Stewardship Code has not been successful in eliciting meaningful shareholder engagement. Rather, it seems to be trapped in the middle of a vicious circle. On the one hand, it has proven to be an insufficient tool to tackle the structural barriers institutional investors face if they were to be effective 'stewards' and on the other hand, it is precisely the presence of these barriers and the Stewardship Code's failure to address them that renders it ineffective.¹⁰

The Stewardship Code and its principles are intended to change the typically passive approach of United Kingdom institutional investors towards their investee companies to one of active engagement. However, according to the Financial Reporting Council's own reports, the Stewardship Code has not impacted on the quality of engagement, nor has it made any discernible impact on the attitude of companies.¹¹ The Financial Reporting Council in 2017 in their annual development report stated that they are still encouraging institutional investors to improve on their reporting regarding the principles in the Stewardship Code.¹²

South Africa, in an attempt to create more active institutional investors followed the approach of the United Kingdom and created the voluntary Code of the CRISA specifically directed at institutional investors but the CRISA has proven to have little to no effective impact on changing the behaviour of institutional investors in South Africa just as the Stewardship Code has proven ineffective in the United Kingdom. Therefore, the first lesson South Africa can learn from the United Kingdom is to seriously debate

¹⁰ Reisberg 'The UK Stewardship Code: On the road to nowhere?' (2015) 15 *Journal of Corporate Law Studies* 226.

¹¹ Reisberg (n 10 above) 224.

¹² Financial Reporting Council 'Developments in Corporate Governance and Stewardship 2016' (2017) 7.

whether another voluntary Code is necessary or whether the principles in the CRISA themselves need to be reconsidered. The literature on institutional investors has extensively researched and identified various reasons as to why institutional investors have remained passive shareholders despite growing demands and efforts such as the Stewardship Code and the CRISA trying to encourage them to be shareholder activists.

3. Challenges to shareholder activism by institutional investors

3.1. The “comply or explain” model

The United Kingdom, in an attempt to adopt a widely applicable soft law tool, became the pioneer in regulatory rulemaking with the introduction of the “comply or explain” principle in the area of corporate governance codes in 1992, whereby companies were required to comply with the provisions of the UK Corporate Governance Code or to explain the reasons they have decided not to do so.¹³ Since its initial adoption, the “comply or explain” principle has been at the centre of attention in corporate governance related matters and continues to be one of the most debated issues with regard to its usefulness, effectiveness and influence on companies. Various national regulators and industry committees, tasked with issuing best practices for their sector, continue to emphasise the suitability of this principle and therefore keep relying on its merits to increase and further legitimise soft law rulemaking.¹⁴

However, the “comply or explain” principle has already shown a series of deficiencies that continue to dent its attractiveness and its persuasiveness as the preferred regulatory tool. The Stewardship Code operates on a comply-or-explain basis, but in a manner that is different to the UK Corporate Governance Code. The UK Corporate Governance Code has the backing of the Listing Rules as listed companies are required to state how they have applied the Code in practice or to explain why they have not applied the Code.¹⁵ For such companies, the failure to comply or explain can result in the imposition of a penalty. Currently, the Stewardship Code and the CRISA do not have this level of backing.

¹³ Sergakis ‘Deconstruction and Reconstruction of the “Comply or Explain” Principle in EU Capital Markets’ (2015) 5 *Accounting, Economics and Law* 238.

¹⁴ As above.

¹⁵ Financial Reporting Council ‘The UK Corporate Governance Code’ (2016) 4.

A problem that has been identified with the Stewardship Code and which may be said to apply to the CRISA, is its overall effectiveness. As a soft regulatory tool that encourages but does not require compliance with a set of principles and is dependent on the "comply or explain" approach, it is highly unlikely that institutional investors will show immediate results in terms of compliance and a change in current practices.¹⁶ Experience from Corporate Governance Codes and the "comply or explain" approach has shown that the issue is twofold. On the one hand, companies in some countries struggle to comply with the Code but even in the case where they declare compliance, the true level of compliance seems questionable since a mere declaration cannot always correspond with a pragmatic one. On the other hand, when companies use the explanatory part of the principle in order to explain the reasons for non-compliance, they tend to give perfunctory explanations that prove useless for investors since they lack the necessary degree of transparency and information.¹⁷

In addition, the limited nature of the legal obligation for disclosing whether an institution subject to the Stewardship Code has "complied or explained" potentially weakens the Stewardship Code's application and undermines its position as an industry-wide standard. Institutional investors can choose not to comply with the Stewardship Code, and the only penalty for non-compliance is failure to be listed on the Financial Reporting Council website as compliant. In South Africa, although the King Report has no force of law, in 1995, the Johannesburg Stock Exchange made it compulsory for listed companies to disclose the extent of their compliance with it or explain their lack of compliance thereby leveraging the report's application.¹⁸ However, the CRISA is voluntary and seems to have no penalty for non-compliance.

The Stewardship Code requires that institutional investors deliver meaningful explanations whenever they decide not to comply with one of the principles.¹⁹ Regarding the elements for a "meaningful explanation", the Financial Reporting Council consultation document issued three criteria.²⁰ Firstly, the explanation should

¹⁶ Sergakis 'The UK Stewardship Code: Bridging the Gap between Companies and Institutional Investors' (2013) 47 *Revue Juridique Themis* 135.

¹⁷ Sergakis (n 16 above) 136.

¹⁸ Frynas & Yamahaki 'Institutional Determinants of Private Shareholder Engagement in Brazil and South Africa: The Role of Regulation' (2016) 24(5) *Corporate Governance: An International Review* 513.

¹⁹ Stewardship Code 4.

²⁰ Financial Reporting Council 'What Constitutes an Explanation under "Comply or Explain?" Report of discussions between companies and investors (2012) 6.

provide the context and the historical background. Secondly, it should provide a convincing argument for the solution adopted by the company and further analyse any potential moderating actions that have been taken by the company to resolve any eventual additional risks and to ensure a certain level of compliance with the Code's provisions. Thirdly, the company should explain whether the respective deviation was limited in time and when it intends to start complying with the Code's provisions again.

Despite the outlined criteria on how to deliver meaningful explanations for non-compliance, institutional investors in the United Kingdom are still being required to improve on their reporting regarding the principles in the Stewardship Code.²¹ The “comply or explain” model has been deemed appropriate in regards to voluntary Codes but when it comes to the Stewardship Code and CRISA it seems to be contributing to their lack of effectiveness due to the fact that it fails to create a legal obligation to comply with the principles and further lacks any substantive penalties for non-compliance. Institutional investors are then left with little incentive to discard their passive behaviour.

3.2. The issue of short-terminism

Many critics argue that, left to their own tendencies, institutional investors are largely short-terminist in nature.²² Although some view shareholder power as the tool that can effectively curtail managerial short-termism, when shareholder choice is carefully studied, there is no reason why diversified shareholders should focus on the long term.²³ Shareholders of public companies with dispersed ownership have few, if any, incentives to interfere with their company's managerial activities. Consequently, promoting a company's long-term goals does not come naturally to institutional investors. Measuring a company's long-term performance is a complex task and for institutional investors, a more rational option is to concentrate on short term indicators, such as quarterly reports and share prices, irrespective of the fact that such indicators may not represent properly the underlying value of their company.²⁴

²¹ Financial Reporting Council (n 12 above) 7.

²² Chiu 'Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance' (2012) 6 *Brooklyn Journal of Corporate, Financial & Commercial Law* 401.

²³ Arsalidou (n 4 above) 412.

²⁴ As above.

3.3. The costs related to shareholder activism

The free-rider phenomenon, where the passive free-riders enjoy the participation efforts of the more active shareholders, underlines the dilemma of collective action.²⁵ Large investors face disincentives to becoming activists because of the free rider problem which would mean that they would incur large costs from intervention, costs that would be borne solely by the activist, but any benefits from these activities would be spread among all shareholders.²⁶ Instead of becoming actively involved, the rational option for institutional investors is to keep the costs to the minimum and not take informed decisions and if shareholders are dissatisfied, they will prefer to sell their shares and reinvest in other shares, elsewhere.

3.4. Conflict of interests

Research shows that conflicts of interest are also considered as a barrier to shareholder activism. It was discovered that investors are sometimes reluctant to engage with a company because they feel this could have a negative impact on their future ability to communicate with management and their relationship with the targeted company.²⁷ However, the greatest emphasis was on internal conflicts of interest within institutional investors themselves and on conflicts of interest between investors who engage collaboratively on a topic. With respect to this, the Stewardship Code has taken a step backward because it focuses only on “managing” conflicts and fails to impose a requirement to minimise or avoid them altogether. The CRISA also focuses on managing conflicts of interests rather than avoiding them.

3.5. Complex investment chains

The distance between a company and its investors continues to become lengthier and more complicated due to a series of factors that characterise modern investment and trading techniques²⁸. Financial intermediaries continue to increase, and this does not facilitate the establishment of a true dialogue between a company and its shareholders. Moreover, the tendency to diversify investment portfolios does not encourage shareholders to commit themselves in a long-term relationship with the

²⁵ As above.

²⁶ McCahery *et al* ‘Behind the scenes: The Corporate Governance Preferences of Institutional Investors’ (2016) 71 *The Journal of Finance* 2921.

²⁷ Ivanova ‘Institutional investors as stewards of the corporation: Exploring the challenges to the monitoring hypothesis’ (2017) 26 *Business Ethics: A European Review* 183.

²⁸ Sergakis (n 16 above) 141.

investee company. Current investment strategies and the very nature of institutional ownership have become extremely complicated and interrelated to a series of other investment priorities that need closer examination. Empirical evidence further supports the claim that the structure of the investment management industry impedes intervention.²⁹

3.6. Company transparency and investor experience in activism

A commonly cited challenge to shareholder activism relates to on the one hand, the lack of sufficient information on companies' activities and, on the other hand, the lack of investor experience in terms of how to effectively engage with companies.³⁰ Surveys of the ethical investment scene conducted by researchers identified information as the key to effective action. However, interviewed investors reported that their time and resources were scarce, limiting their ability to focus on the company's issues and to ascertain with clarity the problems with investee companies. The Stewardship Code and CRISA both fail to address this commonly cited issue. In South Africa, the CRISA does not place any new disclosure obligations on companies towards institutional investors regarding a company's information nor does it address the fact that institutional investors have little to no experience on how to effectively engage with companies due to the passive approach that they have mostly adopted when it comes to engaging with investee companies.

4. The role of the biggest institutional investors

Because various challenges exist which may potentially prohibit institutional investors from being actively involved with their investee companies, certain institutional investors such as pension funds have been identified as being the most suitable to take on shareholder activist responsibilities. Pension funds are a type of institutional investor often associated with a potential to adopt a long-term perspective on equity holding and management and they are therefore seen as potential model investors for shareholder activism.³¹ Pension funds in the United Kingdom are among the largest asset owning types of investors and the United Kingdom is the second largest market after the United States with about 10% of the world's total pension assets.³² Therefore,

²⁹ Ivanova (n 27 above) 181.

³⁰ Ivanova (n 27 above) 182.

³¹ McNulty & Tilba 'Engaged versus Disengaged Ownership: The Case of Pension Funds in the UK' (2013) 21(2) *Corporate Governance: An International Review* 166.

³² Ivanova (n 27 above) 184.

there is optimism about the ability of public pension funds to act as a powerful catalyst for change in the practices of companies and there is belief that they can serve as surrogate regulators. Yet, despite their potential for bringing about change, the current empirical findings, as well as previous research suggest that, in their majority, pension funds, alongside other types of institutional investors, are currently not acting as long-term stewards.³³

This lack of oversight on the part of pension funds could be explained by looking further down the investment chain to their clients, the pension savers.³⁴ The main argument is that employees (pension savers) should exercise democratic control over companies and should ensure that their practices benefit them, their families, and the communities they live in rather than the financial services industry. Research suggests that there is demand from within the investment management industry for pension savers to become more involved and express their views on how their money is managed. Furthermore, their involvement is seen as a factor that could drive a change toward greater active ownership by institutional investors.

There are also expectations on pension fund trustees and executives to have a clear policy on voting and engage with investee companies individually or collectively with other investors.³⁵ Currently, there seems to be a large gap between the notion of stewardship, as configured by the Stewardship Code on the one hand, and what is happening in practice. Operating at a distance from their investee companies, most pension funds build a working relationship with asset management companies, rather than the companies whose equity they hold. Research into pension funds provide further evidence to support the notion that a trading mentality, rather an owner mentality, prevails amongst pension funds and that investment performance overrides governance concerns.³⁶ Empirically, the research findings enable a distinction to be drawn between engaged and disengaged pension funds, the latter being much more prevalent and more reliant on external financial experts for investment strategy formulation and implementation.³⁷

³³ As above.

³⁴ As above.

³⁵ McNulty & Tilba (n 31 above) 177.

³⁶ As above.

³⁷ McNulty & Tilba (n 31 above) 171.

Accordingly, in the United Kingdom for the vast majority of pension funds, the investment management process is laced with dynamics of dependence and influence, and the primary focus is on fund investment performance, rather than corporate governance considerations. In the United Kingdom and in South Africa pension funds are highlighted as being the most suitable institutional investors to be shareholder activists. Therefore, another lesson from the United Kingdom would be that greater emphasis should be placed on determining how to capitalise on the potential of pension funds and turn them into active shareholders who monitor their investee companies.

5. Conclusion

The United Kingdom has long been an international leader in the development of successful non-statutory voluntary codes and guidance relating to corporate affairs.³⁸ Therefore, it's worth analysing how the United Kingdom has dealt with institutional investors and the role they play in corporate governance. This chapter firstly discussed the Stewardship Code which like the Code for Responsible Investing in South Africa is aimed at institutional investors and aims to encourage more active engagement. Despite the admirable principles of the two Codes, their effectiveness is yet to be clearly established in both jurisdictions. Both Codes have proven to be insufficient in tackling the structural barriers institutional investors face in overcoming their passive approach to their shareholder responsibilities. This chapter then briefly explored some of the structural challenges that have been identified in literature as being barriers to institutional investors being shareholder activists. These challenges seem to indicate that if shareholder activism by institutional investors is to become a reality then the Code for Responsible Investing South Africa may need to address some of these existing barriers that face institutional investors.

This chapter also discussed the positive role of pension funds. In South Africa and the United Kingdom, pension funds have been identified as institutional investors who are most suitable for shareholder activism. South Africa has already followed in the footsteps of the United Kingdom and enacted a voluntary Code to attempt to change the behaviour of institutional investors, but a closer examination of the position in the United Kingdom suggests that more may still need to be done. Therefore, instead of

³⁸ Reisberg (n 10 above) 219.

creating more soft law targeting institutional investors in general and trying to encourage more active behaviour from them, greater focus should be placed on narrowing the law to target the institutional investor that has the most incentive and proclivity towards being an engaged shareholder.

Chapter 4: Shareholder activism through voting: A lesson from the USA

1. Introduction

The body of academic research has found that legislation and legal systems are important factors that influence corporate governance.¹ Specifically, the use of voting to engage in activism has long been seen by researchers as fundamental to the corporate governance of companies around the world. Most of the research supporting this hypothesis has been conducted in the United States of America.² In addition, the approach by the United States of America to corporate governance differs vastly from the South African corporate governance framework which is based on voluntarism.³ Corporate governance in the United States of America is regulated by legislation as well as the rules of the stock exchanges and various voluntary codes.⁴ Therefore, this chapter will briefly explore whether legislation as found in the United States of America such as mandating certain institutional investors to vote is an effective way to increase shareholder activism in South Africa. This chapter will firstly discuss the position in the United States of America by providing a brief history of shareholder activism, the technical rules applicable to shareholder voting and the effect of mandating institutional investors to vote. Secondly, this chapter will then discuss the current voting culture of institutional investors in South Africa to determine whether a similar approach to the United States of America may be useful in providing a platform for shareholder activism.

2. The example from the United States of America

2.1. A short history of shareholder activism in the USA

Regulation in the United States of America has strongly influenced whether institutional investors adopt a policy of exit, voice, or loyalty in a company.⁵ In the early 1900s, insurance companies, mutual funds, and banks became active in corporate governance. In all cases, however, laws were passed to limit the power of financial

¹ Frynas & Yamahaki 'Institutional Determinants of Private Shareholder Engagement in Brazil and South Africa: The Role of Regulation' (2016) 24(5) *Corporate Governance: An International Review* 511.

² Iliev *et al* 'Shareholder Voting and Corporate Governance Around the World' (2015) 28 *The Review of Financial Studies* 2198.

³ Wiese *Corporate Governance In South Africa - With International Comparisons* (2016) 211.

⁴ Wiese (n 3 above) 207.

⁵ Gillian & Starks 'Corporate Governance, Corporate Ownership, and the Role of Institutional Investors: A Global Perspective' Weinberg Center for Corporate Governance Working Paper No. 2003-01 (2003) 9.

intermediaries and to prevent them from having an active role in corporate governance. Banks were prohibited from owning equity directly, and this regulation has caused the corporate governance system in the United States of America to differ historically from that in other countries such as Germany and Japan where, by design, institutions (particularly banks) have played a large role in the ownership and monitoring of companies.⁶

With the suspension of hostile takeovers at the end of the 1980s and the steady growth in ownership of American companies, institutional investors were forced to play a more active role in corporate governance.⁷ Institutional investors held only about 10% of shares in the United States of America in 1953, but their percentage of ownership had jumped to over 70% by the end of 2006. Along with the rise of institutional investor activism in the mid-80s, the Department of Labor began to pressure corporate pension funds to assume a more active role in monitoring the companies in their portfolios.⁸ They advocated the voting of proxies by the pension funds rather than delegating that responsibility to their external managers, arguing that voting was part of their fiduciary duty.

A number of other developments have contributed to changing the landscape of institutional investor voting in the United States of America, including:⁹

- a) **Regulations on fiduciary duty.** In the late 1980s, the Securities and Exchange Commission and Department of Labor formally attached fiduciary obligations to voting on corporate governance matters. These actions “demand that, instead of passive adherence to management’s recommendations, each institutional investor vote all of its portfolio shares on every matter brought to shareholders in accordance with the standards of the proverbial prudent man.”
- b) **Vote disclosure requirements.** In 2003, the Securities and Exchange Commission began requiring mutual funds to disclose their proxy voting policies and voting records.

⁶ As above.

⁷ Gillan & Starks ‘The Evolution of Shareholder Activism in the United States’ (2007) 19 *Journal of Applied Corporate Finance* 56.

⁸ Gillian & Starks (n 7 above) 58.

⁹ Bew & Fields ‘Voting Decisions at US Mutual Funds: How Investors Really Use Proxy Advisers’ The Investor Responsibility Research Center Institute (2012) 5.

c) Increasing number of matters to be voted on.

It's important to note that in the United States of America when institutional investors were being encouraged to take a more active role in corporate governance, the emphasis was placed on their voting. Fiduciary duties were attached to voting, voting disclosure became necessary and more matters could be voted on. These factors force institutional investors to not only monitor how the company is managed but also allow institutional investors to participate in deciding on pertinent issues affecting the company.

2.2. An overview of shareholder voting in the USA

Shareholder voting is a primary means by which investors can influence a company's operations and corporate governance.¹⁰ As institutional shareholders have become the dominant players in the stock market, they vote billions of shares each year on thousands of items. The recent rise of shareholder activism has attracted much attention and resources to shareholder voting.¹¹ However, history suggests that many shareholders do not vote unless they own large blocks or are legally obliged to vote. However, shareholders who are legally obliged to vote have been criticised as simply following off-the shelf voting recommendations by proxy advisors.¹² In the United States, certain institutional investors are legally bound to vote in their portfolio firms.¹³ Moreover, those that are custodians of retail investments (like mutual funds) have to report their actual votes, as well as their intended voting policies which are submitted to the Securities and Exchange Commission annually. The rest of the investors (e.g. hedge funds or individuals) can essentially freely decide whether they want to vote and are not required to disclose their votes.

The rules governing shareholder voting in the United States have four primary sources. Namely, state corporate law, the federal securities laws, the rules of the securities exchange and a company's certificate of incorporation and bylaws.¹⁴ The

¹⁰ Li 'Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry' (2018) 64 *Management Science* 2951.

¹¹ Cvijanovic *et al* 'Free-riders and Underdogs: Participation in Corporate Voting' (2017) Working Paper https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=AFA2018&paper_id=1030 (Date of use: 4 September 2018) 2.

¹² As above.

¹³ Cvijanovic *et al* (n 11 above) 3.

¹⁴ Davis & Elfenbein 'The United States' in Baums & Wymeersch (eds) *Shareholder voting rights and practices in Europe and the United States* (1999) 355.

growth of institutional investors has led to increased regulatory emphasis on their fiduciary duties to investors in casting a vote. However, this area of the law in the United States of America is difficult to summarise because different types of institutions are regulated by different government agencies.¹⁵ However, the rules governing private pension institutions are being used as a model for other institutions.

Private pension institutions are regulated by the United States Department of Labor under the Employee Retirement Income Security Act.¹⁶ The Department took the position that ‘the ability to vote proxies is a [pension] plan asset...and that it would be a dereliction of duty if managers of plan assets didn’t vote or voted without paying close attention to the implications of their vote’.¹⁷ ERISA provides that a private pension investment manager has the exclusive authority and responsibility for voting proxies.¹⁸ The investment manager must issue guidelines regarding how it will vote on both routine matters and non-routine matters. Public pension institutions are not subject to ERISA, but they generally look to the ERISA standards for guidance. Similarly, ERISA’s influence regarding shareholder voting issues has extended to private investment institutions. The ERISA example in the United States indicates that even if a certain category of institutional investors is legally obliged to vote, that may still be enough because it may influence other institutional investors to take their voting seriously.

2.3. Effects of voting

Research on companies in the United States of America show that although shareholders’ votes are overwhelmingly cast in favour of management’s recommendations, meaningful dissenting vote percentages are followed by changes in the board, management, compensation, or other policies over the next year. Collectively, the research suggests that the voting process is an effective shareholder activism method for companies in the United States of America because board of directors also listen to dissent voting.¹⁹ Therefore, the shareholder vote is increasingly

¹⁵ Davis & Elfenbein ‘The United States’ in Baums & Wymeersch (n 14 above) 364.

¹⁶ Employee Retirement Income Security Act of 1974 (hereafter ERISA). The ERISA is a United States federal law that sets minimum standards for most voluntarily established pension and health plans in the private industry to provide protection for individuals in these plans.

¹⁷ Davis & Elfenbein ‘The United States’ in Baums & Wymeersch (n 14 above) 364.

¹⁸ Davis & Elfenbein ‘The United States’ in Baums & Wymeersch (n 14 above) 365.

¹⁹ Illiev *et al* (n 2 above) 2168.

considered as one of the most powerful means that institutional investors have to engage with the boards of directors of their investee companies.²⁰

Previous empirical studies have also found that shareholders exert pressures on boards of directors even when their vote at the shareholders' meeting is not legally binding, because in many cases proposals that win a majority vote end up being implemented by the board of directors.²¹ Boards of directors that choose to ignore the shareholder vote have been shown to draw negative press and receive downgrades by governance rating firms. In the United States of America, such directors become less likely to be re-elected and more likely to lose other directorships.²² Another important effect of mandatory voting in the United States of America is that voting turnout is high and institutional investors vote on issues affecting the company. In 2017 alone, 91% of institutional investors exercised their votes during the voting season.²³

3. South African voting culture

At common law, shareholders' meetings are held in order to provide shareholders with an opportunity to debate and vote on matters that the shareholders are empowered to decide upon based on the Companies Act or the Memorandum of Incorporation.²⁴ The annual general meeting is also a key mechanism for promoting transparency and accountability in the management of the company's affairs.²⁵ The right to participate in a meeting and the right to vote are inherent in the ownership of shares. The board of directors may not frustrate or impede that right.²⁶ However, institutional investors in South Africa have been found not to be eager participants in the exercise of control within the corporate structure.²⁷

²⁰ Mallin & Melis 'Shareholder rights, shareholder voting, and corporate performance' (2012) 16 *Journal of Management & Governance* 172.

²¹ As above.

²² As above.

²³ Broadridge & PriceWaterhouseCoopers '2017 Proxy Season Review' (2017) 2 available at <https://www.broadridge.com/assets/pdf/broadridge-2017-proxy-season-review.pdf> (Date of use: 8 September 2018).

²⁴ *Letseng Diamonds Ltd v JCI Ltd and others; Trinity Asset Management (pty) Ltd and others v Investec Bank Ltd and others* 2007 (5) SA 564 (W) para 16. See also *Byng v London Life Association Ltd* [1990] 1 Ch 170.

²⁵ Kotze 'How loud is a shareholder's voice at a general meeting?' (2018) 18 *Without Prejudice* 36.

²⁶ *Smith v Saddler* 1997 NSWSC 525.

²⁷ Jacobs 'Pure corporate control in South Africa: chapter 3: part two: South Africa on corporate control' (2010) 2010 *Transactions of the Centre for Business Law* 46.

The annual general meeting which is compulsory for public companies in terms of section 61(7) of the Companies Act, is designed to be the forum in which the shareholders can exercise ultimate control over all the company's affairs.²⁸ However, in practice the annual general meeting falls short in achieving its intended purpose of providing a forum for debating, information exchange and decision making because most shareholders, particularly institutional investors decide on their votes before the meeting and simply appoint proxies to vote on resolutions at meetings.²⁹ In addition, most institutional investors in South Africa prefer private negotiations with investee companies to public forms of engagement, such as proxy voting.³⁰ Although South African institutional investors are legally permitted to file shareholder resolutions, very few do so.³¹ It has been argued that this is so because shareholders are not educated in corporate governance issues affecting their rights and their role in the corporate structure. In essence, the South African voting culture of institutional investors still needs to be developed to ensure that institutional investors utilise their legal rights of attending meetings, voting and filing shareholder resolutions where needed. This will ensure that institutional investors effectively monitor the company and where necessary, adopt shareholder activism to counteract any unacceptable governance practices.

In a study to determine to what extent regulations influence private shareholder engagement attitudes and behaviour of pension funds with listed companies in Brazil and South Africa, the research findings strongly suggested that legislation provides an indirect encouragement to shareholder engagement behaviour.³² According to 52 percent of the interviewees, legislation encourages responsible investment thereby creating an enabling environment for engagement. Such research further supports the notion that mandating institutional investors or more specifically pension funds to vote

²⁸ Delport *Henochsberg on the Companies Act 71 of 2008* 230.

²⁹ Cassim *Contemporary Company Law* 370.

³⁰ De Bruin & Viviers 'Spotlight on shareholder engagement: Is proxy voting an effective tool for shareholder activists in South Africa?' (2015) available at <http://www.grayswan.co.za/pdf/press/pdf/Shareholder%20Engagment%20Proxy%20Voting%20%20Moneyweb,%204%20May%202015.pdf> (Date of use: 30 September 2018).

³¹ Smit & Viviers 'Institutional proxy voting in South Africa: Process, outcomes and impact' (2015) 46(4) *South African Journal of Business Management* 24.

³² Frynas & Yamahaki (n 1 above) 519.

will encourage more active engagement by institutional investors and improve the voting culture in South Africa.

If institutional investors do become more involved in corporate governance issues through voting they will get an opportunity to learn more about their rights, their role in the corporate culture, their functions and monitoring management actions.³³ In addition, institutional investors can control the decisions of the company by monitoring their performance. Monitoring can be either direct or indirect. Direct monitoring means that institutional investors have to take an active role in the meetings of the company and inform themselves of the going-ons in the company.³⁴ In South Africa there have been arguments for imposing a duty to vote on institutional investors based on the fact that institutional investors are in most instances trustees of their own investors hence they have a duty to act in the best interests of their own investors as well.³⁵ Therefore, it stands to reason that legally obligating institutional investors to vote will not only allow them to exert a certain amount of control over the company but it will also be an effective way to monitor the corporate governance of a company.

4. Conclusion

Institutional investors have several 'tools of governance' to help them engage with their investee companies. These tools include the use of the vote. The right to vote can be seen as fundamental for some element of control by shareholders.³⁶ Considering the importance of voting, this chapter aimed to determine whether legally obliging institutional investors to vote is a viable mechanism for institutional investors to carry out shareholder activism by amongst other things using voting to monitor a company's corporate governance. The United States of America was used as an example since it legally obliges institutional investors to vote.

The literature discussed provided that four main positive effects of mandated voting can be deduced from the United States. Firstly, that the voting process is an effective shareholder activism method for companies because board of directors also listen to dissent voting. Secondly, that shareholders exert pressures on boards of directors

³³ Jacobs (n 27 above) 48.

³⁴ As above.

³⁵ As above.

³⁶ Mallin 'Institutional investors: the vote as a tool of governance' (2012) 16 *Journal of Management & Governance* 178.

even when their vote at the shareholders' meeting is not legally binding, because in many cases proposals that win a majority vote end up being implemented by the board of directors. Thirdly, that boards of directors that choose to ignore the shareholder vote become less likely to be re-elected and more likely to lose other directorships. Finally, voting turnout by institutional investors is high. The example from the United States of America also indicates that mandating a certain category of institutional investors to vote may be enough to set the standard for others. Whilst legally obliging institutional investors to vote has been criticised on the basis that they may simply vote in whichever way they are advised by proxy advisors, the positive effects of their voting are still persuasive because institutional investors are forced to take their ownership responsibilities seriously and are exercising some control over the running of the company.

Chapter 5: Conclusion and Recommendations

1. Conclusion

This dissertation aimed to determine the role that shareholder activism by institutional investors can play in furthering corporate governance in South Africa. Good corporate governance is fundamental to the success of a company and contributes to the wider public good by promoting the growth of the economy and investment in South Africa. Historically, shareholder activism has not been a significant factor in South Africa. It is more common to see activism in the South African context from interested parties such as trade unions, rather than shareholders. More recently, following global trends shareholder activism has been on the rise and the market has started to take note of the influence shareholders can wield. This dissertation found that institutional investors in South Africa have already been identified as shareholders who can play the role of corporate governance overseer due to their unique nature. This dissertation then proposed that shareholder activism should be further adopted to help institutional investors better monitor corporate governance. Since shareholder activism by institutional investors is still a relatively new phenomenon in South Africa, this dissertation also discussed the position in the United Kingdom and United States of America to determine what lessons South Africa can learn.

1.1. South Africa

The second chapter focussed on shareholder activism by institutional investors in South Africa. Shareholder activism was highlighted as being a necessary tool to use for various reasons. Firstly, due to the enormous power that shareholders hold in terms of the rights conferred by legislation such as the ability to elect and remove directors. Secondly, shareholder activism is a very flexible concept in the sense that various actions by shareholders can be deemed to be activist behaviour. From private methods that include writing letters or negotiating with management in private to public methods that may include filing shareholder resolutions or asking questions at annual general meeting.

Research on the activist mechanisms used by institutional investors in South Africa is limited but the little that is available revealed that institutional investors in South Africa prefer speaking to management behind closed doors. Whilst this is good in the sense that any form of engagement is beneficial, this form of engagement has its

disadvantages. Given the confidential nature of private negotiations the frequency, intensity and outcomes of these engagements remain a mystery to all but those who were partaking in the negotiations. Considering how uncommon shareholder activism is in South Africa, being able to measure the frequency and success of such engagements would be beneficial. Therefore, when it comes to institutional investors they should be further encouraged to pursue more public methods of engagement.

Chapter two also discussed the fact that the South African corporate governance framework is also conducive to shareholder activism by institutional investors. The Companies Act amongst other things, has the objective of promoting high standards of corporate governance and as a result has various provisions that encourage shareholders to attend meetings and decide on pertinent issues affecting the company. The King IV report and Code for Responsible Investing in South Africa have also created soft law that is dedicated to encouraging institutional investors to play a more active role in the governance of companies. Despite these efforts to help institutional investors become less passive shareholders, the industry is still largely characterised by a passive and selective approach to responsible investment.¹ Therefore, chapter three and four discussed what lessons South Africa can learn from the approach of the United Kingdom and United States of America.

1.2. United Kingdom

The United Kingdom created the UK Stewardship Code to encourage more active engagement by institutional investors and South Africa followed suit and created the Code for Responsible Investing in South Africa. However, both Codes have proven to be insufficient in tackling the structural barriers institutional investors face in overcoming their passive approach to their shareholder responsibilities. As institutional investors have grown in recent years, a lot of research has been conducted on the reasons why they remain passive despite their large stake holding in companies. The reasons focus on mainly four factors, namely incentives to engage, conflict of interest, legal barriers and the investment management industry structure.²

¹ Institute of Directors Southern Africa 'Responsible investment research: CRISA disclosure by institutional investors and their service providers' A research report by the CRISA Committee and EY 1.

² McCahery *et al* 'Behind the scenes: The Corporate Governance Preferences of Institutional Investors' (2016) 71 *The Journal of Finance* 2921.

This dissertation briefly mentioned a few of the common reasons which have been identified in literature. Both the Codes do not address the identified challenges, and this may be one of the reasons both Codes have struggled to have any real impact on the behaviour of institutional investors. Due the wide range of obstacles that prevent active engagement it's been suggested that regulators who want to encourage more engagement face the challenge of addressing a range of economic and legal factors because simple solutions do not seem to exist.³ Consequently, it was concluded that the Code for Responsible Investing in South Africa should be re-evaluated to address some of the obstacles that prohibit institutional investors from fully embracing an active role in companies.

In South Africa and the United Kingdom, pension funds have been identified as institutional investors who are most suitable for shareholder activism. Therefore, instead of creating more soft law targeting institutional investors in general and trying to encourage more active behaviour from them, greater focus should be placed on narrowing the law to target the institutional investor that has the most incentive and proclivity towards being an engaged shareholder. South Africa has already taken a step towards this by creating Regulation 28 for the Pension Funds Act which aims to ensure that savings invested in South African retirement funds are prudently invested from an economic, social and governance perspective. But unfortunately, the Code for Responsible Investing in South Africa was thought to serve as a guidance to how pension funds carry out Regulation 28 and the problem with this approach is that the Code for Responsible Investing in South Africa is broad as it targets institutional investors in general and may not address the specific needs of pension funds as one type of institutional investor.

1.3. United States of America

Considering the importance of voting, this dissertation used the United States of America to determine whether legally obliging institutional investors to vote is a viable mechanism for institutional investors to carry out shareholder activism. The literature discussed provided that four main positive effects of mandated voting can be deduced from the United States of America. Firstly, that the voting process is an effective shareholder activism method for companies because board of directors also listen to

³ McCahery *et al* (n 2 above) 2922.

dissent voting. Secondly, that shareholders exert pressures on boards of directors even when their vote at the shareholders' meeting is not legally binding. Thirdly, that boards of directors that choose to ignore the shareholder vote become less likely to be re-elected and more likely to lose other directorships. Finally, voting turnout by institutional investors is high. The position in the United States of America also indicated that mandating a certain category of institutional investors to vote may be enough to set the standard for others.

2. Recommendations

Given the wide range of options available regarding the methods of shareholder activism, institutional investors must be encouraged to commit to at least one form of activist behaviour. For example, if they are not comfortable criticising the company on social media they are free to write letters or negotiate with management directly. In addition, institutional investors should be further encouraged to pursue more public methods of engagement. Institutional investors are specifically encouraged to increase public disclosure of their proxy voting policies, results and details on the issues they raised in private with investee companies. Since institutional investors are highlighted by the King reports in South Africa as playing an important role in monitoring the corporate governance of investee companies, they have an added responsibility to set the standard for the ways in which shareholders hold management accountable. This can only be done if their actions can be viewed and measured by outsiders hence the emphasis on more public methods of engagement.

The Code for Responsible Investing in South Africa should be re-evaluated to address some of the obstacles that prohibit institutional investors from fully embracing an active role in companies. In South Africa pension funds have been identified as institutional investors who are most suitable for shareholder activism therefore, greater focus should be placed on narrowing the law to target pension funds. In addition, institutional investors and preferably pension funds should be mandated to vote and disclose their voting policies and results. This will force them to actively engage with the company and act as a monitor for good corporate governance practices in investee companies. This would also set the standard for other shareholders and hopefully erase the shareholder apathy that currently exists regarding the corporate governance of companies.

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