Talk by Allan Greenblo to "The Premier Corporate Governance Conference", organised by Chartered Secretaries Southern Africa, 17 Sept 2014.

The need for shareholder activism and why you should encourage it.

I recently came across a joke, or perhaps not much of a joke, that was popular during the depth of the 2008 financial crisis. Karl Marx, it was said, was wrong on communism but right on capitalism.

Well, I'd suggest that he was wrong on capitalism too. Or at least on capitalism as it has evolved over the last century, from the robber barons' dominance of the large corporations to the public ownership of listed entities.

As it was put in the King III code on corporate governance: "An analysis of the registers of shareholders of the major companies listed on the JSE will show that they are mostly comprised of financial institutions, both foreign and local. These institutions are 'trustees' for the ultimate beneficiaries, who are individuals. The ultimate beneficiaries of pension funds, which are currently amongst the largest holders of equities in South Africa, are individuals who have become the new owners of capital. This is a departure from the share capital being held by a few wealthy families, which was the norm until the end of the first half of the 20th century. This is a worldwide trend."

Marx and Engels wanted "the people" to own the "commanding heights" of the economy, such as the banks and mining houses. Similarly, the Freedom Charter urged the nationalisation of "monopoly industry". All of this has been overtaken because the nature of ownership has changed so radically.

What we now have is capitalistic socialism or socialistic capitalism. It makes no difference what we call it because of the passing of corporate ownership to the millions of people who're members of pension funds and other collective investment schemes is irreversible.

Equally immutable is the obligation of the financial institutions to act as their fiduciaries; in other words, to assert rights of ownership that best serve the interests not of managements but of beneficiaries. That, simply, is what's meant by shareholder activism.

Yet the South African political discourse remains trapped in an "us versus them" time warp. Debate continues to be influenced by ideological clichés, where Marx resonates, rather than modern-day concepts of where ownership resides.

Grist to the mill of the wealth-redistribution lobbyists, which SA has in abundance, is the 700-page tome *'Capitalism in the 21st Century'* by French economist Thomas

Piketty. Remarkably, for such heavy research and reading, it's an international bestseller that now pervades discussion on inequality.

Its essential recommendation is that, to prevent soaring inequality from contributing to social or political instability, governments immediately intervene to impose a global tax on wealth. Seen in isolation, it will be music to the ears of many who won't bother to read the whole book and who probably won't understand much of it if they did. It risks unpredictable consequences, except to make the rich less rich and the poor not necessarily richer, were the academic scholarship subverted into political slogans.

What the Piketty book has done, in a studied worldwide context, is thrust to the fore the relationship between practices of modern capitalism and trajectories of income inequalities. Not that SA, where arguments fly hither and thither, needed the thrust. For a new phrase of sound and fury has entered the lexicon of the ANC government.

This is 'radical economic transformation', conveying seriousness to campaign against inequality. To be an accepted policy objective, it must be converted from a catchphrase to a term that's properly understood. It must also be accompanied by recommendations that are practical and, especially in the current SA environment of worsening inequalities, quickly capable of implementation.

Impute positive spin. Take it that the term is intended to encapsulate, as a rallying cry that submerges Julius Malema, the transformation of the SA economy from less divisive to more inclusive under the Constitution. No problem with that, surely.

At present, demonstrated by the proliferation of strikes and worse, the socio-economic environment is divisive in too many ways that are intolerable. Fault lines used to be in the apartheid demarcations. Now they have class characteristics. Contrasting with the expectations that the advent of democracy aroused, and the more incendiary for it, perceived and real inequities undermine the social stability and economic growth on which remedy relies.

It's self-evident that inclusiveness be significantly extended by participation in economic activity and responsibility for its outcomes. Better than government trying to conceive grand plans and further interventions is for it to encourage the use of existing levers.

One of the most powerful levers, immediately available, is through pension and provident funds. This is because SA retirement funds:

- Represent the largest single category of shareholders in JSE-listed companies;

- Have voting rights as shareholders to nominate directors and approve the pay policies of these companies;
- Are the major, and often the only, repositories of black workers' savings.

The trick is to enhance bottom-up awareness. In Kenya, for one, retirement funds disseminate to individual members monthly updates on their accrued savings. This is done by smartphone. SA should get a move on with something similar, to include within the benefit statement a disclosure of the major investments held by the particular fund for its members.

Then, when there's talk of nationalisation, it's rendered nonsensical by retirement funds' predominant ownership of SA corporates. When workers go on strike, they'll know whether they're striking against the companies where their funds are invested. When foreigners take fright, both the equity and bond components of local funds' portfolios are hit. Business confidence and fund members' pockets are intertwined.

Assume that there are roughly eight million members of SA retirement funds, the majority of whom are black. Assuming six million black members, each with four dependents, some 24 million black South Africans receive benefits that depend on the performance of these funds. Relate this number of 24 million beneficiaries, in jobs and jobless, to the size of the total SA electorate.

Or relate it to the value of shares held by black South Africans. Independent research, commissioned by the JSE from Trevor Chandler, found that at end-2011 the value was almost 30% of available shares (not owned by foreigners) of SA's top 100 companies. Most were held through "mandated investments", particularly retirement funds. The value is currently estimated at closer to 40%.

Thus, it is argued, shareholder activism – provided it is used by retirement funds – can be a lighting rod to accelerate economic transformation. Not only do fund trustees have a legal right and fiduciary duty to use this power, for the benefit of their funds' members, but they also have a moral obligation to use it for the benefit of SA society as a whole.

Shareholder activism is not limited to voting at meetings of company shareholders. It extends to engagement with the boards of those companies; a notable example being on matters of executives' and workers' remuneration. This is potentially more potent than strike activity because it shifts the action from monologue in streets to dialogue in boardrooms. The shareholders' ultimate weapon is their vote.

Importantly, trustees of retirement funds are responsible to their respective funds. Similarly, directors of companies are responsible to their companies. The activism

process is therefore reciprocal, between parties respectively responsible, making it the vehicle to build consensus. The more that companies flourish, and their prosperity is shared, the better for beneficiaries of retirement funds.

It then becomes insufficient for the shareholder simply to vote "no" without first having attempted to reach agreement on policies likely to ensure the company's sustainability i.e. to grow in ways that will optimise the funds' long-term investment returns.

Clearly, these factors include employee relationships and social involvements. Consolidate the separate levers available here and now:

- **Regulation 28 of the Pension Funds Act.** It obliges retirement funds to consider environmental, social and governance (ESG) criteria in making their investment decisions;
- **The Financial Services Board good-governance circular PF 130** (at present a guidance note, but soon to be redrafted into law). It obliges retirement funds to compile investment-policy statements that include proxy-voting mandates to their asset managers;
- **The Code for Responsible Investment in SA (CRISA),** to which all major SA asset managers are signatories. It obliges these managers (usually the registered shareholders on behalf of the funds) amongst other things to vote at shareholder meetings in accordance with defined ESG principles and to be transparent in how those votes are exercised;
- **The King III code on corporate governance**, endorsed by the Institute of Directors. It records the preponderance of retirement funds as shareholders and encourages shareholder activism. It provides that "shareholders are ultimately responsible for the composition of the board" of a company and that procedures for the appointment of directors be "subject to shareholder approval". It further provides that shareholders "should approve the company's remuneration policy";
- **The JSE Securities Exchange.** Companies listed on the JSE are required to comply with King III or explain to the JSE where/why they have not done so;
- **The Companies Act.** It defines the rights of shareholders to vote at meetings of company shareholders and lays out procedures for the election of directors. It also provides that directors' remuneration must have prior approval by 75% of shareholders who vote.

These levers can be strengthened by bringing the Companies Act more into line with King III. Certain specifics:

Firstly, the Act speaks only of directors' remuneration for their services as directors, not as executives. There's inconsistency, which invites rectification, between the Act's silence and the King III requirement for shareholder approval of remuneration policies implicitly affecting all employees;

The policies are critical because they embrace, or should embrace, performance indicators. These provide context to measure pay against productivity, and incentives against attainments, for assessment of the fairness or otherwise of remuneration differentials from the most senior to most junior members of the workforce. Disclosure of remuneration policies, recommended only in King III, should underlie shareholders' engagement and voting principles;

Secondly, King III's recommendation is limited to shareholders annually exercising a non-binding advisory vote, enabling them "to express their views on the remuneration policies and on their implementation". A number of overseas jurisdictions have recently moved to binding votes. SA should too, say by an amendment to the Companies Act that a binding vote needs a special resolution (75% majority of votes cast).

It's been proposed (notably by former City minister Lord Myners in a UK government report) that this vote be restricted to long-term investors like pension funds, which have held their shares for at least three years, so as not to disrupt companies' long-term strategies. The intention, to help counter short-term thinking and speculation, is to strengthen the alignment of funds' and companies' longer-term objectives;

Thirdly, it should be made clear in law that institutional investors, including retirement funds, are exempt from charges of collusion in their activism. This will enable them more easily to pool resources for research on companies' policies, to challenge managers and directors on the findings of that research, and to act cooperatively so that requisite majorities are achieved in voting on shareholder resolutions. Assertions of ownership should remain distinct from bids for control.

In 1996, mainly at the insistence of Cosatu, the Pension Funds Act was amended to provide for equal representation by employers and members (employees) on the boards of retirement funds. A main purpose of this amendment was to allow employees an equal say in how fund members' money was to be invested. It introduced a new generation of trustees, such as shop stewards, to the boards of retirement funds.

Despite this amendment, in general terms the newly-restructured funds have not adequately used the platform for the advancement of members either in shareholder activism or in the exercises of black economic empowerment. It is particularly regrettable that BEE opportunity has been lost.

As shareholders in large JSE-listed companies that had initiated BEE transactions by the issue of new shares to arbitrarily-selected beneficiaries, existing black shareholders (indirectly through retirement funds) were ignored and allowed themselves to be ignored. They could have been included as beneficiaries and should have voted on the proposed transactions.

Instead, they subsidised these transactions (allowing for huge wealth transfers to a relative few) by being diluted in their shareholdings (thus receiving a lessened proportion of dividends and capital appreciation). At the least, they should have insisted that they be 'ring-fenced' for protection from prejudice.

It's noticeable that these days the larger retirement funds most prominent in shareholder activism are mainly in the public sector. In fact, the Government Employees Pension Fund has led the way. But it is a lead that other funds, including funds related to trade unions, have so far followed with less enthusiasm than might have been expected and certainly less than might be considered desirable.

By and large, asset managers have focused on purported "engagement" with investee companies. However, the extent and effects are difficult to discern. Several are faced with conflicts of interest. Few are directly mandated by their clients, being the retirement funds themselves, on what is required of them. Were they specifically mandated, the asset managers would have no discretion than to engage and vote in terms of those mandates.

Put bluntly, retirement funds are the owners of capital and the owners of companies. Where they don't act as owners, they abrogate a duty to protect the millions of members who comprise the most representative cross-section of SA's demographic.

Were these sleeping giants to awaken, not only would there be an instant acceleration of economic transformation within parameters offensive in the national debate to nobody of any ideological bent.

There would also be glue for a social compact because the interests of all South Africans are inextricably tied to the interests of their retirement funds, in turn reflecting the outcomes of economic policy. This linkage represents a virtuous circle on the high road to transformation.

Assertive behaviour by retirement funds is not the total answer to 'radical economic transformation'. But it is an essential component. Invigorated, it will amount to a giant leap long overdue. Politically neutral and practically implementable, joining the interests of millions, it depends on the funds themselves being alive to the opportunities that a shareholder democracy offers.

Through activism, they can make an invaluable contribution to the social compact -- between government, business and labour -- for which the National Development Plan explicitly pleads and relies for success.

- *Allan Greenblo is editorial director of Today' Trustee (www.totrust.co.za), a quarterly magazine mainly for principal officers and trustees of retirement funds.*