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Protecting minority shareowners’ interests

Singapore Management University

PROTECTING MINORITY SHAREOWNERS' INTERESTS

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Understand what rights you are giving away when approving a general mandate request.

"Equitable Treatment of Shareholders" is one of six principles listed in the *Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance*. Part of this Principle reads thus:

> *"Corporate boards, managers and controlling shareholders may have the opportunity to engage in activities that may advance their own interests at the expense of non-controlling shareholders… Common provisions to protect minority shareholders, which have proven effective, include pre-emptive rights in relation to share issues."*

What are pre-emptive rights?

"Suppose you are a shareowner, you have the right to subscribe to new share issues as and when companies issue them," explains **Padma Venkat**, Director of Capital Markets Policy (Asia Pacific) of CFA Institute. "These are called pre-emptive rights. If you waive these rights, you lose the ability to subscribe to these new shares."

Pre-emptive rights are important because when a company issues additional shares, a shareowner's proportional ownership in that company decreases if he does not have the option to participate in the new share sale. However, a CFA Institute study of four Asian markets – Hong Kong, Singapore, Thailand, and Malaysia – found that companies often ask for general mandates from shareowners, who approve such requests and give up those rights as a result.

"Such mandates not only temporarily suspend the right of existing shareowners to subscribe to the sale of new shares but also give company directors the right to issue shares to parties at their discretion," wrote Venkat , in the study titled "*Non-Preemptive share issues in Asia: Role of Regulation in Investor Protection*." "Worse, these shares usually are issued at a discount to current share price that ranges from five percent to 20 percent."

Lax regulation

For Hong Kong, almost two in three placements in 2012 of such shares without pre-emptive rights – called non-preemptive share issues – involved a discount of between five and 10 percent. In 2009, more than one in five placements there was performed at the maximum 20 percent discount. Malaysia and Singapore operate with a ten percent limit, while Thailand has a no discount policy.

However, it is the identity of placees that causes the most worry. In Hong Kong, if a share placement – where stocks are sold directly to individual or institutional investors – involved fewer than six placees, then the issuing company must provide the names of these individuals. If more than six placees are involved, then a generic description of these placees will suffice. A look at the breakdown of placements from 2009 to 2012 showed that, except for 2011, at least 67 percent involved six placees or more, and therefore no individual names need to be published by the companies.

The opaqueness of share placement is not the only problem. The study by CFA Institute highlighted the high limit – 20 percent – of issued share capital that may be made available in non-preemptive share placements. In Hong Kong, 29 percent of companies had multiple placements of non-preemptive shares in one year, with two companies doing it eight times.

"In the UK, there's a five percent limit," says Venkat, pointing to the British roots[1] of corporate governance law in much of Asia Pacific, "so companies listed there issue such shares for up to five percent of their issued share capital in accordance with preemption guidelines. They also have a 7.5 percent cumulative cap over a three-year rolling period. In Asia-Pacific, it varies from anywhere between 10 and 20 percent. What's alarming is you don't have a cumulative cap over any period."

Venkat suggests that a three-year rolling period limit be instituted to protect minority shareholder rights. On top of that, she also recommends that regulators require general mandates to be passed by a special resolution, which requires 75 percent approval. Currently, general mandates required only a 50-percent approval rate to be passed in Hong Kong, Singapore, and Malaysia, while Thailand followed the UK requirement for a 75 percent shareowner approval rate. If special resolutions had been required in Hong Kong, at least 15 percent of general mandates in 2012 requests would have been turned down.

Minority shareowners should protect their rights

The current state of affairs prompted Venkat to comment that "the regulatory framework in Asia-Pacific is a lot more permissive towards companies." What can Asia Pacific companies do better in practising corporate governance?

"Number one: Disclosure of the placees," urges Venkat. "Who are these placees? How are they selected? What are the selection criteria? And also, the interconnection between management and the placees. Number two: What does the management do with the funds? In many cases, it's a generic description such as 'working capital needs'."

Indeed, Venkat's research found that 61 percent of companies provided some variant of raising "working capital" as the rationale for conducting a non-preemptive share placement, but provided no detail on how that money will be used. As such, minority shareowners would do well to actively protect their own interests.

Padma Venkat was a speaker at the conference "Corporate Governance and Sustainable Economic Development In Asia: Stakeholder and Stockholder Perspectives", organised by the Wee Kim Wee Centre at Singapore Management University on March 7, 2014.

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[1] The report compares regulations in four different jurisdictions in Asia (Hong Kong, Malaysia, Singapore and Thailand) with those in the UK, as the regulatory frameworks in these markets have been either influenced by or derived from the UK system.