Column

EASY DOES IT: SHAREHOLDER ACTIVISM IN AUSTRALIA

Poorly-governed companies are in a vulnerable position when unhappy investors come knocking.

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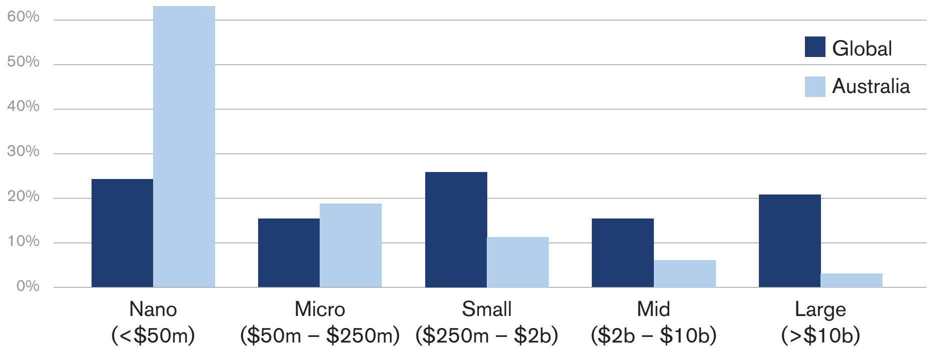
Investors around the world seek different methods to drive superior company performance. But shareholder activism often receives little sympathy as a way of effecting change. Since 2010, the pool of funds deployed in shareholder activism campaigns around the world has quadrupled from approximately US$50 billion to more than US$200 billion today. These strategies involve both private negotiations, as well as public campaigning stances such as shareholder voting proposals or proxy contests for board control.

What is unique to Australia is the relative absence of public activist demands towards mid- to large-cap ASX companies – those with a market value greater than $2 billion. Proxy contests at the top end of the ASX are extremely rare, with a mere handful observed over the last decade. In fact, around 80 per cent of public shareholder activist demands in the first half of 2019 (up from around 60 per cent in 2018) targeted ASX companies with a market value below $50 million. Globally, just over 40 per cent of shareholder activist campaigns targeted mid- and large-cap companies in the first half of 2019.

One explanation for this difference is the enhanced access to boards and senior management institutional shareholders enjoy in Australia. This is a privilege supported by shareholder rights, such as the annual two strikes say-on-pay vote or the ability to call a shareholder meeting pursuant to the *Corporations Act*. These are clear incentives for boards and management to seek engagement with shareholders around grievances to produce meaningful outcomes. In many offshore markets, public campaigning is often the only available option.

Additionally, in recent years some of the largest ASX companies have received environmental-related shareholder voting proposals put forward by not-for-profit, non-shareholder groups. Measurable outcomes for these non-binding shareholder proposals are limited. But this method of activism illustrates the growing importance of corporate governance considerations for institutional shareholders. Whereas the traditional model of shareholder activism focuses on corporate strategy or valuation considerations, ESG integration into mainstream investment models requires a considerable and growing proportion of shareholders to consider the financial and reputational risks associated with corporate governance deficiencies.

Companies targeted by public shareholder activist campaigns (2018)



Source: Activist Insight, Sovereign Governance Advisory

Where governance practice and disclosure requirements are not satisfied, institutional shareholders are increasingly inclined to vote their shares accordingly. Tactics that could benefit activist shareholders seeking more company influence include a willingness to dissent on the re-election of directors to enforce accountability and the propensity to attempt a board spill under the two strikes rule.

A 2019 survey conducted by Squarewell Partners representing the views of global investors totaling more than $US10 trillion of funds under management, found 87 per cent of respondents were more likely to support activist investors if they were seeking to improve a company's corporate governance practices. It is for this specific purpose more ASX companies are now conducting annual governance roadshows for shareholders. These are held separately to an investor roadshow, to maintain rapport with proxy teams and ESG investment analysts.

Due to their inability to sell specific stock holdings, some of the largest passive, index style fund managers, such as BlackRock and Vanguard, continue to grow their governance engagement capabilities for this purpose.

Global activist investors rarely consider Australia given its geographic distance and the multitude of opportunities abroad. But one trend to watch is the expected consolidation of Australia's superannuation industry, following a government review earlier this year that identified various inefficiencies in the sector. Superannuation investors are already some of the largest governance-conscious shareholders on ASX. Their growing scale, and capability to purchase larger blocks of shares, combined with the moral obligation to act as stewards of retirement savings, could over time tempt them towards more aggressive methods of corporate influence at larger Australian companies. In seeking better returns for their clients, pension funds in markets such as the US have for many years outsourced hundreds of millions of dollars of investment capital to hedge fund activists with a successful track record.

The implication is clear. Poorly governed companies are more likely to lose against a shareholder activist, and those companies that continue to take a proactive approach towards governance disclosure and engagement expectations are better positioned to withstand shareholder scrutiny. It remains to be seen whether Australia will require the scale of public activist campaigning that is now characteristic of other offshore capital markets.