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The Influence of Institutional Shareholder Activism as a Corporate Governance Monitoring Mechanism in Malaysia

Maizatul A. Musa

Abstract**—**Not many studies have been undertaken on shareholder activism in emerging economies, including Malaysia. Shareholder activism in emerging economies is on the rise. This paper seeks to comprehend the elements of this activism that are unique to Malaysia, specifically with respect to how the agency problem is controlled through shareholder activism in improving corporate governance practices within target companies. Through shareholder activism, shareholders make contact with a target company to voice their dissatisfaction, suggestions, or recommendations. This paper utilises agency theory to explain institutional shareholder activism. This theory has been extensively used within literature on corporate governance with regards to shareholder activism. The effectiveness of shareholder activism in improving corporate governance will be examined as well. This research provides a further understanding of shareholder activism in emerging economies, such as Malaysia; this research also has the potential to enhance shareholder activism and corporate governance practices in general.

Keywords**—**Agency Theory, Corporate Governance, Emerging Economies, Institutional Shareholder Activism, Malaysia.

I. Introduction

THE quest to perfect problems in corporate governance is never-ending; included in these many ways to improve corporate governance is shareholder activism. The purpose of shareholder activism is to deal with issues that have arisen because of agency problems in companies [1][2][3]. The agency connection in a company exists when one party (the principal) engages another party (the agent) to perform services on its behalf [4]. The principal will delegate a number of decision-making authorities to the agent; if the objectives and interests of the agents and principals correspond, then, there will be no agency issue. Shareholder activism has been widely exercised, especially in the United States of America and the United

Kingdom, but it is a new concept to other countries—especially to emerging economies [5]. Many research have looked into this matter in order to understand this particular corporate governance mechanism from various standpoints and to see how shareholder activism can improve governance structure and performance [6][7]. Because emerging markets have different challenges and different ways of implementing and practicing corporate governance, research on shareholder activism in the Malaysian business environment needs to be carried out in order to understand how shareholder activism is applied in the Malaysian context [8].

M.A. Musa is with University Teknologi MARA 40450, Shah Alam, Selangor, Malaysia (e-mail: maiza610@ salam.uitm.edu.my).

II. Shareholder Activism as Method of Investment Monitoring

For the purposes of this paper, shareholder activism is defined as the action of shareholders voicing dissatisfaction and making suggestions in order to change the status quo of a company in which they have invested without, at the same time, changing the company's control; shareholder activism seeks to maximise both returns and social good through corporate governance that centres on accountability, and it seeks to safeguard the interests of parties who have stakes in the company. This definition is based on the definitions provided by Gillan and Starks (1998) [9] and Guy, Doh, and Sinclair (2004) [10]. Shareholder activism has become a very significant mechanism by which shareholders are able to force the management of underperforming companies to steps forward the company's performance and develop shareholder value [11]. In order to solve their dissatisfaction, shareholders do not always resort to selling their shareholdings (notwithstanding discontents with the management of the company). Instead, they optimistically remain and monitor in order to rectify the situation by voicing their displeasure. By selling their shareholdings, these unsatisfactory issues may be left behind to the company, and shareholders do not know whether this action leads to the betterment of the company or has fallen on deaf ears with the management or board of directors.

Shareholder activism is also known as 'relationship investing' [11]. It promotes better governance of companies in order to safeguard the interests of stakeholders and to increase shareholders' wealth. Intervention and control by shareholders (especially institutional shareholders, who have more bargaining power and expertise) may hinder companies and encourage them to act beyond the limits and powers bestowed upon them by all the parties who have stakes in these companies [11].

All shareholders must be responsible for their investments by becoming involved with the company. Shareholder activism can include a broad range of actions on the part of shareholders who are in the process of changing a company's behaviour, correcting any undesirable actions, or voicing suggestions about various issues [12].

III. Why Shareholder Activism over Other Mechanisms?

According to Fama and Jensen (1983) [13], common control mechanisms across all organisations include those internal and external controls that reduce agency problems. If internal governance fails, an organisation can rely on external controls, which are uniquely available to publically listed companies. These two external controls are the stock market and the market for takeovers. Share prices respond to decisions made by companies. The quality of these decisions will be reflected in a company's share prices, and they will potentially open the company to takeovers or acquisitions [13]. Still, imperative issues remain. How swift can the market become aware of problems? And putting aside the fact those takeovers is costly, how feasible is that mechanism for ensuring performance and long-term ability once takeovers transpire? [14]. Because of high shareholder ownership concentration, pyramidal shareholding, cross-board membership, and government influence in the market, takeovers rarely happen in Malaysia. These issues are explained in details below.

Another external control mechanism that is available to companies is shareholder activism. Shareholder activism can act as a secondary governance mechanism in case of poor internal governance, but it can also serve the purpose of enhancing internal governance [15]. By intervening and engaging in strategic areas in the companies in which they have invested, shareholders indicate that they are responsible. Losses caused by the divergence of interests can also be minimised by imposing these controls, for example, through involvement and engagement of the principals [16] (Pinto 2006). Indeed, many authors argue that the involvement of large shareholders (usually institutional shareholders) in monitoring or controlling activities has the prospective to limit agency problems [17][18][15].

IV. Institutional Shareholders versus Retailer Shareholders

Institutional shareholders usually include public or private pension funds, insurance companies, banks, government agencies and other collective investment vehicles such as charity organisation. Agents such as investment managers who are appointed by institutional shareholders to invest on their behalf are also considered as institutional shareholders or investors. These are large entities with huge amounts of money that they pump into the capital market. The institutional shareholders investment funds that are present in the market usually invest in huge amounts across various companies [19]. Therefore, the costs of shareholder activism can be covered by gains at the end of this process. As organised and structured entities that have the responsibility to ensure expected returns from their various investment activities, institutional shareholders allocate a certain amount of resources for the purposes of controlling and monitoring their investment portfolios [20].However, this engagement and interference should have a limit. Excessive interference on the part the institutional shareholders may jeopardise a company's operations and can cause friction among various parties [21][22]. In the course of exercising their rights, shareholders must refrain from stepping over the boundary that demarcates the power of the company and that of its shareholders.

The maintenance of good corporate governance ensures that the interests of all the stakeholders in a company are well represented, especially the welfare of its minority shareholders. Involvement and engagement as suggested by best practices can lead to better corporate governance, which can help companies to gain both strength and competitive advantage.

Furthermore, the growing size of institutional shareholders makes these shareholders a significant force as they have both the expertise and resources to serve as leaders in the process of ensuring shareholder value [23]. According to Lee & Park (2009) [20], individual or non-coordinated activism has been comparatively unsuccessful when measured by voting outcomes and voting results. For this reason, institutional investors and coordinated groups may act as substitutes in applying pressure on corporate managers to yield towards these shareholders' desires.

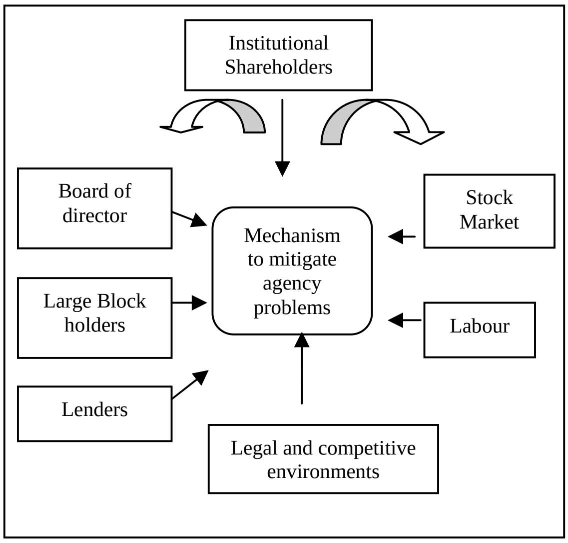

Fig. 1 The Position of Institutional Investors in Monitoring and Controlling [24]

V. Governance Structure in Malaysia

A. Ownership Concentrations

The 1997–98 Asian financial crises had a powerful impact on the Malaysian economy. Many of its companies were not resilient enough to survive. A post-crisis analysis reveals corporate governance problems in Malaysia. Two main issues have been identified: the first is inadequate shareholder control and protection; the second is a lack of creditor monitoring of management and board of directors [25][26]. Realising these problems, shareholder activism is now a part of the best practices in the Malaysian Code on Corporate Governance, and an emphasis on institutional shareholders and government encouragement of shareholder activism is emerging in the corporate sector [27].

Malaysia is an emerging economy. The major shareholders in the Malaysian capital market are government agencies and family-owned corporations.

These characteristics are shared by many east Asian countries, such as Indonesia, Thailand, Korea, Hong Kong, and Japan [28][26] (Mohd Ghazalli 2007, Claessens and Djankov 1999). Given that shareholder concentration in Malaysia is high and owners also serve as managers of their companies, there may seem to be no need for a mechanism that can alleviate agency costs and problems. In fact, shareholder activism may still be a useful mechanism in the fight to reduce agency costs and to protect the interests of minority shareholders [29].

More often than not in Malaysia, annual general meetings are chaired by the members in power, who control the agenda of these meetings, especially in family-owned companies.

This does not guarantee that the interests of all of a company's shareholders are secured.

The importance of shareholder activism does not exist only for institutional shareholders with huge investments, but also for minority shareholders.

To summarise, the typical ownership structures of publically listed Malaysian companies are cross-holdings, family-owned companies, and Bumiputra (Sons of the Soil) [26] (Claessens and Djankov 1999). These ownership concentrations impose a severe constraint on corporate control of the market as they leave little or no role for hostile takeovers, which otherwise take a corrective role on insiders who are not working in the direction of the maximisation of shareholder value [30][26].

B. Government Influence

The economic direction of Malaysia is profoundly influenced and steered by the government through development plans, policies and agencies such as government-linked wealth funds or sovereign funds (Khazanah Nasional Berhad,

Employees Provident Fund, Pemodalan Nasional Berhad) [27][31]. The development plan already started in 1950 during British colonial rule and the purpose is to hasten the growth of the economy by injecting capital and investing in selective sectors of the economy and accordingly assembling infrastructure to support the respective sectors [30].

The government agencies and investment arms such as Khazanah Nasional Berhad, Employees Provident Fund, and Pemodalan Nasional Berhad invest and more often than not own main companies within key sectors of the Malaysian economy. This can be illustrate in this example of Khanazah Nasional is a major shareholder in Proton Holdings, Malaysian national car manufacturer.

Other, example for the above scenario is its major ownership the CIMB banking group, leading financial services provider in the country [30].

The table below shows the list of the Malaysian government sovereign funds and their respective fund size.

TABLE I
GOVERNMENT SOVEREIGN FUNDS IN MALAYSIA

Institution	Fund Size (USD)
Employees Provident Fund (EPF)	100 billion as at March 2010
Retirement Fund incorporated (KWAP)	19 billion as at December 2009
The Social Security Organisation (SOCSO)	5 billion as at December 2007
Pilgrimmige Fund	7 billion as at December 2009
Permodalan Nasional Berhad	47 billion as at December 2009
Army Pension Fund	2 billion as at December 2009
Amanah Raya Berhad	19 billion as at December 2009
Khazanah National Berhad	29 billion as at December 2009
1Malaysia Development Berhad	3 billion as at December 2010

(Source: http://www.malaysiapropertyinc.com)

VI. INSTITUTIONAL SHAREHOLDER ACTIVISM IN MALAYSIA

Based on the above explanations, institutional shareholders in Malaysia face a huge challenge in seeking to produce a balance between creating shareholder wealth and dealing with other pressures in the capital market. Institutional shareholders in this case cannot act impartially as external monitors. Shareholder activism must be practiced in good faith in order to benefit both the investors and the beneficiaries of institutions [22][29].

Institutional shareholder activism in Malaysia must be investigated further in relation to the shareholder activism that is being practiced in other markets. There is a glimpse of hope for this shareholder activism in Malaysia given that it is led by institutional shareholders (in particular, government agencies). Research conducted among 434 companies listed on the Bursa Malaysia from 1999–2002 indicates that institutional shareholder ownership has a significant and positive relationship to corporate governance [32].

In Malaysia, the institutional shareholders that resort to shareholder activism are, in general, government agencies, and looking at Malaysian publically listed companies overall, better performance is seen in those companies with government ownership [33][34]. Furthermore, a well-governed and transparent company makes shareholder activism more feasible [35]. A general awareness of shareholder activism among institutional shareholders who seek to establish transparency, together with evidence of a significant relationship between institutional ownership and earnings quality, can further support shareholder activism in Malaysia [36]. The effectiveness of this activism can be seen not only in terms of earnings, but also in corporate governance practices. Institutional shareholders are sensitive to their rights. Four groups of shareholder rights are decision-making rights; appointment and removal rights; shareholding rights; and intervention rights [37].

For example, throughout the years the Employees Provident Fund (EPF) has transformed from a passive shareholder into a major enthusiast of sound corporate governance. The action taken by EPF to stop Golden Hope Bhd.'s sale of its subsidiary to Island & Peninsular Bhd., and the Fund's success in pushing for higher prices in the privatisation of Malaysian Oxygen Bhd. in 2007, are recent evidences of increasing awareness of the importance of corporate governance in preserving the interests of shareholders [37]. Through pro-active interaction and engagement with the board and management of investee companies, as well as on-going participation in companies' shareholders meetings, EPF aims to promote the best practices of corporate governance amongst its investee companies. Recent active participants are KWAP, with attendance of 150 meetings, 50 company visits, and 5 discussions with the company management [38]. Meanwhile, Permodalan Nasional Berhad (PNB) and Lembaga Angkatan Tentera Malaysia (LTAT) control and monitor their investee companies through representation on boards; they therefore often act as insiders and play an important active role in performance monitoring and even in corporate governance [30]. One possible explanation for the active engagement of government agencies (sovereign funds) in investee companies is the large amount of investments that these agencies have across the equity market.

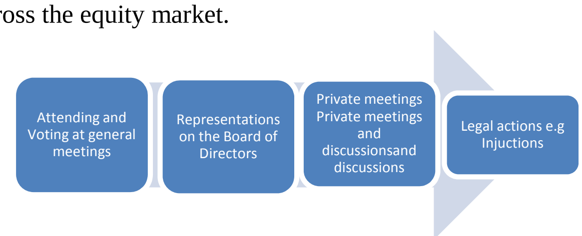

Fig. 2 The Shareholder Activism Continuum

VII. Conclusion

Shareholder activism allows shareholders to impose control through involvement and engagement in company management; it also provides a secondary control system that can complement the existing governance structure of companies with poor governance [13][15]. This activism can play an important role in reducing the agency costs of equity by closely monitoring action of corporate management through voting powers, the power to file suit, and the selling of interests in the firm, thus aligning the interests of managers and shareholders in order to ensure corporate sustainability and longevity [39]. It is therefore interesting to see how institutional shareholder activism is conducted in Malaysia, and to compare Malaysian and foreign institutional shareholders. The interests of shareholders may be varying depending on time and the issues that are present in the market at that particular time and across different types of institutions

[24]. Financial matters may not be the only reasons that trigger activism. The idea behind activism is to target other, non-financial aspects in order to promote better governance that can prevent corporate failure and promote corporate sustainability in the future. This shareholder involvement affects the management of companies in different ways. Effective monitoring and engagement require transparency and a mechanism to support engagement in order to be effective and efficient [40][35][41].

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