



Thoughts on Minority Shareholders and Independent Board Directors

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Corporate Governance Practices are an important part of investor relations, especially here in Turkey where the professionals are required to be a member of the Board Level Corporate Governance Committee. An integral part of investor relations communications are stakeholders. In an effort to continuously improve the corporate governance aspect of the company, we look at best practices to improve our position and get ideas to implement with company strategy. So, in this article I will be attempting to look at some corporate governance practices with international comparison, specifically the topics on minority shareholding and independent Directors.

Setting the Stage

Remember Enron's collapse in the beginning of this millennium? Well, while there were a few factors that came together, the report titled "The role of the Board of Directors in Enron's collapse" prepared by the permanent subcommittee on investigations of the Committee on Governmental Affairs United States Senate states its first findings as: "Fiduciary Failure. The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the United States, ..." Really, outside directors were blamed of being negligent, which basically brought to light the importance of clear corporate governance policies. "An independent director, in corporate governance, refers to a member of a board of directors who does not have a material relationship with a company and is neither part of its executive team nor involved in the day-to-day operations of the company." is the definition by the Corporate Finance Institute. After Enron's collapse the general consensus was that more independent directors need to take an active role in the Board of Directors. A Director's independence would support the company's health and operations with their perspective and accountability, as well as their objective view. Additionally, they could voice their views without any worry about keeping their jobs within the company. Further, a director's task may also include the protection of minority shareholders' views against a controlling block holder. While in Enron's case some of the independent directors were on the Board for nearly twenty years, the length for board participation had to be reevaluated. Alongside several other issues, changes were triggered to the principles of corporate governance to refine further its initial design of controlling and directing a company as well as balancing the interests of all stakeholders.

The legal definition of minority shareholder according to the Merriam-Webster is "a shareholder whose proportion of shares is too small to confer any power to exert control or influence over corporate action". As investor relations professionals, we speak to everyone who contacts us. Minority shareholders, however, do not participate in the decision-making process, the management rarely knows of their dissatisfaction. Instead of voicing their thoughts or giving feedback through us or at the General Assembly, they tend to sell their shares and exit the company ownership. Globally, the corporate governance framework focuses on various aspects, however each country uses their own institutional, legal and regulatory basis. With this context it would be interesting to see how major issues such as minority shareholder rights and independent directors are addressed worldwide. The OECD Corporate Governance

Factbook 2019 has information compiled of OECD and non-OECD countries which puts major corporate governance practices across borders into comparison.

On Board Representation of minority shareholders

Taking a closer look at the minority shareholder rights and the role of independent directors, eight countries have special voting arrangements. Together with Turkey, minority shareholders in these four countries – Brazil, India, Portugal and Spain – have similar arrangements to facilitate the influence in the Board nomination and election. The election to the Board in Italy has to be at least one candidate brought forth by the minority shareholder. Accordingly, in Israel, the majority of minorities appoints the outside directors for recommendation in the initial appointment and requirement in the re-election. The UK Financial Conduct Authority published a rule in 2014, enabling the minorities with additional voting power where a controlling shareholder is present. In this case, initial appointments are to be approved by the majority of the minorities and independent directors are to be approved 1) by shareholders as a whole and 2) by independent shareholders as a separate class.

To further analyze this information, I have taken the liberty of pointing out the relevant parts of the information from the Factbook in the Table below.

COUNTRY	Required for Re-election	BOARD REPRESENTATION OF MINORITY SHAREHOLDER
Brazil	Allowed	One or two members of the board may be elected separately by minority shareholders, pursuant to the following rules: <ul style="list-style-type: none"> ▪ Minority shareholders holding <i>voting shares that represent 15% or more of the voting capital</i> are entitled to appoint one member for the board; and ▪ Minority shareholders holding <i>non-voting preferred shares or preferred shares with limited voting rights that represents 10% or more of the total capital stock</i> are entitled to appoint one member to the board ▪ if neither the holders of shares with voting rights nor the holders of preferred shares without voting rights or with restricted voting rights achieve the percentages mentioned above, they are allowed to aggregate their shares in order to jointly elect a member for the board of directors, as long as their shares represent at least 10% of share capital; and ▪ in the case of state-owned enterprises, minority shareholders have the right to elect one representative for the Board with no minimum share capital requirement.
India	Allowed	Companies Act, 2013 provides for nomination of one director by small shareholders. In this context, a small shareholder is someone holding shares of nominal value of not more than twenty thousand rupees.
Israel	<ul style="list-style-type: none"> ▪ Recommended for initial appointment ▪ Required for re-election 	All outside directors must be appointed by a majority of the minority.
Italy	Required	At least one board member must be elected from the slate of candidates presented by shareholders owning a minimum threshold of the company's share capital. His/her appointment is not a necessary condition for the valid composition of the board (i.e. the board composition is still valid if only one slate has been presented and the board is consequently made up of only directors elected from that slate).
Portugal	Required	The articles of association of public listed companies must provide that: i.) a maximum of one-third of board members are appointed within candidates proposed by a group of shareholders holding between 10 and 20% shareholding; or ii) that minority shareholders representing at least 10% of the share capital appoint at least one director.
Spain	Allowed	Shares that are voluntarily grouped to constitute share capital amounting to or exceeding the sum resulting from dividing the capital by the number of members of the board of directors, shall be entitled to designate the number of members deduced from the proportion of share capital so grouped, rounding any fractions. In other words, depending on the number of directors, shareholders can pool their shares in order to appoint a number of directors to the board in proportion to the share capital they hold in accordance with the proportional representation system. For instance, if minority shareholders possess 100 shares and the board has 12 members, they may pool the 100 shares divided by 12 in order to designate a member of the board.
Turkey	Allowed	The minority shareholders (holding 5% of the equity capital for listed companies) may be given the right to be represented at the board (maximum half of the members of the board can be elected in this way, provided that the articles of association of the company allow.)
United Kingdom	Required for premium listed companies with controlling shareholders	Premium listed companies with controlling shareholders must ensure that their constitutions provide for the election of independent directors by a dual voting structure. This structure requires that independent directors must be separately approved both by the shareholders as a whole and the independent shareholders as a separate class.

Source: OECD Corporate Governance Factbook – 2019, 11 June 2019, www.oecd.org

Among the countries above, the Factbook states that five countries have a regulation, two have a code in place for the independence term. Brazil has no defined maximum term in place. Turkey, on the other hand, has one of the

shortest periods regulated at 6 years. Israel and Italy have a code and the UK has a regulation in place with 9 years, where Italy and the UK require an explanation at the end of the term if the director was to stay on. In India, the term is regulated at 10 years, with a 3-year break at expiration for another 5 years of independent re-election. The regulation in Spain and Portugal are set at 12 years with no independence afterwards.

Truthfully, I find it quite interesting that among several countries implementing corporate governance practices, whether OECD and non-OECD, there are only eight countries that have a national provision on facilitating the board representation of minority shareholders. Of course, there are several pro and con factors that should be considered. Things to be debated are factors incorporating, such as the knowledge of the independent directors - aside from their skills and experience - of the company, to make a sound decision; the objectivity of the minority shareholders in selecting their representation to the board, the independence of the director from the company as well as the majority of the minorities. And several more thoughts come up.

The Power of Proxy Advisory Firms

Here is where proxy advisory firms play a big role. Globally there are two big ones, ISS (Institutional Shareholder Services) and Glass, Lewis & Co. Their service is designed for shareholders who are voting at the company's shareholder meeting. The management and Board of Directors take care of daily business tasks, but shareholder's also have a duty on making decisions on important issues, whether this is the voting on a new candidate to the Board, remuneration, related party transactions etc. While some shareholders cast their vote themselves, many vote "by proxy". Institutional investors, who have shares in maybe hundreds of companies, cannot track all information for all companies and hence their voting cannot be done equitably, which is why they turn to proxy-voting advice. Therefore, these proxy advisory companies, voicing recommendations, have an immense influence on the voting decisions and maybe even outcomes done by proxy. Investor Relations Professionals may have several hundreds of meetings in a year, corporate governance related issues may not always be a current topic. This is why it is also important for investor relations professionals to speak with such proxy advisors. Some agenda items may be clear for the company but may not be so obvious for the shareholder, which is why they seek advice. These advisory firms have policy guidelines in which they reference to the pertaining national regulation or code and their guideline to voting recommendations.

As investor relations professionals here in Turkey, we might be on a search to improve our governance position through best practice examples from different countries. Yet at the same time, this type of information is quite interesting in shaping our message and customizing it to a diverse international arena. Knowing, on a macro level, the basics of such principles can help the investor relations professional in tailoring the conversation to point out features on a micro level and help the potential investor or shareholder understand the position of the company. Having regular contact with proxy advisory firms can also help improve the outcome of the shareholder meeting as well as help improve the information shared prior to the general assembly.