

# 3 Give us more shareholder democracy

**Josephine Woolley**

Well, what do you know? Strip back the dirty linen of history and there they are again: the cheeky boys from the likes of Enron and WorldCom. Those corporate bedbugs of the 1990s have caused some serious itching in the business world, so much so that the shareholders are finally starting to scratch back. As corporate scandal and excess have forced the door wide open onto an era of accountability and transparency, so investors have begun to poke around inside the company, exercising their shareholder rights to do some long-overdue spring-cleaning.

Consequently, more than 40 countries now boast codes or laws to improve shareholder rights, reports *Business Week* (2004). Of these, the Tabaksblat code, drawn up for the Netherlands, is generally considered one of the best. It recommends that corporate boards reveal all—from board structure to the contract terms of top management—and that shareholders get to voice an opinion on management pay deals. While the code is voluntary, companies are discovering that they'll need to present some pretty convincing arguments to shareholders should they choose not to adopt the recommendations.

## Shareholder shake-ups . . .

In the UK, giant bonuses and enormous salary increases and payoffs are common, even in cases of failure. Bob Mendelsohn, former CEO of insurance group Royal & Sun Alliance, banked a massive £1.4 million payoff despite shares falling by 90% during his reign there as chief executive. These have been some of the issues pushing the shareholders to the limit—so much so that an annual shareholder vote on board pay was instituted by the government. GlaxoSmithKline CEO Jean Pierre Garnier was one such corporate cat getting fed too many titbits. At least, that's what 51% of the pharmaceutical giant's shareholders decided when they historically voted against a massive £22 million 'golden parachute' payout. Historical because it was the first time that a FTSE 100 company had the eject button pushed on an executive pay deal. As a result of shareholder pressure, GlaxoSmithKline replaced its two-year contracts with one-year, no-compensation deals.

In many Asian countries, families have dominated the corporate world for years with no one daring to challenge them. 'Around 60% of companies are family-owned in Asia,' says McKinsey director Dominic Barton in a *Business Week* article (Balfour and Tashiro 2004). Consequently, the concept of listening to shareholders is tricky. But, when the financial markets in the region collapsed, shareholders' voices started to ring loud and clear above the chaos. According to the same article, today independent directors are sitting on boards in Singapore. And in Japan investors have forced companies to reveal their boards' pay packet, shaming a Sony president into donating his \$13 million retirement bonus to charity in the process. Not a complete revolution, maybe, but the wheels are starting to turn.

Big shareholder victories occurred in March 2004 when the chairmen of both Walt Disney and Royal Dutch/Shell were unceremoniously relieved of their duties. In the case of the former, 45% (BBC 2005) of the votes were withheld from CEO Michael Eisner. 'It is an unprecedented no-confidence vote in the annals of American business,' said Stanley Gold, one of two ex-board members seeking Eisner's removal (CNN/Money 2004). Days earlier, Eisner had failed to impress during a conference call with more than 200 investors—the latest in transparency techniques (Henry 2004).

Meanwhile, that same year, shareholders were shell-shocked following revelations that the Anglo-Dutch petroleum giant Royal Dutch/Shell had been exaggerating its oil reserves for several years. To pour more oil on troubled waters chairman Sir Philip Watts declined to take

part in a conference call about it. Furious investors weren't standing for it and out he had to go.

Sometimes sending just one head rolling won't do it. Private shareholders at Eurotunnel made French corporate history when they succeeded in ousting the entire board of a major company. Fed up with the loss of 90% of investments since 1997 and the board's failure to clear the company's debt, 5,000 shareholders, following a court case forcing Eurotunnel to let them vote on keeping or ditching management, won their campaign to overthrow the entire board in 2004. The revolt, led by a rather notorious Nicolas Miguel who heralded the event as 'the financial world's equivalent of the fall of the Berlin Wall', means that Eurotunnel is now owned by 65% of small shareholders compared to the previous 43% (Jameson 2004).

### . . . Success or failure?

But as with any rebellion, there will always be critics. The National Association of Pension Funds in the UK said the rebels failed to demonstrate an understanding of Eurotunnel's business and legal structure (BBC 2004a). And the Brits holding shares in Eurotunnel called the newcomers a 'rag tag team with no concrete plans' (Bevens 2004). While some were of the opinion that it was a much-needed electric shock, others scorned the event as being a 'politically inspired coup d'état' (Bevens 2004).

Maybe we should be asking ourselves just how successful these shareholder rampages are. *The Economist* points out that the Disney story does not hold such an unhappy ending for Mr Eisner after all. He lost the chair but remained the CEO.

Disney's board chose to interpret the massive vote against Mr Eisner as 'governance driven'—in other words, that the disaffection had more to do with the governance structure than the boss. That is why they merely separated the roles of chairman and chief executive rather than sacking Mr Eisner as so many of the shareholders were clearly demanding (*The Economist* 2004a).

In the same vein, the article goes on to take a closer look at the events at Shell, claiming that what was really infuriating the shareholders was the company's complicated and bureaucratic two-board structure (one in the UK, one in the Netherlands) which was likely to remain even after the lights went out in Sir Watts's office.

So is shareholder democracy really the way forward? US markets watchdog the Securities and Exchange Commission (SEC) seemed to be sending out an ambiguous signal when it proposed new rules to make it easier for shareholders to put forward candidates. Why ambiguous? *The Economist* points out: ‘The SEC’s proposals would not, as bosses fear, turn American firms into models of corporate democracy. The proposal is, if anything, too timid. It would allow shareholders controlling more than 5% of a firm’s shares held for two years minimum to nominate just two rival candidates—not enough to control the board—moreover they would only get this right a year after either a majority of shareholders had voted for a resolution demanding it or if at least 35% of votes were withheld from any director’ (*The Economist* 2004b). But, despite such limitations on shareholder power, critics wailed that the proposal would be a ‘recipe for chaos with decision-making constrained by a cacophony of voices’ (Tran 2004).

Marjorie Kelly, in her book *The Divine Right of Capital* (2001), sheds a darker light on the situation. She believes that corporate scandals have arisen from boards trying to please their shareholders too much. Accounting misdeeds, after all, led to short-term profits and raised share prices. ‘We think of this as a situation where shareholders got harmed, but forgot that leading up to it, shareholders got precisely what they wanted,’ she is quoted as saying (Mokhiber and Weissman 2002). She goes on to advocate a corporation that is accountable to someone besides their shareholders, adding that shareholders contribute very little to the company. ‘In 15 out of the last 20 years, companies have spent more on stock buybacks than shareholders have invested in new equity.’

Meanwhile, fighting the shareholders’ corner is Robert Monks, founder of Institutional Shareholder Services. He firmly believes that boards are supposed to represent shareholders and that shareholders should have the right to pick who represents them best: ‘When companies destroy value instead of building it up, shareholders deserve the right to do something about it—not just to sell their stock, but to change the directors and the managers’ (Millman 2003).

## Workers with invested interests

What happens though, when the shareholders are also the employees? It’s not a new idea. Back in 1897 a little-known parliamentary candidate named Winston Churchill argued that, if employees held shares in their employer, they would be less vulnerable to layoffs in bad times and would share in the benefits of good times. Two decades later, one John

Spedan Lewis, worried by the spread of communism, wanted labour to employ capital rather than the other way round. Consequently, he turned his father's London department store, John Lewis, into a partnership by setting up an employee trust, describing it as the sharing of gain, knowledge and power. In 1950 the company became employee-owned and nowadays 59,000 employees own the company, getting a slice of the profits at the end of each year. Five of the 12 board members are elected by the partnership council representing the staff, who also get reduced price theatre tickets, deals on holiday apartments and loans.

Over in the US, almost every employee of the Science Applications International Corp is a shareholder in the firm, the largest employee-owned research and engineering outfit in the US, worth \$5.9 billion. CEO Bob Beyster believes that, since employees contribute the intelligence and effort, they should reap the rewards. 'Having everybody own part of the company is a big step forward. It tells that you're not afraid to have them participate. And it signals your desire to let them be heard,' he says (Lindquist 2002). Five workers sit on the board of directors and every April the company has bonus rounds giving recognition to outstanding employees. 'Clearly it's an enterprise that realises that value is in the employees, in their hearts, souls and minds,' says a board member in the same article.

### Employee ownership: the good . . .

But can work really be that rosy? On the plus side it's generally felt that there's a sense of openness and less hierarchy. 'There's more sharing the pain in these companies than if senior people are fighting junior people or the administrative staff over who takes the cuts,' says J. Michael Keeling (Lindquist 2002), president of the Employee Stock Ownership Plans Association. Attracting and keeping staff poses less of a problem and employee motivation tends to be high because they have a financial stake in any successes.

It may be a success for personnel but what about business? Researchers at Rutgers University found that companies using employee stock ownership plans (ESOPs) actually improve sales and financial performance and are likely to stay in business longer than comparable companies without similar plans. In a survey, ESOP companies averaged 2.4% greater annual sales growth in the three years after adopting the process than in the three years prior to it (Leonard 2001).

### . . . The bad

But remove the rose-tinted glasses for a second and take note of a few grey areas, especially when it comes to making quick changes. When Sunday trading was permitted in England in 1994, most companies gave their staff three months' notice of the change. But at John Lewis the switch took a year as partners were given a say at every stage. The internal newsletter is another outlet for employees to voice their thoughts. Every week managers are obliged to reply to anonymous complaints but not everyone is convinced this is the best use of time. After all, when Beverly Aspinall, managing director of a John Lewis outlet, was spotted queuing at the cash desk of a rival store, she had to put pen to paper to explain how she'd been pushed for time and was hungry so she 'just nipped into Safeways for apples' (Morais 2002).

And some partners at John Lewis are more equal than others, said a *New Statesman* article (Barker 1999), remembering a piece in the *Daily Telegraph* in 1998 which calculated that John Lewis partners would get £100,000 in the event of demutualisation. Thus ensued a tug of war. Those who wanted to sell were described as 'jackals', while management were nicknamed 'vultures'. The working 'co-operative' was far from being flawless and it became apparent that being a trust meant that a staff vote would not be enough to dissolve the partnership.

### . . . And the not so ugly

Nevertheless, when a company lasts three-quarters of a century under employee ownership, then it can't all be bad. Another *New Statesman* article (Leadbeater 1997) suggests that employee ownership is indeed the key to success in the knowledge economy, where ideas and computers rather than land and raw materials are at the core of business. It describes how

a company's success rests upon a set of relationships with its suppliers, employees, customers and partners, as well as its shareholders. The way to make stakeholding effective is for the interests of the stakeholders to be translated into specific and enforceable rights to influence the corporate: this is best done through sharing ownership . . . Employee ownership is not just a co-operative corrective for past failings, it is the foundation stone for tomorrow's future.

## Power is money

Increasingly, companies are recognising that shareholders, whether working side by side on the shop floor or scattered across the country voting by proxy, are demanding more of a say in how things are run. Shareholders are sending shockwaves throughout the corporate world and any company wishing to be at the forefront of change is realising that it can't simply brush their views aside anymore. Best then for board members to sit down and take heed of investor opinion if they don't want to end up paying some awkward consequences.



### Case study: as transparent as clingfilm

When Dutch-based international food supplier Royal Ahold was heralded Europe's Enron, CEO Anders Moberg was determined to make the company more transparent than the clingfilm he wrapped his sandwiches in. Immediately he gave shareholders a say on pretty much anything. He invented the new position of chief corporate governance counsel, getting leading Dutch lawyer Peter Wakkie to fill it. Meanwhile, the management team was overhauled, an internal whistle-blowing scheme was set up and a centralised system to track contracts was created to prevent any repeat fraud scenarios occurring. As Mr Wakkie explains, 'We're not hiding behind barriers. We've abandoned our old ways, adopted an open structure and given shareholders more say.' And it seems that not only is Ahold neutralising the sour taste of scandal left in investors' mouths, but prompting other companies to take a closer look at their own corporate governance structures.

*Source: K. Capell, 'Royal Ahold: From Europe's Enron to Model Citizen', Business Week, 17 May 2004.*



### Case study: hanging on the telephone (conference setting)

On 23 February 2004, Michael Eisner, chairman and chief executive of Disney, picked up a conference call from 200 shareholders. Unable to control the agenda, he had to answer sticky questions submitted before and during the call. Why are you both the chairman and CEO, Mr Eisner? Why did you get such a high pay deal last year? What made you reject the Comcast takeover bid before hearing how much it could be

worth? Days later Eisner was chairman no more. Currently there are two companies that run shareholder calls: Institutional Shareholder Services and Glass Lewis & Co. The calls mean that shareholders can communicate between one another and with the CEO. Small investors get to submit questions while big investors can ask difficult questions anonymously so that relationships with management are unhurt.

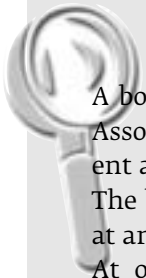
*Source: D. Henry, 'A Wake-up Call From Investors', Business Week, 15 March 2004.*



### Case study: Asda employee incentive scheme pays dividends

It was back in 1995 that Asda chiefs put their heads together to come up with an incentive scheme for all its employees as part of the company's corporate recovery programme. The thinking behind it was that, by empowering and involving the workforce, customer care and productivity would rocket, thus placing Asda sky high above the competition. Enter the Colleague Share Ownership Plan. This year almost 5,000 Asda employees will see the company's five-year Sharesave Plan mature and the news is good: an average worker who has been putting £35 aside a month can hope to pocket share options worth more than £4,000. The scheme seems to be paying off: Asda has secured its place among the top 10 'Best companies to work for' in the UK for the third year running.

*Source: R. Jones, 'Bumper rewards in store for Asda staff', The Guardian, 27 March 2004.*



### Case study: demand what's yours, but do it nicely

A booklet has been published in Singapore by the Securities Investors Association aimed at unruly shareholders. It lists antagonistic, belligerent and insulting behaviour taking place inside shareholder meetings. The booklet advises investors to refrain from rushing for food provided at annual general meetings (AGMs) and consuming excessive amounts. At one shareholder meeting the Chairman of the Singapore Stock Exchange angrily threatened to evict a shareholder who had been asking apparently irrelevant questions.

*Source: BBC, 'Singapore wants nice shareholders', 30 April 2004, news.bbc.co.uk/1/hi/business/3672745.stm (accessed 22 June 2005).*

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