Shareholder Activism

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Corporate Governance Reforms in Korea

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To my family and friends

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*Han-Kyun
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List of Abbreviations

ABI	Association of British Insurers
ACGA	Asian Corporate Governance Association
AFL-CIO	American Federation of Labor and Congress of Industrial Organizations
AGM	annual general meeting
APEC	Asia Pacific Economic Co-operation
AR	average abnormal return
ASA	Australian Shareholders Association
ASrIA	Association for Sustainable and Responsible Investment in Asia
BOK	Bank of Korea
BW	bond with warrant
CalPERS	California Public Employee Retirement System
Calstrs	California State Teachers Retirement System
CAR	cumulative average return
CB	convertible bond
CCEJ	Citizens' Coalition for Economic Justice (Korea)
CGCG	Center for Good Corporate Governance (Korea)
CII	Council of Institutional Investors (US)
Colpera	Colorado Public Employee Retirement System
CRSP	Center for Research in Security Prices
DSW	Deutsche Schutzvereinigung für Wertpapierbesitz (Germany)
EGM	extraordinary general meeting
EIU	Economist Intelligence Unit
EPB	Economic Planning Board (Korea)
Eurosif	European Sustainable and Responsible Investment Forum
FIGHT	Freedom, Integration, God, Honor-Today (US)
FSBA	Florida State Board of Administration
FSC	Financial Supervisory Commission (Korea)
EIRIS	Ethical Investment Research and Information Service (UK)
ERISA	Employee Retirement Income Security Act (US)
ESOA	employee stock ownership association (Korea)
FKI	Federation of Korean Industries

FOE	Friends of the Earth
FSC	Financial Supervisory Commission (Korea)
FSS	Financial Supervisory Service (Korea)
FTC	Fair Trade Commission (Korea)
ICCR	Interfaith Center on Corporate Responsibility (US)
ICGN	International Corporate Governance Network
IFMA	Institutional Fund Mangers' Association (UK)
IMF	International Monetary Fund
IRAA	Investors Rights Association of America
IRRC	Investor Responsibility Research Center (US)
ISS	Institutional Shareholder Services (US)
KCCI	Korea Chamber of Commerce and Industry
KCTU	Korean Confederation of Trade Unions
KDI	Korea Development Institute
KFB	Korea First Bank
KIF	Korea Institute of Finance
KINDS	Korea Integrated News Database System
KLCA	Korea Listed Companies Association
KSE	Korea Stock Exchange
KSE-KIND	Korea Investor's Network for Disclosure System, KSE
LAPFF	Local Authority Pension Fund Forum (UK)
MOFE	Ministry of Finance and Economy (Korea)
MOTIE	Ministry of Trade, Industry and Energy (Korea)
NAPF	National Association of Pension Funds (UK)
NYSCR	New York State Common Retirement System
OECD	Organization for Economic Co-operation and Development
OSS	Office of Securities Supervision (Korea)
PEC	Participatory Economy Committee, PSPD
PIRC	Pensions & Investment Research Consultants Ltd (UK)
PSPD	People's Solidarity for Participatory Democracy (Korea)
S&P 500	Standard & Poor's 500 Common Stock Index
SEC	Securities and Exchange Commission (US)
SIC	Standard Industrial Classification
SMWIA	Sheet Metal Workers' International Association
SWIB	State of Wisconsin Investment Board
TIAA-CREF	Teachers Insurance and Annuity Association: College Retirement Equities Fund (US)
UBCJA	United Brotherhood of Carpenters and Joiners of America
UKSA	United Kingdom Shareholders Association
USA	United Shareholders Association (US)

Note on Korean Spelling

It is not easy to convey Korean pronunciation, with precision, via the English alphabet. The McCune–Reischauer System (or the Martin System for linguists) is the converting system that Western authors have usually resorted to. Notwithstanding, this book is based on a new guideline *How to Romanize Korean* prepared by the Korean government (Ministry of Culture and Tourism, Public Notice No. 2000-8).

I have tried to spell proper nouns as preferred by the individuals concerned. When it is difficult to identify their spelling, I followed the aforementioned guideline. With Korean names, the surname traditionally comes first. The given name then follows in the form of one word (whether hyphenated or not) or two words. To avoid Westerners' confusion, many Koreans, including myself, invert their names. This book has kept to the Korean way in its main body. Elsewhere, including the cover and acknowledgements, the name is inverted.

Foreword

There is a compelling neatness about the Korean iteration of shareholder activism. The syllogism is that national wealth is enhanced through corporate growth; the legitimate definition of wealth is political as well as economic; therefore, the process of monitoring corporate power is necessary – shareholder activists, thus, are performing a public good.

The asserted congruency of corporate and national interest colors shareholder involvement with purpose. It is a device through which the power of the *chaebol* can effectively be addressed without disturbing the delicate equilibrium of public and private power. “The virtuous cycle between corporate governance reform and shareholder activism” compels the conclusion that financial support for this institution should be forthcoming either from the corporation itself or from the government. Unhappily, the incapacity of societies to deal with the disabling conflicted interests of institutional investors – the largest global shareholders – deprives the movement of the breadth and depth of support necessary for full effectiveness.

The splendid tradition of courageous personal activism that has distinguished the last half century of Korean history is a unique and welcome addition to the global tapestry of corporate governance.

*Robert A.G. Monks
Principal, Lens Governance Advisors
& Chairman,
Governance for Owners, LLP*

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Introduction: Shareholder Activism and Corporate Governance Reform

In recent years, there has been growing interest, both political and academic, in the operation and reform of international systems of corporate governance.¹ Of particular interest, in the wake of the 1997 Asian crisis, have been the use of shareholder rights and the encouragement of shareholder activism² in reforming corporate governance regimes (e.g., IMF staff, 1998).

Among policymakers, the general consensus has been that there exists a virtuous cycle between corporate governance reform and shareholder activism. With policy support, shareholders can monitor and thus assert their interest to corporate management more forcefully than before. This shareholders' self-assertion forces managers to adopt a more shareholder-interest-centered stance than before. Shareholder- or investor-centered management brings about more efficient operations, and thus the national economy as a whole can secure the foundation for sustainable growth. It is widely believed that the sustainable growth of the economy is one of the key policy goals a national government should achieve, and accordingly, corporate governance reform encouraging shareholder activism is regarded as desirable. Meanwhile, as a shareholder-centered view of firms becomes gradually more widespread, demands for the protection of shareholder interests will also increase, which will in turn reinforce shareholder-centered corporate governance reform.

The significance of shareholder activism within the overall process of corporate governance reform can be summarized as in Figure 0.1. For this reason, encouraging shareholder monitoring has been recommended as an important goal for corporate governance reform (e.g., Iskander, Meyerman, Gray and Hagan, 1999). International organizations such as the Organization for Economic Co-operation and Development (OECD) and the International Bank for Reconstruction and Development (World

Figure 0.1 Shareholder activism in corporate governance reform

Bank) have helped developing and transition countries increasingly with the design and implementation of shareholder empowerment programs (World Bank, 1999). To take an example of a recent reform in an Asian developing country, the Malaysian government amended the Securities Commission Act in April 2000, allowing shareholders to pursue civil actions against companies, directors and their advisors³ (World Bank, 2000). Similarly in European transition economies, recent legal reforms have concentrated on investor protection and empowerment (Pistor, 2000).

The growth of shareholder activism

Apart from the causal relationship between policy change and the growth of shareholder activism, which will be discussed in Chapters 3, 5 and 8, shareholder activism has increased quite dramatically in recent years. To take an example from the US experience, the number of shareholder resolutions on corporate governance issues (excluding those proposed by individual shareholders) has increased more than seven-fold over the last two decades (Figure 0.2). Although there have been some fluctuations, the trend line in Figure 0.2 clearly shows a steady growth during the period.

Observers maintain that shareholder power is now spreading on a global scale. In January 1999, for example, Phillips and Drew Fund Management, Hermes Lens Asset Management and other large shareholders ousted David Montgomery from the position of chief executive of the UK media firm Mirror Group (Sherer, 1999). Since the early 1990s, Deutsche Schutzvereinigung für Wertpapierbesitz (DSW), Deutsche Bank's mutual-fund arm, has quietly prodded German companies to boost shareholder returns. The results of DSW's efforts were the restructuring of the three

Figure 0.2 Growth of shareholder resolutions, US, 1987–2005

Sources: Gillan and Starks (2000), Georgeson Shareholder (various years). *Annual Corporate Governance Review*.

pillars of Germany Inc.: the conglomerate Siemens, the retailer Metro, and the chemical manufacturer Hoechst (Flynn, 1998). Shareholder activism can be observed in other corners of the world: to cite but a few, Hungary (*Central European*, 1999), Malaysia (Jayasankaran, 2000), China and Chile (Sherer, *ibid.*). Sherer (1999) concludes “[f]or years, agitating by stockholders was largely a US convention, held down overseas by long-held customs, practices or laws. . . . Now the picture is starting to change (n.p.)”.

Studying the rise of shareholder activism

Considering the relatively long history of activism by other stakeholders such as employees and consumers, shareholder activism is a relatively recent form. Nevertheless, the current rapid growth of shareholder activism has attracted considerable academic attention and consequently a large body of research has accumulated over the last two decades. Two early channels for publication were law and financial economics journals, but recent research outlets include journals of general management, business and society, and business ethics. Current articles on shareholder activism appear not only in journals specializing in corporate governance, but also in those in labor (Chakrabarti, 2004) and the environment (Monks, Miller and Cook, 2004). Much work has been done to understand the rise

of shareholder activism (Gillan and Starks, 1998; Karpoff, 1998). Although some scholars have reviewed the literature in this area (Black, 1998; Gillan and Starks, 1998; Karpoff, 1998; Romano, 2001), there is still a need to understand this in a more systematic way.

Four chapters in Part I review the achievements in the area of shareholder activism and seek to analyze them in a more critical and comprehensive way. Chapter 1 questions what shareholder activism and its emergence mean and which aspect the study of shareholder activism has paid, and should pay, attention to. Using a general framework of decision-making, the following three chapters introduce three different approaches which previous scholars have taken, explicitly or implicitly, to explain the rise of shareholder activism. Each approach looks at a different stage, or aspect, of the emergence process and presents a different theoretical foundation. The first approach in Chapter 2 looks at the objective and observable existence of a problematic state so as to explain the occurrence of shareholder activism. Chapter 3 introduces the second approach, exploring the conditions under which a dissenting shareholder finally chooses activism among many various alternatives to correct an unsatisfactory situation. The third approach in Chapter 4 criticizes the rational unitary actor model of the previous two approaches, whether explicitly or not, and suggests a political and symbolic approach based on social movement theory to understand the rise of shareholder activism.

The case of Korean shareholder activism

The emergence of shareholder activism and related corporate governance reforms in Korea have been warmly commended by Western economists. For example, John Plender (2000), former chairman of Pensions and Investment Research Consultants Ltd (PIRC) and a lead writer of the *Financial Times*, once dubbed them the most impressive gain in Asian corporate governance reform. Other observers also cite the Korean case as an outstanding example of the global spread of shareholder power (e.g., Sherer, 1999; Wright, 1999). The leading activists are described as a “classic activist group” (*Forbes*, 2001) and as the creator of a shareholder rights movement (EIU, 2001). Thanks to this remarkable success, Jang Hasung, a leader of Korean shareholder activism, was chosen as one of 50 Asian Stars by *Business Week* in 1998 and 1999, and as one of Asia’s best Advocates of Shareholder’s Rights by *Asia Week* in 2000. Along with Adrian Cadbury and Ira Millstein, he was selected to receive one of the first International Corporate Governance Network (ICGN) Annual Awards in 2001.

The prominent Korean shareholder activism was led by the People's Solidarity for Participatory Democracy (PSPD), a civil society organization. Originally it did not own shares of any target firms, nor was it concerned with enhancing shareholder rights. The PSPD's major concern is, as its name implies, participatory democracy, a political issue. Nevertheless, since its first shareholder activism against the Korea First Bank (KFB) in 1997, the PSPD has been leading Korean shareholder activism and has won international praise, as noted above. Despite its political nature, the PSPD is now piloting one of the most successful shareholder activism campaigns in developing countries.

What makes its success even more surprising is that the atmosphere in which the shareholder activism had emerged was not at first sight particularly favorable. Conventionally, Korea was thought to be a country where shareholders had been poorly protected, at least in practice, and almost inactive in corporate governance. It is a popular belief that, ever since the economy and the capital markets started developing in Korea since the 1960s, shareholder rights had usually existed only in legal textbooks and provisions. It has been believed that this poor corporate governance was one of the main causes of the 1997 financial crisis (e.g., IMF staff, 1998). Although the Korean government has continuously strengthened shareholder rights since 1998, even a survey of the public opinion on business reveals that most Koreans believe that business profits should be returned to the society rather than to the shareholders (*Maeil Business News*, 1999).

However, in December 1997, in the midst of the 1997 financial crisis, the PSPD launched its first shareholder activism; and its achievements since then have been highly praised. From this viewpoint, the PSPD exemplifies a unique case where an alternative activist group, a civil society organization, may complement or even encourage the monitoring role of more traditional activists such as institutional investors. Therefore, a question arising from the PSPD case is: "How could the shareholder activism led by the PSPD, a civil society organization, grow and thrive in the poor soil of Korea to become a success story of corporate governance reform in developing countries?"

The explosive development of shareholder activism in Korea might well become a matter of great concern for scholars (e.g., Kim and Kim, 2001; Choi and Cho, 2003; Milhaupt, 2004). Milhaupt (2004), for example, sees the dramatic rise of the PSPD and the series of remarkable victories achieved by PSPD-led shareholder activism as a real "puzzle". However, we have at least three challenges in applying the first and the second approaches reviewed in Part I to explain the PSPD case. First, an assumption

that the PSPD tries to solve the problem of low stock returns through its shareholder activism is not plausible *prima facie*. Therefore, we need to examine what problems the PSPD is trying to solve and what meaning shareholder's financial interests, if any, bear in the PSPD shareholder activism. Second, we need to change the exit-voice alternatives that the existing theories of shareholder activism consider. If the PSPD, as a civil activist organization, tries to reform a current situation of a firm, it can regard neither exit nor takeover as appropriate alternatives. The alternative set of the PSPD as a civil society organization may contain traditional political voice options such as petitions, demonstrations, and boycotts. In this sense, it becomes important to examine how shareholder activism, an unusual voice tool, has entered into the PSPD's alternative set and why the PSPD has chosen it. Third, if the PSPD wants to take shareholder activism without having shares of the target firm, it will need to co-operate with shareholders of the firm to some extent. In this sense, we can apply the first or the second approaches to shareholder activism to the supportive shareholders rather than to the PSPD. However, this does not appear to be sufficient to explain the emergence of the PSPD activism fully.

For the reasons above, we think the third approach of social movement theory can address the three points above relatively well when we explore the rise of Korean shareholder activism.⁴ The three chapters in Part II investigate the three elements of social movement theory (political opportunity, framing process and resource mobilization) respectively. Chapter 5 investigates the political relations between the government, the PSPD and other civil activists. Chapter 6 addresses the process in which the activists view a situation, decide to use shareholder activism to change it and legitimize their action. Chapter 7 identifies what resources the Korean activists required and how they mobilized them successfully. Chapter 8 concludes with the findings and their implications for policy-makers, scholars and corporate managers interested in corporate governance reforms, especially those achieved through shareholder activism.