Property rights, Share rights stripping, & Corporate Governance

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What is Rights stripping

1. Rights stripping, i.e. the severance and alienation of voting rights and dividend entitlements from shares.

2. While such practices add to the liquidity and with it the tradable value of these instruments, they also place corporate control (through practices such as empty voting) in constant play, and generate considerable downside to the governance of entities.

3. These include short term investor and manager focus, stock price as a key surrogate of performance, outsourcing and shrinking of firm activities, and casual and short term employment at the expense of career based occupations.

The consequences

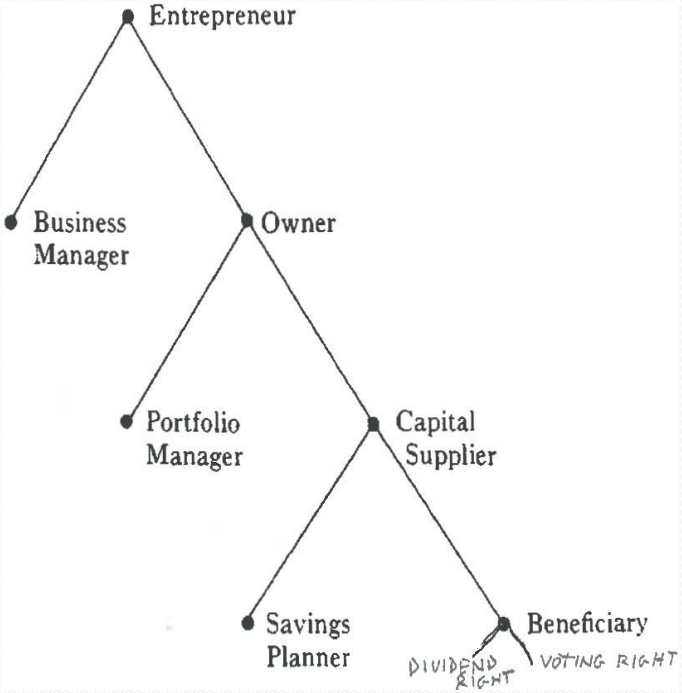
4. Rights stripping enable blockholders to control and divest their interest in the entity without accountability to the general shareholder body, with accountability if at all to only those who fund their activities.

5. Encourages opportunistic behaviour by blockholders and managers acting in cahoots.

6. Opportunistic and moral hazard behaviour by boards and managers is subject to scrutiny by way of independent directors, board committees and say on pay.

7. A nuanced approach to property rights based claims needed to help strike a more balanced shareholder versus board/manager relationship that is needed for economic value creation.

Robert Clark, Four stages of capitalism, 94 Harvard Law Review, 561, 567 (1981)



The Corporate Governance scene

1. From separation of ownership and control, to control by minority shareholder(s), to control by voting rights holders:

2. Splitting of voting and dividend rights as flowing from developments in Taxation Law and CG respectively, i.e the acquisition of "temporary" shareholder rights" to aspects of entitlements attached to shares:

(1) Taxation: circumventing assessability to tax based on residence and source, nature of receipt (capital/income), type (dividend/interest), realisability (fixed/contingent); capturing tax deductibility benefits & deferral through sourcing of dividend rights;

CG & Shareholder rights

(2) Corporate Governance: Exercising corporate control through the strategy of empty voting to address the problem of managerial entrenchment, and as a means of empowering shareholders.

3. Ownership as a bundle of rights

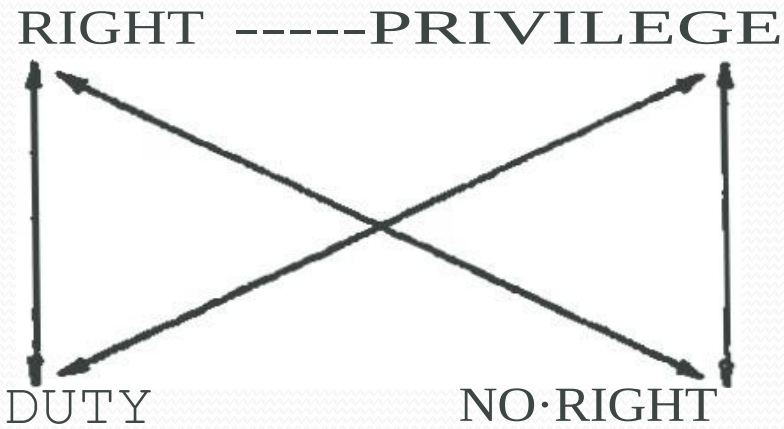
(1) Received norms: Title, Possession, Control, Opportunity for gain and risk of loss, and how parties perceive transaction.

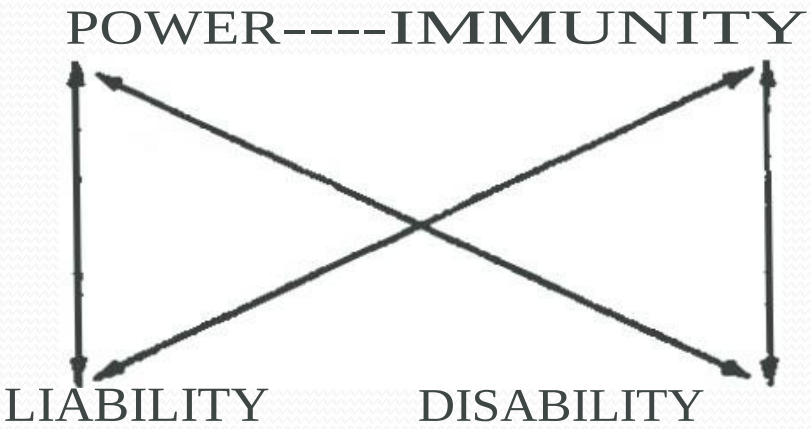
(2) Relevance of Title and Possession attached to share – street name shares held by broker in broker's name

(3) Rights identified with shareholder: Voting, Dividend, Voice, Exit, Return of capital on liquidation, and the separation of each from the other.

Hohfeld: Jural correlatives & opposites

Vertical arrows indicate correlative concepts, and diagonal arrows indicate opposites





CG & Shareholder rights

4. The notion of shareholder:

(1) CG perspective: Balancing rights betw Managers, Boards, & Sharehs;

(2) Investor perspective: focus on share price, overcome inefficiencies, capitalise on efficiencies, exit, voice, loyalty.

(3)Corporate Finance perspective: "shareholders as owners"

(i). Effect of shareholder as owner:

(a) personalise shareholder; (b) depersonalise labour as an input or commodity;

(ii) Excessive focus on share price in evaluating:

(a) value of entity; (b) managerial performance; (c) market effic; (d) pricing of capital & capital allocation process; (e) Executive remun; (f) Excessive focus on Quarterly Financials

The problem of Short Termism

5. ST is much more than a managerial phenomenon

(1) ST as a multifaceted continuum resulting from multiple interacting events with a supply and demand side.

(1) Governance: Agency theory compensation strategy requires high risk, high return investment decisions by managers;

(2) Blockhs facilitate corporate control transfers, require managers to comply (high dividends, divest L/T investmts with uncertain returns, e.g. R&D), force managers to focus on ST investments;

(3) Investors as responding to the uncertainty caused by the new form of corporate control transaction; portfolio diversification enables high risk high returns based investment strategy;

(4) Managers focus on share price to keep share price up and protect their employment and associated privileges;

Evolving notions of CG

6. What is CG

(1) Cadbury Committee, The financial aspects of corporate governance, Dec 1992, para 2.5, CG as 'the system by which companies are directed and controlled'

(a) Focus on shareholder to the exclusion of stakeholder

(2) Cadbury in 2000:"Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society." Foreword by Sir Adrian Cadbury, in Magdi R. Iskander Nadereh Chamlou, Corporate Governance: A Framework for Implementation Overview 30446, The World Bank Group (2000).

(a)Focus on balancing control betw Mgrs, Boards, & Sharehs

Evolving notions of CG

(3) G20/OECD Principles of Corporate Governance OECD Report to G20 Finance Ministers and Central Bank Governors September 2015, p9.

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined".

(a) Includes stakeholders, focuses on relationships, agenda setting and monitoring performance.

Evolving notions of CG

7. Share stripping (SS) shows that value of a share lies not in divid rights (what you can get from), but in its voting rights (what you can get for); i.e. break up than going concern val.

8. Is SS a (1) govern, (2) effic, (3) equity, or (4) a market generated prob?

9. Is CG an "efficiency" issue, or an "equity" issue?

(1) Agency theory claim of increasing managerial performance through compensation packages, & increased accountability focuses on efficiency

(2) Debate on where power should reside: Focus on Board, Managers, Shareholders – point toward efficiency;

(3) Debate on private benefits of control, executive compens, & say on pay – point toward equity.

Evolving notions of CG

10. Does SS cause excessive market volatility ?

11. Is volatility the product of excessive finance or the securitisation of products?

12. If SS is an excessive securitis'n prob, then prob lies more with the actions of intermed's (Hfunds) & less with CG (though intermed's actions impact on CG).