

The 25 per cent proposition

by John Egan

An article based on our submission to the Productivity Commission.

When the Productivity Commission made a Draft Recommendation (Number 15) that entire Boards could be required to stand for re-election when specified proportions of shareholders had voted against the Remuneration Report in two successive years, it became clear that enough attention had not been paid by the market over the years as to how many, and which, shareholders vote at meetings.

The proportion of votes specified for the first meeting was 25%. We prepared our submission on the basis that this is meant to be 25% of the **votes cast** (which is the basis for the 75% proportion required for a special resolution to be passed under the Corporations Act).

Our analysis of voting patterns has revealed that in the top 200 companies, at the median, 54% of available votes are cast. On that basis, the 25% of votes cast would represent 13.5% of the total shareholdings in the company. We doubt that most shareholders want their companies managed in that way.

Published annual reports and outcomes of companies whose financial year ended in calendar year 2008 reveals the following.

1. The average percentage of shareholders voting among the top 200 companies was 54%, and
2. The maximum vote cast was 88% of potential shareholders.

Percentage of votes cast in 2008 reporting season

	75 th Percentile	Median	25 th Percentile	Average
Top 25	59%	52%	46%	55%
Top 50	65%	58%	48%	57%
Top 100	68%	59%	46%	57%
Top 200	66%	54%	43%	54%
Second 100	63%	50%	37%	52%

The voting influence of the 'Top 20' shareholders

In reflecting upon Recommendation 15 and our observations as to what factors might contribute to a negative vote in relation to the Remuneration Report, but which might stand outside the content of the Remuneration Report, we also explored the proportion of total shareholders represented by the top 20 shareholders and observed that the average holding of the top 20 shareholders among the top 200 companies was 65% of all shareholders.

See table following.

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Top 20' as a proportion of total shareholder in 2008 reporting season

	75 th Percentile	Median	25 th Percentile	Average
Top 25	77%	63%	50%	60%
Top 50	79%	72%	53%	64%
Top 100	81%	74%	56%	66%
Top 200	81%	72%	53%	65%
Second 100	81%	69%	52%	64%

The voting influence of the 'Top 3' shareholders

In order to explore the potential influence of the top three shareholders we also considered their shareholding as a proportion of a company's total shareholding and note that among the top 200 companies the top three shareholders have an average holding of 40% of the company. We also observe that the maximum holding across all categories reported in the table below was 88%, being least substantial among the top 25 companies where it stood at 69%.

'Top 3' as a proportion of total shareholder in 2008 reporting season

	75 th Percentile	Median	25 th Percentile	Average
Top 25	55%	42%	35%	43%
Top 50	55%	46%	35%	43%
Top 100	53%	45%	35%	43%
Top 200	52%	39%	30%	40%
Second 100	47%	37%	26%	38%

In 2008, the top three shareholders in the top 200 companies held, at the median, 39% of the shares. Egan Associates concluded that there is the potential for 13.5% of the total shareholdings to vote against the Remuneration Report in any year and say 27% at a subsequent meeting to trigger an election for the whole board. This reflects neither democracy nor good governance.

The proposed remedy raises even more problems

The recommendation proposes that the votes of a small cadre of the total shareholders should be able to unseat the board. This means that small groups of major shareholders may have control over the survival of many of the boards of the major companies in the country. See the charts attached.

There is no indication as to when the enforced election should take place. Would this be at a special general meeting or at the next annual general meeting? If the former, this entails additional expense for the company, or if the latter the board and management would have control of the company for a year, with management in particular knowing that the entire board must stand for re-election, though in the meantime the directors are accountable to provide effective stewardship of the company for the year.

There is an even more important reason and precedent why the whole board under current Corporations Act provisions is not required to stand for election at the one meeting. The re-election and appointment of directors is a staggered process by design as a board of directors represents an accumulation of company knowledge, individual director expertise, networks and commercial savvy. To ask any company to risk the destruction of such an important team is most prejudicial.

Good governance and advisers

In our initial submission to the Productivity Commission, we emphasised the importance of the independence of the advisers to the board. The recommendation makes no reference as to whether the **vote** on the remuneration report is well-advised or not. Here proxy advisers should have considerable accountability to be thorough in preparing their voting recommendation. There are times when boards must make unpopular decisions for the continuing good and sustainability of the company. Egan Associates recognise that on occasions boards get it wrong and a negative vote generally leads to a modification in pay practices and increases transparency in disclosure. In light of the complexity of remuneration decisions across the market, caution should prevail before mandating a universal formulaic solution.

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Balanced reporting of negative votes

'No' vote distribution

In relation to the distribution of shareholders voting against the remuneration report the table below reveals that the average negative vote in the top 200 companies was 10%, with the smallest negative vote among the top 25 companies. The table below sets out the percentage of those shareholders voting at the 2008 annual general meetings who voted against the remuneration report.

Percentage of 'No' votes cast in 2008 reporting season

	75 th Percentile	Median	25 th Percentile	Average
Top 25	8%	4%	2%	8%
Top 50	9%	4%	2%	11%
Top 100	9%	5%	2%	10%
Top 200	11%	4%	2%	10%
Second 100	14%	4%	2%	10%

'No' vote distribution modified

If we assume that those shareholders who did not exercise their right to vote were either positive or neutral and the negative vote was assessed having regard to the expressed concern of all shareholders, the table below reveals that the average negative vote among all shareholders recorded (though not necessarily voted) in respect of the top 200 companies stood at 5%.

'No' votes in 2008 reporting season – modified.

	75 th Percentile	Median	25 th Percentile	Average
Top 25	3%	2%	1%	4%
Top 50	5%	2%	1%	6%
Top 100	5%	2%	1%	6%
Top 200	6%	2%	1%	5%
Second 100	6%	3%	1%	5%

Observations

In the above context we acknowledge that many significant financial institutions act as nominees for shareholders whose identity is not always directly revealed. Our research does, however, highlight the fact that in the era that sponsored the Government's enquiry into executive remuneration the median negative vote among the top 200 companies stood at 2% of total shareholders and the average 5%.

It would be our judgement in this context that there was not widespread disquiet in the 2008 reporting season, although we readily acknowledge that in a small number of companies shareholders express significant concern in relation to the level of executive remuneration or proposed contractual arrangements, particularly in relation to the issue of shares, options or share rights.

Voting patterns illustrated

In our final illustrations we reveal the percentage of total shares voting on the Remuneration Report compared to the shareholding of the top three shareholders and the percentage of votes against the Remuneration Report compared with the shareholding of the top three shareholders.

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