"Role of No-Voting shareholder activism in corporate governance in a developing Arab country"

AUTHORS	Ali Mohamed Albakoush https://orcid.org/0000-0002-6139-0546 http://www.researcherid.com/rid/F-7050-2019 Zuaini Ishak https://orcid.org/0000-0002-9971-4606
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Ali Mohamed Albakoush (Libya), **Zuaini Ishak** (Malaysia)

ROLE OF NO-VOTING SHAREHOLDER ACTIVISM IN CORPORATE GOVERNANCE IN A DEVELOPING ARAB COUNTRY

Abstract

Because of agency conflict in firms with dispersed ownership, governance mechanisms to mitigate this agency cost, such as shareholders' active monitoring of the firm's management, have been developed. However, shareholder activism is contextual; therefore, the characteristics of shareholder activism in corporate governance practices in Libyan listed companies we explored. The data were collected from the 42 non-financial and 22 financial companies listed in the Libyan stock market during 2007–2016. Data envelopment analysis was done to generate an efficiency score based on corporate governance and shareholder activism. Linear regression analysis was used to determine whether a relationship exists between the efficiency of corporate governance and shareholder activism. All the companies were characterized by joint private-government ownership. The companies had an average corporate governance index of 2.24. Implementation of the Libyan good corporate governance practices is anticipated to give a score ≥ 2.95.

Vote "No" shareholder activism targeting the boards of directors and their committees was the predominant form of shareholder activism (average number of annual events = 3.08) compared to shareholder proposal (average annual events = 1.67) and shareholder negotiation with management (average annual events = 1.6).

Shareholder activism was more frequent in companies with low than with average governance scores compared to those with above-average governance scores. Moreover, the scores of shareholder activism were inversely related to corporate governance scores ($r = -0.766$, $p < 0.01$). Ordinary least-squares regression analysis revealed that a decrease in corporate governance score of one unit was associated with a 57% increase in shareholder activism ($B = -0.57$, $F = 30.64$, $p < 0.01$).

Our study findings indicate that poor corporate governance practices do influence the frequency of shareholder activism in Libyan listed companies. Vote "No" activism is the most frequently used form of shareholder activism. The less frequent use of shareholder proposals and negotiation with management is probably related to legal and sociocultural factors.

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Ali Mohamed Albakoush, Ph.D. student, Tunku Puteri Intan Safinaz School of Accountancy (TISSA-UUM), Utara Malaysia University. Assistant lecturer, Department of Accountancy, Economy faculty, Al-Asmarya university, Libya.

Zuaini Ishak, Associate Professor, Tunku Puteri Intan Safinaz School of Accountancy (TISSA-UUM), Utara Malaysia University, Malaysia.

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INTRODUCTION

Good corporate governance is required to protect stakeholder interests and improve corporate performance. Well governed companies are more likely to attract investors (Charreaux, 2008). Due to the separation of ownership from corporate management, an efficient monitoring system in the form of good corporate governance practices enables shareholders to monitor firm directors. Implementation of corporate governance codes worldwide is consistent with shareholders' right to monitor their business (Chiu, 2008). Shareholder activism increases governance quality and helps to maintain effective corporate govern-

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ance (Aggarwal, Erel, Ferreira, & Matos, 2011; Chung & Zhang, 2011), and large shareholding institutions are likely to engage in beneficial shareholder activism (McCahery, Sautner, & Starks, 2015).

However, most of the existing theoretical arguments and evidence on shareholder activism has been studied in developed countries and only few developing countries (Mahadeo & Soobaroyen, 2016; Ntim, Soobaroyen, & Broad, 2017). In particular, very little information is available on shareholder activism in Arab countries, in which informal relationships and tribal affiliations have a powerful influence on decision making (Denes, Karpoff, & McWilliams, 2016). Several Arab countries have developed appropriate corporate governance mechanisms and adopted more institutional and public governance systems (Al-Bassam, Ntim, Opong, & Downs, 2018). The objective of this paper is to provide insight into the characteristics and determinates of shareholder activism in relation to corporate governance quality in a rich Arab country, Libya. The Libyan Corporate Governance Code 2007, Corporation Law 2010, and the establishment of Libyan Stock Market Law 2010 provide guidance to listed companies for corporate governance practices, corporate general meetings, transparency requirements, and facilitation of shareholder participation. According to Corporation Law 2010 (article 163), the shareholders in general meetings are "exclusively responsible for the appointment of board members and an external auditor and determining their remuneration". Corporation Law 2010 (article 183) empowers shareholders to monitor remuneration. The board must provide a report for the shareholders that includes a full statement of board and executives managers' remuneration and any salaries or other compensation that have been given to them. Corporation Law 2010 (article 167) requires the approval of shareholders at an extraordinary meeting for central transactions such as mergers, divisions, changes of form, and voluntary dissolution of a company. In addition, Libyan Corporate Governance Code 2007 emphasizes that companies must adhere to the best practices of shareholder protection. Shareholders are given the right to monitor management, the right of inquiry, and the right to request information that does not compromize the interests of the company. The Code also encourages representation of minority shareholders on the board. A few studies have described corporate governance practices in Libya (Abdou, 2015; Abdulsaleh, 2014), but no empirical studies have described the characteristics of shareholder activism and its impact on corporate governance practices in Libyan listed companies. In the empirical literature and according to the agency theory, the antecedents of shareholder activism vary by the motivation of the shareholders to improve the performance of the firms (Goranova & Ryan, 2014). This study hypothesized that lower compliance with corporate governance is associated with higher frequency of shareholder activism.

1. LITERATURE REVIEW

Shareholder activism is a term for a multitude of specific actions undertaken by shareholders. Shareholder activism is the way in which shareholders use their rights as the company's owners to influence the board of directors and the management decision process without gaining any control (Goranova & Ryan, 2014; Hendry, Sanderson, Barker, & Roberts, 2007).

From the agency theory perspective, shareholder activism is the involvement of shareholders in monitoring firm operations in order to reduce agency costs. This activity increases governance effectiveness (good corporate governance) and reduces risky management behavior (Obermann & Velte, 2018; Ramly, 2013; Souha & Anis, 2016). Importantly, shareholder activism enables the involvement and engagement of shareholders in firm management.

The main motives of shareholders in exercising their rights is to gain benefit by increasing firm value through better management, which enhances firm performance. Shareholder activism usually targets the financial underperformance of companies and tries to raise shareholder value and to improve strategies, policies and corporate governance policies, as well as replace directors (Boyson & Pichler, 2016; Denes, Karpoff, & McWilliams, 2016; Goranova & Ryan, 2014).

Shareholder activism can produce significant results and mitigate monitoring costs (Bebchuk,

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Brav, & Jiang, 2015; Coffee & Palia, 2014). An example of this is vote "No" activism that rejects the election of a director found to be associated with improvement in a company's performance in order to mitigate the divergence of interests between shareholders and management (Del Guercio, Seery, & Woidtke, 2008).

Shareholder activists can be shareholding institutions, majority shareholders or individual shareholders. Shareholders of large institutions, such as mutual funds and public pension funds, tend to adopt a defensive approach and to focus on protecting their investments and ensuring that the company is running smoothly. Shareholder activism of small shareholder institutions such as private equity tends to adopt offensive strategies (Afza & Nazir, 2015). On the other hand, individual shareholders usually acquire large stakes in target companies in order to gain significant influence on management decisions. Shareholders can also use minority shareholder rights to present proposals and demand meetings to discuss the replacement of board members.

Shareholder activism may be manifested in the form of private discussions, open communication with directors and management, asking questions, press campaigns, public 'naming and shaming', open discussions with other shareholders, media debate, putting forward shareholder resolutions, calling together general meetings, ultimately seeking to replace individual directors or the entire board, and taking legal action. Vote "No" activism has been found to be effective in sending messages about shareholders' priorities and in directing the management to make policy changes to meet the interests of the shareholders.

In the United States, owners frequently negotiate with firm managers and board directors to make changes in management or strategy and submit proposals at a company's annual shareholder meeting about corporate governance issues (Becht, Franks, Mayer, & Rossi, 2010). In Europe, shareholder activism is commonly conducted through private negotiation with management (Becht et al., 2010), with most activism negotiations focusing on governance structure (Becht et al., 2010). But shareholder proposals are uncommon in Europe (Cziraki, Renneboog, & Szilagyi, 2010).

1.1. Theoretical framework

Firms are characterized by separation of ownership from control functions. Firm managers represent corporate owners who delegate some of their decision-making authority to agents. Then, owners have to monitor management and address the conflicts of interest that arise in their relationship (Jensen & Meckling, 1976). Corporate governance is a set of mechanisms that includes contracting, such as in property rights, executive compensation and debt covenants, as well as corrective shareholder engagement that seeks to align the interests of managers and owners (Rose & Sharfman, 2014). The largest shareholders hold a majority portion of voting equity capital, engage in management, and dominate the board. This leads to conflicts of interest between controlling and minority shareholders. Agency theory addresses the relationship between owners and their managers in order to better align their conflicting interests. Shareholder activism are actions that shareholders take to influence corporate practices and policies. However, shareholder activists are not a homogeneous group and may act by different methods (Goranova & Ryan, 2014). The main theoretical foundation of shareholder activism is the agency theory (Goranova & Ryan, 2014). Activism may be financially or socially motivated (Denes et al., 2016; Renneboog & Szilagyi, 2011). In the empirical literature, agency theory supports most antecedents of shareholder activism (Goranova & Ryan, 2014). Also, stakeholder theory is the main theoretical alternative to agency theory when social issues motivate the activism.

2. METHODS

The study hypothesis is that lower compliance with corporate governance is associated with higher frequency of shareholder activism. To test this hypothesis, the collected data were analyzed to generate an efficiency score (based on the Libyan Corporate Governance Practices Code 2007) and a shareholder activism level events score. Then, ordinary least-squares linear regression was used to evaluate the association between shareholder activism and corporate governance efficiency. Finally, a non-parametric test was used to analyze the impact of the corporate governance score on shareholder activism level during ten years.

2.1. Sample

Data on corporate governance and shareholder activism at all 64 Libyan listed companies were hand collected from the Libyan stock market and the databases of shareholder activism events for the years 2007–2016. The data were used to calculate the level of shareholder activism targeting the boards of directors and their committees. On the other hand, to measure the efficiency of corporate governance, we used the Libyan best practices of Corporate Governance Code 2007 and the average of data for firms' corporate governance structure to determine the optimal and acceptable corporate governance efficiency scores.

The firms' corporate governance scores were then classified into three categories: optimal ≥ 2.95, acceptable < 2.95 but > the study sample mean, and low < study sample mean. The number of shareholder activism events was recorded and a score was calculated.

There were 633 observations during study period. The ownership of the 64 firms was classified as governmental (government institution or government companies) or private (private institution or individual). Ownership, firm size, firm age and leverage were considered as control factors. Companies were classified as financial (insurance, banking, investment, and financial services) or non-financial (services, air transport, tourism, agriculture, media, industry, trading, and construction).

2.2. Statistical analysis

IBM-SPSS Statistics version 25 was used. Distribution statistics of shareholder activism scores of financial and non-financial listed companies according to their corporate governance score levels are presented as median and range, and mean and standard deviation (SD). Pearson correlation was used to correlate shareholder activism scores with variable of corporate governance scores and control variables. Ordinary least squares linear regression was used to evaluate the association between shareholder activism and corporate governance efficiency. The assumption of data linearity was tested by the time series test function of SPSS. The equation represents the regression of the original efficiency scores on the corporate governance score:

$$SAE_{it} = \beta_0 + \beta_1 CGE + e_i + u_{it}, \tag{1}$$

where SAE – shareholder activism score, CGE – corporate governance score, β – estimated coefficients, e – error term, u – composite error for the estimation, i – indicating data for the firm and t – time.

3. RESULTS

As shown in Table 1, industrial and tourism companies together formed over half (52%) of the non-financial sector, whereas insurance and banking constituted over three-quarters (77.3%) of the financial sector.

Table 1. Types of the listed companies classified by industries

Non-financial sector			Financial sector		
Type of firm	***n***	**%**	**Type of firm**	***n***	**%**
Industry	14	33.0	Insurance	9	40.9
Tourism	8	19.0	Banking	8	36.4
Construction	6	14.2	Financial investment	5	22.7
Services	5	11.9	–	–	–
Trading	4	10.0	–	–	–
Air transport	3	7.1	–	–	–
Agriculture	1	2.4	–	–	–
Media	1	2.4	–	–	–
All companies	42	100.0	All companies	22	100.0

The ownership of all 64 companies was joint private-government ownership, with the private component on average accounting for 76% (%43± SD) of ownership.

Table 2 shows that there was no difference in firm size between financial and non-financial sectors, but firm age was significantly higher in the financial sector compared to the non-financial sector (24.0 vs 15.5 years, $p < 0.001$) and leverage (0.37 vs 0.24, $p < 0.001$).

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Table 2. Descriptive statistics for the control variables

Company type and characteristics	Median	Minimum	Maximum	Mean	SD
Non-financial					
Firm size	8.00	7.00	11.00	8.23	0.77
Firm age	12.00	1.00	66.00	15.51	12.38
Leverage	0.16	0.00	4.23	0.24	0.32
Financial					
Firm size	8	7	10	8.44	0.71
Firm age	17	11	66	23.95	16.22
Leverage	0.39	0.01	0.79	0.37	0.23

Note: SD: standard deviation.

Table 3. The average annual shareholder activism scores among listed financial and non-financial companies

Forms	Shareholder activism scores				
	Median	Minimum	Maximum	Mean	SD
Non-financial sector					
Vote "No"	3.5	1.25	7	3.56	1
Proposal	2.16	0	4	2.16	0.86
Negotiation	1.74	0	5.25	1.74	0.90
Financial sector					
Vote "No"	2.64	1.98	3	2.60	0.274
Proposal	1.18	0.78	1.5	1.18	0.167
Negotiation	1.5	1	1.83	1.46	0.202

Note: SD: standard deviation.

Three forms of shareholder activism existed in the 64 companies: vote "No", shareholder proposal, and shareholder negotiation with management (Table 3). Overall, all forms of shareholder activism were more frequent in the non-financial companies compared to the financial companies. Vote "No" activism was the most frequent form of shareholder activism among both financial and non-financial Libyan companies.

The optimal Libyan corporate governance index calculated on the basis of the Libyan Governance Code is ≥ 2.95. A governance score above the study mean (2.4) was considered acceptable and a score below the mean was considered low. Table 4 shows that shareholder activism was more frequent in companies with low scores compared to those with optimal or acceptable scores. Moreover, correlation analysis shows that the scores of shareholder activ-

Table 4. Distribution of shareholder activism scores for the listed companies according to their corporate governance score levels

Corporate score level according sector	Shareholder activism scores				
	Median	Minimum	Maximum	Mean	SD
Non-financial sector					
Optimal (n = 40)	2.76	2	3	2.75	0.30
Acceptable (n = 160)	2.90	2.50	3.20	2.87	0.22
Low (n = 213)	2.92	2.60	3.39	2.94	0.21
Financial sector					
Optimal (n = 160)	1.76	1.25	1.88	1.73	0.16
Acceptable (n = 60)	1.79	1.72	1.94	1.80	0.082

Note: Scores: optimal ≥ 2.95, acceptable ≥ 2.4 but < 2.95, low < 2.4. SD: standard deviation.

Table 5. Pearson correlation of shareholder activism scores with scores of corporate governance and control variables

Variables	Corporate governance	Shareholder activism	Ownership structure	Firm size	Firm age
Shareholder activism	–0.766**	–	–	–	–
Ownership structure	–0.228	0.034	–	–	–
Firm size	0.499**	–0.250*	–0.227	–	–
Firm age	0.554**	–0.3*	–0.41**	0.357**	–
Leverage	0.486**	–0.688**	0.07	–0.09	0.097

Note: ** $P < 0.01$, * $p < 0.05$.

Table 6. Ordinary least squares regression analysis of shareholder activism score versus corporate governance efficiency

Variables	*B*	SE	*t*	*p*-value
Constant	4.364	0.531	8.221	0.000
Ownership	–0.078	0.104	–0.748	0.457
Firm size	–0.009	0.069	–0.133	0.894
Firm age	0.003	0.004	0.688	0.494
Leverage	–0.073	0.247	–4.342	0.000
Corporate governance	–0.570	0.106	–5.358	0.000

Note: B: unstandardized regression coefficient beta; SE: standard error for beta; *t*: *t*-value for beta.

ism in the Libyan stock market are inversely related to the scores of corporate governance ($r = -0.766$, $p < 0.01$) (Table 5). In agreement with this, ordinary least-squares regression analysis shows that shareholder activism in Libyan listed companies was negatively related to corporate governance scores. A decrease in corporate governance score of one unit was associated with 57% increase in shareholder activism ($B = -0.57$, $F = 30.64$, $p < 0.01$) (Table 6).

4. DISCUSSION

In 2007, Libya started to reform its economy, privatize its companies, and allow foreign investors to own shares. Since then, shareholder protection has been an important goal of the Libyan regulators, such as the Libyan stock market and the Libyan Ministry of Commerce. The Corporation Law was upgraded by empowering monitoring committees and embedding minority shareholders' rights in the Libyan Governance Code. Such legislative and administrative changes seek to protect shareholder rights and enhance the effectiveness of corporate governance frameworks (Morck, Wolfenzon, & Yeung, 2005). However, to the best of our knowledge, this is the first report to explore the characteristics of shareholder activism in Libya or elsewhere in North Africa.

Three types of shareholder activism were noted among Libyan listed companies: vote "No", shareholder proposal, and shareholder negotiation with management, with vote "No" activism being dominant (Table 3). Shareholder activism was more frequent among non-financial companies and was probably driven by the observed lower scores of corporate governance among the non-financial companies. It has been shown that poor governance activates shareholder activism (Renneboog & Szilagyi, 2011) and shareholder activism is seen more frequently in companies with a poor standard of corporate governance (Renneboog & Szilagyi, 2011; Yermack, 2010). This notion is supported by the inverse relationship between shareholder activism and corporate governance (Table 6).

The observed dominance of vote "No" activism in our study is probably related to the dominance of the institutional shareholder type in the Libyan market. The use of vote "No" in firms' annual meetings is more convenient for institutional investors who are usually more keen to drive changes in corporate governance practices and improve the performance of boards of directors (Kim, Byun, & Lee, 2014). Furthermore, Libyan legal and social norms give shareholders the right to attend the firms' annual meetings and vote on any issue or matter related to the company (R

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article 516, Libyan Commercial Law 1954). The decision-making process in Libya, as well as in other Arab countries, is usually influenced by interpersonal relationships and social connections, which might make shareholder activism by negotiation and shareholder proposals not as acceptable as in the West, or at least relegates it to second place (Amico, 2014; Cziraki et al., 2010). Furthermore, the observed better quality of corporate governance practices among financial companies compared to non-financial companies is probably due to close mentoring and supervision by the governmental and central bank authorities.

5. LIMITATIONS AND FUTURE RESEARCH

The study included only companies that are listed in the Libyan stock market due to the paucity of information about unlisted companies and their operations. Future studies should examine the influence the ownership groups on expropriation of minority shareholder rights. Also, how minority shareholders is concerned about how the management engages with shareholder activism. It is also worthwhile to study the impact of the laws, regulations and management systems on the forms and characteristics of shareholder activism.

CONCLUSION

From the agency theory perspective, shareholder activism mitigates the agency problems arising from the conflict of interests between manages and shareholders. This study examined the role of shareholder activism in corporate governance in an Arabic context, which is different from Western and characterized by hierarchical social structure and weak corporate regulations. The data were collected from the 42 non-financial and 22 financial jointly owned private-governmental companies listed in the Libyan stock market during 2007–2016. Data were enveloped to generate an efficiency score for corporate governance and shareholder activism, and linear regression was used to determine the relationship between corporate governance and shareholder activism. The study found that vote "No" shareholder activism targeting the boards of directors and their committees was the predominant form of shareholder activism. Shareholder activism was more frequent in companies with low governance scores, and lower scores predicted higher shareholder activism. Shareholder activism in Libya responds more frequently to poor corporate practices and does so by vote "No" activism. In view of the cultural importance of interpersonal relationships and social connections, shareholder-management negotiation and shareholder proposal are probably deemed less favorable culturally. Other similar studies in North Africa and the Gulf region are needed to better understand the impact of Arabic culture and legal systems in Arab countries on the practices of shareholder activism. Furthermore, evaluating the impact of vote "No" activism in Libyan listed companies on improving corporate governance practices, corporate performance and firms' market prices is warranted.

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