

Governance of and by Institutional Investors

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The presentation was a full coverage on different aspects of corporate governance of institutional investors. It explained the need of good corporate governance, the relationship of institutional investors and corporate governance, common characteristics of institutional investors and the factors influencing institutional investors' incentives for monitoring. As a result, I am afraid that my comment can only briefly mention specific limited topics, which I would like to add to or emphasize the issues presented. In addition, I would like to briefly explain the example of Korea in the area of exercising voting rights by institutional investors.

The topics that I would like to mention is as follows:

- Institutional Investor Activism
- Evaluation on Effectiveness of Institutional Investors Activism
- The Changing Environment
- Exercising Voting Rights by Institutional Investors in Korea

1. Institutional Investor Activism

- Institutional investors have been exercising control in financial markets not only as investors but also as shareholders.
- Activism by institutional investors as shareholders has been widely disputed.
- Those who favor of institutional investor activism believe that it improves corporate governance because the monitoring benefits all shareholders. They also argue that some types of institutional monitoring provide incentives for managers to focus on the firm's longer-term prospects, which can counteract tendencies toward managerial myopia.
- Others argue that institutional investors should not have a role in corporate governance because some portfolio managers lack the expertise to advise corporate management. Also activism detracts from the primary role of pension funds, which is managing money for the beneficiaries. They would also see dangers of conflicts of interest if they become too heavily involved in running businesses.
- Until recently, institutional investors have shown preference to liquidity then control because in order to exercise control over corporate management, it requires a sacrifice of liquidity.
- Large institutional shareholder may receive benefits from monitoring where concentrated ownership can reduce market liquidity and in effect prohibit the investor to sell their shares. For monitoring to be credible, the large shareholder would need to maintain their investment for a sufficiently long period of time and hold enough shares to relieve the free-rider problem.

2. Evaluation of Effectiveness of Institutional Investors Activism

- It is difficult to determine the activism's consequences and in many cases activism may be conducted through private negotiations and therefore hard to measure its effectiveness.
- There have been some studies on short-term market reactions relevant to the announcement of certain types of activism but there is little evidence of improvement in long-term stock market performance after the activism.
- Many studies conclude that there are changes in the real activities of the firm subsequent to the shareholder pressure, but not enough to establish a causal relationship between shareholder activism and these changes.
- In order to increase the effectiveness of institutional investor activism, the minimum requirement is that the methods of resolving the conflict of interests should be established and be disclosed.
- In cases of institutional investors under the influence of the government, privately owned institutional investors, asset institutional investors managing entrustments of those who are in special relation with the invested companies, and sales agencies are in special relationship with the invested companies.

3. The Changing Environment

- In the near future increased ownership by foreign institutional investors will be an important influence in many economies, especially in the emerging markets.

- Due to increased globalization foreign investors can be expected to continue to have a large influence on some emerging stock markets and the companies.
- This will affect the firms' corporate governance through direct intervention or through indirect supply-demand effects.
- However, this type of intervention might be limited due to the costs to the institutional investor, and limited number of institutional investors who participate in such activities.

4. Exercise of Voting Rights by Institutional Investors in Korea

- To reform corporate governance in Korea, which is mainly influenced by the largest shareholder, and to enhance management transparency, exercise of voting rights by institutional investors that include trust companies and bank trust has been permitted since September 1998.
 - ✓ However, institutional investors' holding of the shares of its own affiliated companies are strictly regulated and institutional investors are not permitted to exercise voting rights of shares of own affiliates.
- The investment trust companies are required to keep and disclose the records of exercise/non-exercise of voting rights by the corporations that subject to disclosure obligation, and the rationale thereof. Furthermore, the details of exercise of voting rights on the matters relating to the change of management rights such as the merger, business transfer/acquisition, appointment/dismissal of officers, and revision of Articles of Incorporation, must be disclosed.

- Rate of exercise of voting rights by Korean investment trust companies and asset management companies was 2.1% in 2000 and 4.5% in 2001, respectively; which is rather low.

- ✓ Main reasons for the low rate of voting right exercise by Korean institutional investors are:
 - They are a short-term investors, thus have no real interest in the improvement of corporate governance, which contribute to the improved profits in the long-term.

 - As the number of shares held is not large enough to influence the corporate management, it is viewed that the return on the time and efforts spent for exercise of voting rights would be negligible, i.e., no incentive to exercise voting right.

- Recently, however, institutional investors like the National Pension Fund have started to recognize the importance of exercising its voting rights.