

## ***Corporate citizenship and the right to vote: A proposal***

**The Institute for governance of public and private organizations**

**Policy paper # 2**

***This policy paper was written by Professor Yvan Allaire, Ph.D., FRSC,  
Chairman of the board of the Institute and was adopted  
by the board of the Institute\*.***

\*Mr. Pierre Bernier, Executive Vice-President of the Autorité des marchés financiers du Québec abstained because of the regulatory role of the Autorité.

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## Introduction

In this age of momentum investors, day traders and hedge funds, the practice of granting transient “investors” the full and immediate rights of **corporate citizenship**, including the right to vote, is questionable and should be questioned.

The democratic equivalent to this practice would consist of granting the right to vote to anyone who happens to be in the country on Election Day (tourists, business travelers, etc.). Every democracy imposes a minimum period of time before a newcomer acquires the full rights of citizenship, particularly the right to vote.

Whereas in 1960, the average holding period for publicly listed company shares in the U.S. was seven years, it shrank to two years by 1992 (Porter, 1992). This holding period is now estimated at some **seven and a half months** for companies listed on the New York Stock Exchange (Odland, 2006). A similar trend is at work in Canada, with the TSX trading volume increasing at 10% a year for the last ten years and some 200 hedge funds with assets under management in excess of \$50 billion.

Though very unorthodox in the North American context, the notion that some time should be required before a shareholder acquires the rights of **corporate citizenship**, including the right to vote, is proposed here for due consideration.

## The case

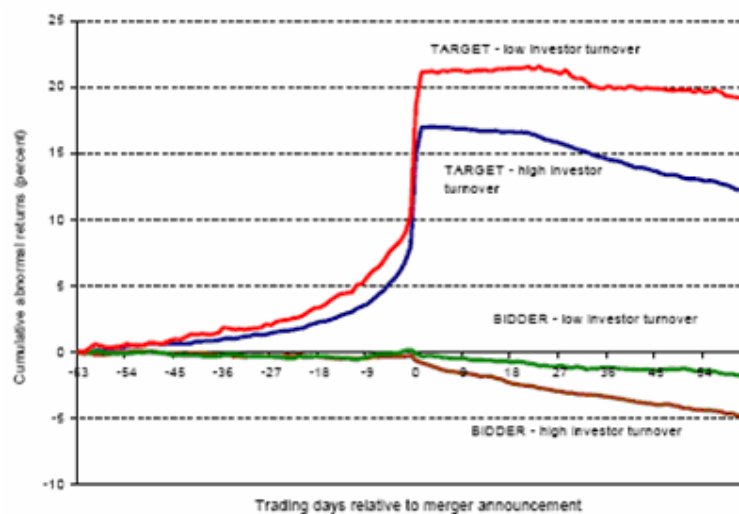
The recent saga surrounding the Falconbridge and Inco takeovers has vividly captured the power of hedge funds, located in Connecticut, to shape to their liking the industrial structure of a country and reap enormous financial riches in the process. Hedge funds, it is estimated, now represent between 30% (Moyer, 2006) and 50% (Campos, 2005) of all transactions on the New York and London Stock Exchanges, an astounding statistic.

Furthermore, it seems that, through derivative techniques and other means, hedge funds and other sophisticated market players are able *to acquire voting privileges in companies without incurring any economic risk*, a practice labeled “**empty voting**” (See Martin and Portnoy, 2004; Hu and Black, 2006). As a result of such strategies, the

frequency of which is unknown and unknowable, hedge funds may, for instance, play a decisive role in takeover situations, generating large profits for themselves without taking all the inherent risks, all this to the possible detriment of the long-term interests of other shareholders.

The practice of granting all the privileges of corporate citizenship immediately upon purchase of a share has two negative, or at the very least, dubious, results.

1. It gives undue influence and power to transient shareholders determined to create short-term value for themselves by all possible means, in particular, by leveraging a short-term stock position to influence the outcome in takeover situations or to provoke such situations. Given a sufficient number of investors with a short-term perspective, these takeovers may be carried out at less than optimal terms for the shareholders of the target company. That is one of the conclusions of a recent study of takeovers by Gaspar, Massa, and Matos (2005). These researchers conclude that short-term investors in a target company *“enhance the likelihood of a takeover and lower its cost. At the same time, short-term shareholders in the bidder give managers more leeway to carry out value-reducing acquisitions. Long-term investors defend management from takeovers (by making bids more expensive) but also prevent overbidding and value-reducing acquisitions.”* (p.163). Their Figure 2, presented here, summarizes their empirical findings. It shows that, on average, the shareholders of target firms received less value and the shareholders of bidding firms lost more value, when short-term investors were a significant presence among the shareholders of the relevant companies.



2. Transient investors induce in managers a short-term perspective attuned to the expectations of these shareholders; for instance, a study by Brian Bushee concludes that "...high levels of transient ownership are associated with an over-weighting of near-term expected earnings....This finding supports the concerns that many corporate managers have about the adverse effects of an ownership *base dominated by short-term focused institutional investors*" (Bushee, (2004).

In another paper, Graham, Harvey, and Rajgopal (2005) report on a survey of some 400 financial executives in the U.S. They found that financial executives would forego positive NPV projects to meet short-term earnings benchmarks. They write: "*In the end, many of our results are disturbing. The majority of CFOs admit to sacrificing long-term economic value to hit a target or to smooth short-term earnings.*" (p.36)

### **Recognizing the value of loyal shareholders**

Should it not be recognized that, based on tenure as shareholders, there are indeed ***different categories of shareholders***? For instance, should we not make a difference among the following types of shareholders?

<b><u>Category</u></b>	<b><u>Shareholders for:</u></b>
I	Less than a year
II	More than a year but less than five (5) years
III	More than five (5) years

As new types of "investors" muscle in on the financial markets with strategies and tactics that may not be in the best long-term interest of other shareholders, different rights could be associated with long-term ownership of shares.

Already, French companies often grant "loyalty premium" dividends (usually + 10%) to shareholders who hold their shares for more than two years. Shareholders also enjoy reduced rates of taxation on capital gains as a function of the length of their share ownership (the lowest rate achieved after a seven-year holding period). In some cases, different voting rights are associated with different categories of shareholders.

Unfettered trading in the control of companies, as if they were a commodity, a metal, or a piece of commercial real estate, may be the goal of some players in the financial markets; but the aggressive pursuit of that goal may bring about government policies and popular attitudes far less beneficial to reasonable investors. Concentration of economic power in the hands of the few, be they hedge funds, private equity funds, or a small cohesive economic elite, always raises issues of economic efficiency and social equity.

The recent wave of corporate scandals has placed corporate executives and boards of directors in the cross hairs of public opinion. However, the tactics of some new wave “investors” and the relentless efforts to “commoditize” industrial firms may bring the investor community under closer scrutiny. The concept of shareholders as the only and ultimate stakeholder of publicly traded companies received a rare level of support during the 1990’s. It is increasingly coming under attack, as the corporate social responsibility movement recovers some of its luster lost in the euphoric 90’s.

The movement, in its most reasonable variant, will argue forcefully that a company is not just a piece of property, but a social system with an economic finality, that boards of directors do have a fiduciary responsibility to shareholders, **but they also have a moral responsibility to other stakeholders**. Society at large may claim that it has a stake in companies operating in its midst, a stake just as important as that of shareholders (See, for one example of a burgeoning literature, Brennan, 2005).

### **The enhancement of shareholder loyalty**

Long-term, buy-and-hold, investors have rights that should be protected against the chicanery of management and the self-serving behaviour of a controlling shareholder. In a context where new financial players intend to change the rules of the game to their advantage, long-term investors must also be concerned with the behaviour of these fellow shareholders. Driven by different motives and esoteric strategies, these new types of “shareholders” may have interests and goals that are detrimental to the long-term welfare of the company and its shareholders.

In a financial world where one third to one half of all stock transactions are carried out by so called “hedge funds” with their “innovative”, opaque, strategies and tactics, new issues come to the fore. Confronted by these changed market circumstances, rather than further increase the power of transient, fickle, even malevolent, shareholders, should we not propose measures that favour long-term shareholding and instil loyalty and commitment to the long-run goals of the corporation?

## **Recommendation**

**It is time to impose a minimum period (say one year) before a shareholder can exercise its voting rights.**

Perhaps “loyal” shareholders could also acquire other rights and privileges for holding shares for a stated period of time, as described earlier (e.g. increased voting power, different taxation rates on capital gains, different levels of dividends). Such radical changes require a careful examination of many aspects: legal, logistics, fiscal impact, liquidity, etc. At this time, the concept of other rights and privileges, which could be granted to loyal shareholders, is put forward for further discussion and debate. ***But the proposal of a one-year holding period before acquiring the right to vote is actionable now!***

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## Board Members Biographies

**Professor Yvan Allaire** is **Chairman of the Board of the Institute for Governance of Private and Public Organizations (HEC-Concordia)**; Professor emeritus of strategy, UQÀM; and adjunct Professor, HEC. He is a Fellow of the Royal Society of Canada. Professor Allaire is a Member of the board, Caisse de dépôt et placements du Québec; chairman of its governance and ethics committee and member of the risk management committee; he is member of the National Committee for Canada of The Aga Khan Foundation, member of the board, Le Conseil des relations internationales de Montréal (CORIM). He has also been a member of the Board of several publicly listed and not-for-profit organizations including CGI Group, Bombardier, Fondation Chagnon and CRSH. Dr. Allaire is Senior Fellow, C.D. Howe Institute; member of Advisory Committee, Controller General of Canada; Chair of the Quebec Government working group on the modernization of governance for State-owned Corporations. Dr. Allaire was a founding partner, and was chairman (until 1994), of the Secor Group, a Canadian strategy consulting firm; he was Executive Vice-President of Bombardier Inc. from 1996-2001. Professor Allaire is the author of several books and many articles on strategy and governance. He holds a B.Sc. Com. (Summa cum laude) and an MBA from the Université de Sherbrooke, and a PhD from the Sloan School of Management, MIT. Professor Allaire received in 1997 a doctorate *honoris causa* from the Academy of Economic Sciences of Bucharest. In 2001, he was chosen as one of 12 "High Performers" by the Revue *Commerce* and received the "Award of Distinction" from the John Molson School of Business (Concordia University).

**Mr. Pierre Bernier**: A graduate of the Université de Sherbrooke with a degree in commerce, Pierre Bernier joined the management team of the *Autorité des marchés financiers* as **Executive Vice-President** in August 2005, with primary responsibility for operations management and shared services. A specialist in finance, Mr. Bernier has over 14 years of senior management experience in operations management, finance and corporate services. From 2004 until the summer of 2005, Pierre Bernier was employed by Airborne Entertainment, as Vice-President, Finance and Chief Financial Officer (CFO). From 2001 to 2003, he had similar responsibilities, in addition to administrative services, while working at Bell Actimedia, which subsequently became the Yellow Pages Group. From 1992 to 2001, he held various management positions at Bell Canada.

**Mr. André Caillé** was the President and Chief Executive Officer of **Hydro-Québec** from 1996 up until recently. After obtaining his Ph.D. in physical chemistry from the Université de Montréal in 1968, he became a professor and coordinator at the Institut national de la recherche scientifique where he stayed until 1974. He then worked in the environmental sector and served as the Quebec Deputy Minister of the Environment until 1982. That year, he began working for Gaz Métropolitain where he held the position of President and CEO from 1987 to 1996. In November of 2001, the Institut d'administration publique du Québec honoured him with the Pierre Decelles Award in recognition of his excellence as a manager and his influence on Quebec public administration. In 2003, Mr. Caillé became the Chancellor of the Université de Montréal, which had previously awarded him an honorary degree in May of 2002. Mr. Caillé sits on the boards of various organizations.



**Ms. Hélène Desmarais is Chairman and Chief Executive Officer of the Montreal Enterprises and Innovation Centre (CEIM).** She holds a Bachelor of Business Administration degree from the École des Hautes Études Commerciales (HEC) in Montreal. She founded the CEIM in 1996; since then, 225 businesses have been started by the CEIM with a survival rate of 85%. It is now the largest incubator in Canada. Ms. Desmarais also serves as Chairman of the Board of the School of the HEC Montreal (since 2003); Chairman of the Board and of the Executive Committee of the Société de développement économique Ville-Marie (since 1998); Chairman of the Board of the Société d'Investissement Jeunesse (since 2001), Deputy Chairman of the Board of Directors of the Orchestre Symphonique de Montréal (since 2004) and Vice-President of HEC's International Advisory Board (since 1990). She is Vice-President of the Board of Directors and member of the Executive Committee of the Board of Trade of Metropolitan Montreal. In addition she is a member of the Board of directors of The Montreal Economic Institute; of The Institute for Governance of Private and Public Organizations; of l'Institut de recherches cliniques de Montréal; C.D. Howe Institute; of Génome Québec; of VAL-CHUM, L.P. (commercialization activities – technology evaluation); de la Société de développement Angus and of the Institute of Design Montreal. Mrs. Desmarais is a member of the Advisory Board of the Biotechnology Research Institute of the National Research Council of Canada. She is a member of the Investment Committee Hydro-Quebec Capitech - Innovation Fund. She is also a member of the Board of Governors and President of the Steering Committee of the Conference de Montreal (since 1995).

**Mr. Stephen A. Jarislowsky** was born in Berlin, Germany in September 1925. He attended public and high school in the Netherlands and France and then immigrated to the United States in 1941. He attended preparatory school in Asheville, North Carolina, studied mechanical engineering at Cornell University and then served in the US Army. He finished basic training and studied Japanese at the University of Chicago prior to serving in Counter-Intelligence in Japan after the War. On return to the United States in 1946, he returned to the University of Chicago, graduating with an MA and Phi Beta Kappa Honours. He followed this with MBA studies at Harvard Business School, graduating in 1949. He worked three years with Alcan Aluminium in Montreal and briefly returned to the United States prior to starting **Jarislowsky, Fraser Limited** in June of 1955 in Montreal. Now **Chairman and Chief Executive Officer and former president** of the firm, for 50 years he has directed the growth of the company to become one of the largest and most successful investment management firms in Canada. Mr. Jarislowsky has been active in other corporations, participated in educational, cultural and charitable activities of many kinds, has endowed fourteen University Chairs and contributes frequently to television, radio, magazines and newspapers. His hobbies are his family, gardening, tennis, walking, good wines, art and literature. He is a recipient of the Order of Canada, L'Ordre National du Québec, Honorary LL.D from Queens, University of Alberta, Université de Montréal, McMaster University, Concordia University, Assumption University as well as from L'Université Laval.

**Mr. Réal Labelle, CA,** is a member of the Board of Directors of the Institute for Governance of Private and Public Organizations and **holder of the Chair in Governance and Forensic Accounting of HEC Montréal.** He is a full professor at HEC Montréal and a regular guest professor at other universities such as Paris-Dauphine, Grenoble and Geneva. He is a past president of the Canadian Academic Accounting Association and sits on the Board of Directors of the Association francophone de comptabilité. His work focuses on the contractual role of perilegal governance standards, on their harmonization on an international level and on forensic accounting as a method for analyzing, preventing, detecting and resolving legal disputes and economic crimes that governance processes are unable to prevent. Mr. Labelle oversees a research alliance funded by the Social Sciences and Humanities Research Council of Canada and which deals with these topics ([www.hec.ca/cgj/](http://www.hec.ca/cgj/)). This alliance brings together Canadian and European research fellows as well as partners from the business community. He participated in the academic training of over twenty Master's and Ph.D. students, either as a research director or otherwise. He has written or co-authored several chapters of books as well as articles that were published in *Contemporary Accounting Research*, the *Canadian Journal of Administrative Sciences*, the *European Accounting Review*, *Finance-Contrôle-Stratégie* and the *Journal of Accounting Case Research*, among others. Mr. Labelle has made over

fifty scientific presentations in Canada as well as in fifteen other countries. He has received several academic awards and has been invited to write reports and to testify as a public accountant in various cases. Before becoming a professor, he held several positions at the Canadian Chamber of Commerce, the *Canadian Business* magazine, Bell Canada and Touche Ross.

**Mr. Claude Lamoureux :** As head of the Ontario Teachers' Pension Plan, Claude Lamoureux is responsible for overseeing the investment of the plan's assets and the administration of the pensions of 264,000 current and retired teachers in Ontario. Mr. Lamoureux joined Teachers' in 1990 after the province established an independent corporation to manage the pension plan. Today, Teachers' is recognized for its good service to members and its innovative investment program. Before joining Teachers', Mr. Lamoureux spent 25 years as a financial executive with Metropolitan Life in Canada and the U.S., rising through the ranks to head the company's operations in Canada. Mr. Lamoureux serves on the boards of directors of Domtar, the OSC Investor Education Fund, and The Canadian Institute for Advanced Research and the Canadian Institute of Chartered Accountants. He is a co-founder and avid supporter of the Canadian Coalition for Good Governance, and chair of the coalition's Public Policy Subcommittee. As well, Mr. Lamoureux is chair of the Accounting and Auditing Practices Committee of the International Corporate Governance Network; chair of the Nominating Committee of the Public Sector Pension Investment Board; and a member of the International Pensions Conference. Mr. Lamoureux holds a BA from the University of Montreal and a B.Comm. (actuarial science) from Laval University. He is a Fellow of the Canadian Institute of Actuaries, the Society of Actuaries and the Institute of Corporate Directors.

**Dr. Monique Lefebvre** is currently working as a **psychologist specialized in executive coaching, a strategic management consultant** for technology-based companies and a corporate director. She serves on the board of directors of a number of public and private companies, of which Transcontinental Inc., Desjardins Financial Security and Pecunia. She has extensive experience in chairing or participating in Executive, Compensation, Benefits and Governance committees of boards of directors. During the past 25 years, she was successively Dean of Graduate Studies and Research, and then Academic Vice-Principal at the Université du Québec à Montréal; President and Chief Executive Officer of the Centre de Recherche Informatique de Montréal; President of Quebecor Multimédia; President of Innovatech of the Greater Montreal Area; Vice President, Quebec and Atlantic Canada, for Ericsson Canada; and Chairperson of the Transition Committee for the new City of Montreal. She is a member of the INNOV Program for technological transfer of the Natural Sciences and Engineering Research Council of Canada (NSERC) and of the Board of Trustees of the Canadian Foundation for Innovation (CFI). She chairs the Board of Héma-Québec Foundation. Dr. Lefebvre earned her Ph.D. in 1973 from University of Montréal in cognitive psychology, an area in which she published extensively and supervised the research projects of numerous graduate students.

**Mr. Andrew Molson:** A lawyer by training, Andrew Molson joined NATIONAL's **financial communications and investor relations group** in 1997. One of his more significant mandates involved acting as Director of Communications of the Montreal Exchange during the restructuring of the Canadian stock exchanges in 1999, where he handled all media relations and eventually acted as corporate secretary during the demutualization of the exchange. Andrew became a member of the Quebec Bar in 1994 after studying law at Laval University. He also holds a bachelor of arts degree from Princeton University and masters in corporate governance and ethics from University of London (Birkbeck College). In 2003 he was elected Fellow and Professional Administrator of the Institute of Chartered Secretaries and Administrators. Fully bilingual, Andrew is very active in the Montreal community, serving on several non-profit boards, including the McCord Museum, the Ste-Justine Hospital Foundation and Concordia University. He is also a member of the Board of Directors of Molson Coors Brewing Company and the Institute for Governance of Private and Public Organizations.

**Mr Michel Nadeau** is the **Executive Director of the Institute for Governance of Private and Public Organizations**. After having worked as an editorial writer and manager of the financial pages at *Le Devoir* from 1974 to 1984, he held several top management positions at the Caisse de dépôt et placement du Québec for nearly 20 years. Among others, he was president of CDP Capital, the company that held over \$100 billion in assets. For many years, he sat on the Committee of Corporate Governance of the Pension Investment Association of Canada (PIAC). He is currently a board member of various private companies and non-profit organizations.

**Mr. Robert Parizeau** : Today **Chairman of the boards of Gaz Métro and Aon Parizeau Inc**, Mr. Parizeau is also a Director of National Bank Life Insurance Company, the Canam Group, Power Corporation, SCOR Reinsurance Company of Canada and Van Houtte Inc. He is also a member of the Board of the Musée national des beaux-arts du Québec and of the Lionel-Groulx Foundation. Until the sale of Sodarcan to the Aon Group in the summer of 1997, Mr. Parizeau served as its General Manager from 1971 to 1978 and as President and Chief Executive Officer from 1978 to 1997. Mr. Parizeau is the recipient of numerous awards, including the *Bâtisseur* of *Revue Commerce*, the HEC Graduate Award in 1995, the Award of Merit of the Graduates of the University of Montreal in 2003, and an honorary doctorate degree in 2004. He was also selected Director of the Year 2004 for Québec (Korn/Ferry–*Revue Commerce* Award) in the category of Excellence in Corporate Governance. In June 2006, he received the Fellowship Award of the Institute of Corporate Directors.

**Ms. Guylaine Saucier** obtained a B.Comm. from École des hautes études commerciales, University of Montreal and Fellow of the Institute of Chartered Accountants. She was the President and CEO of Le Groupe Gérard Saucier Ltée, a major company specializing in forest products. She is a **Corporate Director** and was recently Chair of the Joint Committee on Corporate Governance (CICA, CDNX, TSX). She sits on Boards of several major corporations, including Petro-Canada, Axa Assurance Inc., Bank of Montreal, CHC Helicopter Corp., Altran Technologies and Groupe Areva. In the past, she was Chair of the Board of directors of CBC/Radio-Canada. Mme Saucier was the first woman to be appointed President of the Quebec Chamber of Commerce. She became a Member of the Order of Canada in 1989 and Fellow of the Institute of Corporate Director in 2004.

**Dr. Jerry Tomberlin** is the **Dean and Professor at the John Molson school of Business**. He has been a Concordia University faculty member since 1984. He graduated with a Ph.D. in statistics from Harvard University in 1982. He has taught at Baruch College of the City University of New York and at the University of Southampton in England. In addition, he has worked as a survey methodologist for Statistics Canada and as a Research Associate for Analysis and Inference, Inc., a small consulting firm in Boston, Mass. He has also consulted with a number of major corporations and other organizations, including the Royal Bank, General Motors, NASA, Statistics Canada, and Le Bureau de la statistique du Québec. Research: His principal research interests are statistical applications in casualty actuarial science, statistical issues in cases of employment discrimination, statistics and the law, the design and analysis of sample surveys, and applications of empirical Bayes estimation techniques. He has co-authored articles appearing in the journal of the American Statistical Association, the Canadian Journal of Statistics, the Journal of Business and Economic Statistics, the Journal of Risk and Insurance, the Canadian Journal of Administrative Science, Survey Methodology, Sociological Methods and Research, the American Journal of Botany, and Public Health Reports.

**Mr. J. Sebastian van Berkomp**, B.Comm., commenced his investment management career at Bell Canada pension fund in 1971. Early in 1979, he became a partner of LRM Investment Management Limited and late in 1984, one of the founding partners of Montrusco Associates Inc. where he was appointed Vice-President and Director. In April 1991, he founded **Van Berkomp and Associates Inc. (“VBA”)** a specialized small-cap investment management company. Mr. van Berkomp is currently a member of the Montreal Society of Financial Analysts, the Acorn Society, the Cercle finance et placement du Québec and he is on the

Securities Review Board of the Canadian Shareowner Association. In 2003, he endowed the Van Berkom Chair in Small-Cap Equities at the John Molson School of Business at Concordia University. In September 2005, Mr. van Berkom was appointed member of the Board of Directors of the Institute for Governance of Private and Public Organizations.