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SHAREHOLDERS INTEREST

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Abstract

The purpose of the scientific paper is to analyze the benefits of well-managed companies and the role of shareholders' participation in the control of the company as well as shareholders' relations with the board of directors, which is considered as one of the major factors of such a control.

This work, first of all, deals specifically with the importance of composition of the board of directors for the shareholders interest. The relationship between shareholders and the board of directors and how shareholders indirectly take part in control of a company were analyzed in this paper. Dismissal options and changes of the Board of Directors by shareholders in different countries of the world are also considered.

Every member of the company wants their company to be well managed, because it can ease manager-shareholder conflicts and safeguard not only shareholders interests but also non-shareholders interests.

The author emphasizes that the activity of a shareholder is not a privilege. First of all, a shareholder must act responsibly. When a shareholder invests in a company, he owns a part of that company and becomes responsible for the progress of the company. The author concludes that the creation of the composition of the board of directors, the right to appoint and remove directors are preconditions to maintain a balance between management powers and shareholders interests in a company.

Key words: the board of directors, shareholders, shareholders interest, corporation, the General Meeting.

Introduction

The two main organs of human agencies through which a company can operate are the shareholders acting together in a general meeting and the board of directors. At this point directors have essential role, as they are the only group which in a position to ensure that the company is managed for their own benefit. Besides, the only group who has the opportunity to control the directors are the members of the company. As a result, relationship between shareholders and directors is significantly important in governance of company. The Governance analysis must serve as a means to organize, structure and to establish an efficient prioritization of interests (French 2013, pp. 3-5).

This work first of all, deals specifically with the importance of composition of the board of directors for the shareholders interest, followed by appointment and dismissal strategy which clarifies how shareholders indirectly take part in control of company. In the last part is given last trusteeship strategy-independent directors.

The purpose of the paper is to analyze advantages of well managed company, how shareholders take part in control of company and their relationship with directors as one of the most important point in such control.

1. Composition of board

Actually, early companies legislation did not require companies to have directors, but it was assumed that they would have them. In Ferguson v Wilson (1866) LR2 Ch App77, Cairns LJ case court held that: "The company itself cannot act in its own person...it can only act through directors".

The governance law of public and private corporations is almost the same in all jurisdictions. It reserves certain type of essential decision-making to the general shareholders meeting, at the same time assigning more decision -making power to one or two-tier boards of directors.

The board of directors is crucial in a corporate governance system as it is representative of the interests of a corporation, and is at the same time responsible for looking after shareholders' interests in the corporation's performance, the generation of profits for the corporation and the realization of dividends. Put succinctly, the board of directors is a platform upon which the powers of those who own the corporation or shareholders as we understand them to be, are balanced against the management who runs the corporation.

Generally, all boards irrespective of their individual board structures serve as the link between corporations and their shareholders. Hence, they have a common legally mandated function to ensure compliance with the law governing corporations and periodical financial reporting.

The oversight of management can be undertaken by either one or two-tier boards, and it is these differences in board structures which are occasionally linked to board performance and efficiencies in the different jurisdictions, where either the one or two-tier board is prevalent. In reviewing the board structures for their shortcomings, one should consider the structural weaknesses that arise from the mere fact of a board structure per se, such board structure being either a one or two tier board structure. The one-tier and two-tier board structures are the two main forms of board structures that have developed in different countries (Kraakman 2009, p. 56).

The one-tier board structure jurisdictions are in countries such as the United States (further – US) and the United Kingdom (further – UK), and in Japan, Singapore, amongst others. It has come to be known also as the Anglo-American board structure. It is characterized by a single board comprising of both executive directors and non-executive directors, all of whom are in the usual course nominated and appointed by shareholders. Besides, a company may by ordinary resolution at a meeting remove a director before the expiration of his period of office, notwithstanding anything in any agreement between it and him (United Kingdom Company Act 2006). In single-tier one board exercises the legal power to supervise and manage a corporation. In the UK and USA, the non-executive directors of a company participate in regular board meetings equally with the executive directors, though they meet separately in the remuneration and audit committees from which executive directors are normally excluded. A main advantage of this board structure can be said to be the non-reliance of the non-executive directors on the executive directors for information which they have direct access to, as a result of being on one board. While in law the company is primarily accountable to its shareholders, and the relationship between the company and its shareholders is also the main focus of the UK Corporate Governance Code, companies are encouraged to recognize the contribution made by other providers of capital and to confirm the board's interest in listening to the views of such providers. Essential to the effective functioning of any board is dialogue which is both constructive and challenging (United Kingdom Corporate Governance Code).

In one -tier board for instance in Singapore, the accountability of the board of directors and the effectiveness of the board is reliant to some extent on the degree of independence of the board of directors. The Singapore Code of Corporate Governance

("Singapore Code") demands a strong and independent element on the Board, which is able to exercise objective judgment on corporate affairs independently, in particular, from Management and 10% shareholders. Singapore Code specifies that independent directors should constitute at least one-third of the board. The Singapore Code defines an independent director as one who has no relationship with the company, its related companies and the officers of these companies, which may interfere with the exercise of the independent director's business judgment. The interesting feature of Singapore Code is that it clearly states the separation of the Chairman and CEO. According to the Code it should in principle be separate persons, in order to ensure an appropriate balance of power, increased accountability and greater capacity of the Board for independent decision making. Moreover, companies should ensure that shareholders have the opportunity to participate effectively in and vote at general meetings of shareholders. Shareholders should be informed of the rules, including voting procedures that govern general meetings of shareholders. The Board should establish and maintain regular dialogue with shareholders, to gather views or inputs, and address shareholders' concerns (Singapore Code of Corporate Governance).

The weak point of the one-tier board structure is the common practice of combining the positions of both the chief executive officer and the chairman. The danger then is that the standard of corporate governance hinges too much on one individual, in this instance, the chairman. Too much concentrated power in the hands of any one executive will act to constrain the monitoring powers of the non-executive independent directors and the representation of the interests of shareholders.

In contrast, with one-tier board the two-tier board structure, which exists in China, Germany, Netherland comprises of both a supervisory board and of an executive board of management. The strict separation between the monitoring function of the supervisory board and the management function of the executive board has often been said to be the main advantage that accompanies this board structure, and members of one board cannot be members of the other. Essentially, the supervisory board of a corporation oversees the executive board to ensure that proper systems have been put in place by the executive board in running the corporation. In most cases, as in Germany, the supervisory board *(Aufischtsrat)* appoints members of the executive board *(Vorstand),* and the members of the supervisory board are formally appointed by the shareholders' meeting. Furthermore, the supervisory boards in certain countries such as Germany and China may have a fair amount of employee representation as employees are voted into the supervisory board by fellow employees rather than by shareholders. In enterprises having more than 500 or 2000 employees in Germany, employees are also represented in the Supervisory Board, which then is composed of employee representatives to one third or to one half respectively(Davies 2001).

In Finland, limited company must have board of director. If the company's share capital is more than 80.000 Euro, then it is obliged to also to have a managing director. These large companies are also entitled to have a supervisory board which is located hierarchically somewhere between the general meeting and the board of directors (http:// www.finlex.fi/fi/laki/kaannokset).

In Azerbaijan Joint stock companies having more than 50 shareholders are required to be organized under a two-tier system, where the management board is appointed by the general shareholders meeting unless the company's by-laws grant this authority to the supervisory board. Under the Civil Code of Azerbaijan 1999- General meeting of participant shall be the supreme superior body of a limited liability company. In a company, where there is one participant only, authorities of the General Meeting shall be executed by the participant. In cases specified in the Charter of the Company, board of directors (or supervisory board) and (or) auditing board (auditor) of the Company can be established. In a

limited liability company an executive body (collective and (or) single person [unilateral]) shall be established, which shall deal with current management of the activities of the limited liability company and be accountable to the general meeting of the participants shall be established. Unilateral executive body [an executive body consisting of a single person] may also be elected from persons other than participants of the company (Civil Code of Azerbaijan 2000, art 91).

The two-tier board structure has weak point as well. It is that independent directors have the task of monitoring their colleagues who exercise management powers. The notional idea of being on the same board, despite the accompanying advantage of facilitation of information transfer between board members, unfortunately brings about the greater dilemma of monitoring your colleagues whilst working with them. It may not be easy to exercise this monitoring function effectively in practice.

Besides these types of boards there are also hybrids. Certain jurisdictions such as Japan may offer corporations the option of choosing either board structure. The Japanese Commercial Code ("Japanese Code') was amended in 2001 to strengthen the supervisory powers of the statutory auditors over directors, in ensuring that the directors act in the interests of the relevant corporation. It was further amended in 2002 to allow corporations the option of either continuing with a separate board of statutory auditors or of adopting the Anglo-American board structure with independent directors, board committees and executive officers who are in charge of daily business operations of the corporation. This can be considered to be an enabling approach which allows corporations to elect the board structure which best suits their particular corporate governance needs and circumstances. In Japan in order to contribute to sustainable growth and the increase of corporate value over the mid- to long-term, companies should engage in constructive dialogue with shareholders even outside the general shareholder meeting. (Japan's Corporate Governance Code 2015).

2. Appointment and the power to remove directors

In all main jurisdictions except US allow shareholders to nominate directors. Generally the board proposes the company's slate of nominees. In UK The Company Act 2006 does not define who is responsible for appointing the directors but it requires the first directors to be appointed by statement signed by, or behalf of the subscribes of memorandum. Moreover, provisions for appointment should be made in a company's articles. In case of absence of that kind of provision directors are to be made by the members.

According to the case law of UK in the condition if there is no any provision about the appointment of directors then it gives right to the members of company to appoint and dismiss directors. Besides, it is inherent power of members to appoint directors in case for some reason article of association is silent.

The model articles of association in SI 2008/3229 give the power to appoint directors both to the members and existing directors. It says that:

17. (1) Any person who is willing to act as a director, and is permitted by law to do so, may be appointed to be a director

(a) by ordinary resolution, or

(b) by a decision of the directors (The Model Articles of Company's 2009)

In public companies, an appointment by directors lasts only until the next annual general meeting, at which the co-opted director may offer him or herself for reappointment by the members.

The model articles for a private company provide that as a result of death, the company has no shareholders and no directors, the personal representatives of the last shareholders to have died have the right to appoint a director.

In Germany the members of the Supervisory Board are elected by the shareholders at the General Meeting and any shareholder can add her own candidates up to two weeks before the meeting. But the Supervisory Board appoints and dismisses the members of the Management Board (German Corporate Governance Code 2002).

Japan Company act provides that "at a Company with Board of Directors, only shareholders having consecutively for the preceding six months or more (or, in cases where shorter period is prescribed in the articles of incorporation, such period or more) not less than one hundredth (1/100) (or, in cases where lesser proportion is prescribed in the articles of incorporation, such proportion) of the votes of all shareholders or not less than three hundred (or, in cases where lesser number is prescribed in the articles of incorporation, such number of) votes of all shareholders may demand the directors that the directors include certain matters in the purpose of the shareholders meeting. As a result a qualified minority (1% of votes or 300 votes) may propose its own slate of candidates".

Canada Corporation Business Act provides that "shareholders of a corporation shall, by ordinary resolution at the first meeting of shareholders and at each succeeding annual meeting, at which an election of directors is required, elect directors to hold office for a term expiring not later than the close of the third annual meeting of shareholders following the election".

Under CBCA s 137 a registered holder or beneficial owner of shares that are entitled to be voted at an annual meeting of shareholders may

- (*a*) submit to the corporation notice of any matter that the person proposes to raise at the meeting (a "proposal"); and
- (*b*) discuss at the meeting any matter in respect of which the person would have been entitled to submit a proposal (Canada Business Corporations 1985).

This means a broad group of people who sit behind investment dealers or other intermediaries in the investment chain are now enfranchised.

In comparison, Continental Europe models in US shareholders do not have too much power to appoint and remove directors. In certain situations, election of director proposals may be excluded by the board from the company's proxy. Insurgent stockholders are thus obliged to solicit proxies themselves. This, however, is prohibitively costly for them.

Under the "Froessel rule" incumbents are almost systematically reimbursed for their expenses, win or lose, whereas insurgents have to win in order to be reimbursed. The problem is made even worse by the collective-action problem shareholders face.

To propose an alternative candidate at the yearly elections is extremely important, since mere abstention or a vote against a proposed candidate will not be sufficient to prevent her election. Indeed, in the absence of a different provision in the charter or the bylaws, directors are elected not by majority but by plurality. In the words of Joseph Grundfest, this means that if "a million shares count as a quorum, and if 999,999 ballots strike your name out and say no, you, as the director, owning only one share, and you vote for yourself, congratulations, you win. You have the plurality". Insurgent stockholders must therefore be prepared to bear the costs of the proxy contest.

The big difference, however, is not in the annual election of the board. The main difference is the degree to which it is possible to remove directors without cause outside the takeover context. The biggest stick for a board that does not act according to the stockholders' wishes is the power to remove the board without cause. Therefore, it is important to know how broad this power is.

At common law, directors could be removed only for cause. As James Cox and Thomas Hazen note, director who is serving the corporation faithfully is privileged to continue in office until the end of the term despite the opposition of a majority of the shareholders.

Today Delaware law provides that outside the election at the end of directors' terms, shareholders can remove members of a staggered board only for cause. Even at the time of the election, shareholders' possibilities of replacing directors are seriously limited because only one third of the directors are up for re-election. Indeed, boards are staggered in the majority of corporations.

Furthermore, Delaware law is liberal in allowing takeover defenses. Unocal Corp. Mesa Petroleum Co. set out the general rule that such defenses must pass a two-prong test. First, the board must have had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" (Cools 2005).

Second, the measure "must be reasonable in relation to the threat posed". In Paramount v. Time it was held that such a threat can even consist of the possibility that shareholders elect to tender their stock to the bidder "in ignorance or a mistaken belief", which led some commentators to conclude that the board could "just say no" to acquisition attempts. It is only when the company is put up for sale or breakup – in "Revlon mode" – that courts apply more stringent standards.

In Continental European countries the law seldom provides such strong entrenchment opportunities against hostile takeovers as in the United States. Directors can generally be removed from office at will (ad nutum), which means at any time, at the mere discretion of the majority of the shareholders. Combined with strong shareholder agenda-setting rights, this means that in most Continental European countries, a shareholder or group of shareholders can convene a meeting and then dismiss all directors by a mere majority vote.

In France, the shareholders' assembly can revoke and replace directors or members of the "conseil de surveillance" even if that issue was not on the agenda. This situation implies that a board that wants to lock in its seats must be able to rely continuously on the trust of a majority stockholder. To formulate it the other way around, only a majority shareholder can be sure that the appointed directors will not be removed the next day. As a result, of all possible board compositions, only that approved by the majority shareholder will produce a stable board.

In UK under the CA 2006, a company may by ordinary resolution remove a director before the expiration of the director's period of office, notwithstanding anything in any agreement between the company and the director. Special notice is required of a resolution to remove a director under the section 168(1) or to appoint somebody instead of a director so removed at the meeting at which he is removed.

The German default rule allows three-quarters of voting shares to remove directors mid-term without cause. Shareholders in German companies have more strong appointment rights (for the supervisory board seat), but can only oust directors from lengthy terms by means of supermajority vote.

In Japan, directors may be dismissed at any time by resolution of a shareholders meeting by simple majority and without cause.

In Finland under the Limited Liability Company Act –"A proposal that has been supported by more than half the votes cast shall constitute the decision of the General Meeting. In an election, the person receiving the most votes shall have been elected. The General Meeting may decide before the election that the person receiving more than half the votes cast shall have been elected. In the event of a tie, an election shall be decided by drawing lots and another vote shall be decided by the casting vote of the chairperson, unless it is otherwise provided in the Articles of Association. The requirement of majority may be relaxed by way of the Articles of Association only as regards elections". The members of the board of directors may be dismissed by the body who appointed them, in normal cases the general meeting is entitled to decide the dismissal of the board of directors.

Summary and concluding remarks

Consequently, everyone connected with a company, whether as a member, employee, customer or director wants it to be well managed. Effective corporate governance able mitigate the manager-shareholder conflicts and safeguard not only major shareholders interests but also interests of minority shareholders and non-shareholders' interests.

Shareholder activism is not a privilege is a right and a responsibility. When they invest in a company, they own part of that company and they are partly responsible for how that company progresses. As a result, composition of board, appointment and removal rights are essential preconditions for keeping balance of management power and balance of interests in Corporation.

Endnotes

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