



# INSIGHT

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# Out with the old, in with the thinking forward

**“10 years from now, Boards will be more diverse and Director tenure will be shorter, whilst shareholder influence over director and senior executive remuneration is going to be greater. All of that will be much better for shareholder returns.”**

## An Orient Capital interview with First Pacific Group

In the fifth of Orient Capital’s Insight series, we move from Australia to Hong Kong.

This edition offers a fascinating conversation with John Ryan, Associate Director of First Pacific. Prior to his appointment as Associate Director in April 2019, John was Executive Vice President of Group Corporate Communications. He is currently Group Chief Investor Relations and Sustainability Officer.

In this interview, Catherine Yu (Orient Capital’s BD Manager in Hong Kong) explores some key topics including ESG, the shape of the modern AGM and corporate governance trends.

**“John, thank you so much for taking the time to share your insights. We are hoping to learn more about your views on the ESG landscape and the latest trends as you see them. Can we start first of all with the AGM. What was your impression of the season and how have things changed?”**

Well, for a start, the AGM has become very hybrid. There’s a big rush by corporates to change their charters (articles of association) so that they can hold online AGMs or a hybrid of online and physical, and that has meant a rather different change from what I expected. I had hoped if people moved towards an online AGM, you’d get far more participation, more give and take and people throwing questions into the

chat box and so on. However, my experience, albeit limited so far, is that shareholders have not taken up their opportunity to increase their attendance and interaction at AGMs. And given the physical restrictions of gathering in Hong Kong owing to the pandemic, it means that there’s been in fact far less participation at AGMs by minority shareholders; indeed our last AGM opened and closed remarkably quickly. In my opinion a net reduction in shareholder influence, is broadly speaking to be regretted.

**“There are generally a lot of retail investors who attend the AGM. In your view, do you think that the AGM fits the purpose as a means of communicating with these shareholders?”**

Oh, yes, absolutely. It’s the only forum where a small retail shareholder can have an on the record, interview with the board of directors or even the Chairman or the biggest shareholder and have

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discussions about things that are important to that shareholder, without that director or the board running away from the question. For many AGMs there has always been a number of small retail shareholders who during AGM season, will hop from hotel to hotel, from AGM to AGM where they own just a few shares of given companies. It seems to be a big part of their lives, particularly if they're retired. There is a kind of charm to engaging with these holders that you see year in and year out. So I think that the AGM is a very important means of keeping boards attuned to the needs of all shareholders.

### ***“Have you noticed any shift during the AGM, specifically with ESG being a key topic?”***

For us, no, not yet so far. It's absolutely made an impact in our meetings with minority shareholders and it never used to come up at all a couple of years ago. But now, you can spend a third to three quarters of your meeting with an institutional shareholder talking about ESG matters, but that hasn't yet quite crept into AGM discussions, it may simply be because of the COVID restrictions, and we'll see a big slam once those restrictions are gone next year or the year after...

### ***“So apart from the yearly AGM and your regular investor relations engagement, what else would you recommend for ways that a company could improve the dialogue between themselves and their shareholders?”***

All of our institutional shareholders, in fact almost all of them in a given portfolio, are going to have a minimum of 100 holdings. So their dialogue with any one company is going to be infrequent and brief. The people who will care most will be the bigger minority shareholders of which we've got, as you're well aware, a small handful who've held big stakes in First Pacific for a long time. They will have long engaged conversations; they will have the institutional memory of the personalities of the people in charge of the company. And they will know what are the best questions to ask and the best issues to probe and where the weaknesses and strengths of the management team are.

I don't think there's a lack of access for institutional investors, I just think the attention of institutional investors is spread desperately thin, and that they are not able to take advantage of the access that's potentially on offer. Evidence of this is the ever increasing power of that unrelated industry, the proxy advisor industry, institutional shareholders by and large offload their voting decisions to proxy advisors like Glass Lewis, ISS, Sustainalytics and MSCI and all of these others, and let us note for the record that these are entirely unregulated. So honestly, if I'm going to say, where change might come to make shareholder interests better defended, I'd regulate these proxy advisors.

### ***“So how has the current governance climate actually informed your strategy and how you communicate that in your IR engagement?”***

Good question. Regarding the proxy advisors, one of them, ISS, has recently given First Pacific a governance quality score of '1', which is the best possible score. I find this quite satisfying, because when I came aboard, the score was 8. According to this one measure, this one snapshot, First Pacific is among the very best governed companies in the world.

At the same time, a unit of ISS called ISS ESG, gave our company a red flag for unrelated ESG matters. And it took months and months of dialogue, to make them understand that this red flag was based on a misunderstanding of propaganda issued by self-interested NGOs, with respect to a plantations business, which is far down our ownership chain.

### ***“Do you think investors' voting and engagement are successful in bringing about desired positive changes in governance?”***

I'm thinking of those surprising things that happened to energy companies a few months ago, like Shell and Exxon. Exxon had three directors put on its board very much against management's will. And they will be pushing the board now to truly focus on a path to net zero.

And that tells me that, shareholder interests, they can win against management or controlling shareholders from time to time. And I think that relative power will ebb and flow. I'm hoping that going forward, there will somehow be a means worked out, whereby shareholders are able to receive the benefits of the ownership that they have of these companies. Very often it doesn't seem like they have a lot of ownership rights.





## **“The fact is that if we don't do something about climate change, climate change is going to do something about us.”**

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**“And apart from the shareholders' power, in terms of the governance of the company, would you like the legislative leaders to actually play a bigger role?”**

I think the Hong Kong Stock Exchange is doing a pretty good job with regard to the management of corporate governance of Hong Kong listed companies. Yes, they are slower than other exchanges, say in Europe, to introduce new requirements with respect to environmental and social matters. But the strength of that going slower approach is that you're learning from the mistakes of others. So in my experience over the past decade, it's improved in Hong Kong.

**“For the gender diversity proposals that you have mentioned, and also other proposals like the TCI climate change proposals, do you think that these proposals are actually finding support with the traditional non activist investor community?”**

Yes, I think so. Such as imposing at least two women on boards, which we have met already. And now we're all told that TCFD is going to be a required reporting standard for companies in Hong Kong from 2025 at the earliest.

At COP26, we had the formation of ISSB, the International Sustainability Standards Board, which will set up a reporting standard based on TCFD. So you know, this acronym soup is going to be turned into ISSB, I imagine, but it's going to look a lot like what TCFD does now.

This is all well and good, but when companies announce targets 20 or 30 years hence, in terms of their climate emissions going towards net zero or carbon neutral, and then they don't show you their path, then that's just so much fluff. That sort of commitment without demonstration on how you're going to get there, is going to be much reduced as the years go by, and shareholders will increasingly demand; “Okay, but how are you actually going to get there?”

**“Even though many companies are still trying to define a way to get there, do you believe that ESG will actually become the new battleground for activist investors?”**

Yes, I think it's going that way. We already have large minority shareholders who are telling us, if you cannot commit to having no coal in your portfolio by 2040, and you don't make that commitment in the next year or 18 months, we sell your shares and not be able to consider investing in you again. I think that sort of thing is going to increase a lot, particularly with respect to coal. And then perhaps 10 years from now with other areas as the landscape evolves.

**“So what do you believe is the driving force behind the ever increasing attention on ESG by both investors and also authorities?”**

Well, honestly, this is a significant threat to our way of life. And it's the tragedy of the commons, the atmosphere is owned by nobody but also owned by all. It's had CO<sup>2</sup> pumped into it, at an ever increasing pace for the past 200 or so years. And that is going to cause dreadful consequences, beginning with the poorest people in the world, who live in the south.

The science of this is very well established, is very clearly understood. And it's very broadly rejected by people in power, particularly electricity producers, or oil and gas producers. The fact is that if we don't do something about climate change, climate change is going to do something about us. And to act as if you do not understand and want to deal with that dilemma, is in fact crazy.

The fund management industry understands, that sooner or later, climate change and how companies are adapting to it, or working against it, is going to be seen in the valuation of a company and its share price. So they're seeing it before the managers of corporates are, and they are seeing it perhaps a step ahead of regulators.

I think that the fund management industry is the most powerful proponent of dealing with and responding to climate change that we've got right now. It's very interesting. I don't think it's something anyone would have predicted or expected to see happen 10 years ago.

**“While you mentioned that bad ESG may take a toll on the investment returns of the company, what would you say if a person tells you that there is a contradiction between investment returns and ESG?”**

So the pursuit of naked profit is not the ultimate goal anymore; I think that is what you're suggesting. The focus is you have to make profit and you have to make the world a better place at the same time. Now, the second item is not recognisably visible in terms of shareholder returns; except that when you survey companies that have strong ESG and



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companies that have weak ESG, research suggests that companies with strong ESG policies deliver greater shareholder returns.

So it may be hard to see when you're looking at vast numbers of listed companies, except by using broad statistics. But it does seem self-evident that if you are strong in ESG, you're going to deliver better returns than a company that isn't.

***“In the face of the growth of the index investors and activists, how can traditional stock pickers maintain their relevance?”***

It's hard to say. We've got quant trading, and we've got all kinds of off exchange trading, huge volumes where people are making money with miniscule increases or decreases in prices on very fast timescales. But you've also got people who will buy into a company that subsequently over the next few years increases in market cap by 50 fold. Like, Baillie Gifford, the Scottish investment fund that bought into Tesla very early. And you see that occasionally, from time to time, funds bet big on a little stock and it goes to the moon.

***“So with passive investors stressing more on the importance of the ESG policies of a company, what does it mean for corporate governance?”***

Well, I mean, we like to think that we're on a steadily improving continuous path, you know, towards perfection. And I imagine with the growing importance of ESG, that will maintain continuing steady pressure on improvement in governance. So I'm hopeful it will get better and better as time goes by.

***So if there was only like one item, which you see us most indicative of the health of the corporate governance at a company, what would it be?***

It's a good question. For ISS, their governance quality score is not a bad proxy. But by and large, for me, you would have a look at the diversity of the board and number of independent directors on it, if both of those are relatively high, you've probably got a well governed board.

***“So what is the corporate outlook in this new environment for 2022? And how do you actually envisage the governance landscape in 10 to 15 year from now?”***

Broadly speaking, if you can respond well, to a world of permanent COVID, then you'll be doing better than everybody else.

Our company's fortunate because we're a holding company, with a small head office of fewer than 40 people, and our two biggest companies have done well in the twisted circumstances that COVID imposes, like travel restrictions and not being able to get out of your house as often. So it's improved our earnings growth more than we had expected, under ordinary circumstances, but, you know, like anyone else, I would rather have the earnings of a non COVID world than their earnings we have with COVID.

In 10 to 15 years, I think boards will be more diverse. I think Director tenure in the future will, be on average, shorter. And I think shareholder influence over director and senior executive remuneration is going to be greater. I think all of that will be much better for shareholder returns.

***“Are there any new hot topics that you think will emerge in the future?”***

I think it's about how serious your path is towards net zero. Because the world doesn't get to net zero without the company's going to net zero.

***“Thank you so much for your time today John, it was great to be able to understand and share your insights.”***

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## Meet the expert



Mr. Ryan received a Bachelor of Arts degree from the University of Connecticut and completed a Master of Philosophy course on Slavonic and East European Studies at St. Antony's College, Oxford University. He spent several years as a financial journalist, opening and leading Bloomberg's Moscow bureau for five years in the early 1990s and later joining Dow Jones as Bureau Chief over the period 1998–2004 in Moscow and Hong Kong.

Mr. Ryan subsequently served as Head of Corporate Communications, Asia Pacific for HSBC's wholesale bank. He joined First Pacific in 2010. Prior to his appointment as Associate Director in April 2019, Mr. Ryan was Executive Vice President of Group Corporate Communications. He is currently Group Chief Investor Relations and Sustainability Officer, and a Commissioner of PT Indofood Sukses Makmur Tbk.

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## Contact us

Vivek Aranha  
CEO Asia  
Orient Capital  
E: [aranha@orientcap.com](mailto:aranha@orientcap.com)

Catherine Yu  
Business Development Manager  
Orient Capital  
E: [Catherine.yu@orientcap.com](mailto:Catherine.yu@orientcap.com)

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## New business enquiries

### For EMEA:

Gustav Pegers  
Head of Sales & Marketing  
E: [gustav.pegers@orientcap.co.uk](mailto:gustav.pegers@orientcap.co.uk)  
T: +44 207 776 7574

### For Australia & New Zealand:

Luke Allshorn  
Business Development Manager  
E: [luke.allshorn@orientcap.com](mailto:luke.allshorn@orientcap.com)  
T: +61 2 9375 7867