A LONG-TERM FOCUS FOR CORPORATE BRITAIN
Call for Evidence Response Form

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Please tick the box from the following list of options that best describes you:

	Quoted company
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
✓	**Non governmental organisation (NGO)**
	Trade Union
	Lawyer or accountant
	Other (e.g. consultant or private individual)

The Board of Directors

Question 1: Do UK boards have a long-term focus – if not, why not?

Comments
There is considerable concern that UK boards do not have a long-term focus, but are driven to achieve short-term returns to meet the requirements of shareholders, in the form of ever increasing dividend payments and an increase in the share price of listed companies. Although there may be lip service paid to CSR duties and limited other responsibilities to other stakeholders and the community, the main driver is financial return for shareholders. This is exacerbated by the fact that a significant proportion of a listed company's shares are held by institutional and international shareholders and their expectation, on behalf of individual capital providers, will be financial return. These shareholders (and frequently others, for instance hedge funds) therefore generally have little interest or concern about the long-term nature of the business or the interests of other stakeholders, in particular employees, suppliers, customers, the local community and society generally As the directors' main focus has to be on financial return for shareholders, there is little feeling that the company is operating as a community in the interests of all the stakeholders. Another reason for the short-term focus is that the shareholding in listed companies frequently changes. There is no incentive for shareholders to hold shares on a long-term basis, or to take an interest in the underlying business of the company and the welfare of the other stakeholders. The markets and legal framework have developed over the years in such a way that shareholders, while taking a financial return, feel no responsibility for the actions of the directors or the impact of the company's operations on other stakeholders and society generally. If they are not satisfied with the financial return, they simply trade their shares. Thus the markets can be seen as more of a gambling exercise than a proper investment with the shareholder taking a long-term stewardship role. It has been observed that directors tend to look after their own interests, whilst accepting that they also have to look after the short-term interests of shareholders. Thus directors' remuneration packages can often be driven by the short-term increase in profitability of the company or the increase in the share price of the company. This again does not lead to a long-term focus by directors. There is much evidence, in addition, that CEOs of listed companies hold their position for only a few years; this is often because they cannot adequately meet the demands of shareholders for financial return. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 2:</u> Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

Comments
There are procedures in law for directors to obtain information on the beneficial ownership of shares, but this is a somewhat laborious and time-consuming procedure. There would be merit in encouraging an increasing number of individuals to own shares directly in listed companies and therefore to disclose their names and to attend meetings with directors and other stakeholders. Requests for disclosure of beneficial ownership set up an adversarial approach and frequently, when the ownership is established, the shareholding has already been transferred. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

Shareholders and their role in equity markets

<u>Question 3:</u> What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

Comments
The reduction in individual holding of shares over the years, and the increase in institutional and overseas ownership, has led to a loss of connection between the directors of a company and those who have the greatest interest in the company and its operations, who generally include the underlying capital providers, employees, customers and suppliers. There is therefore little or no connection or interest by asset owners and managers in the business of the company and the welfare of all its stakeholders. As shareholders take no responsibility for the operation of the company (but generally simply seek short-term financial gain), regulators and the government need to step in to impose legal and regulatory requirements in respect of the duties of directors and the way in which companies are managed. This accentuates the lack of responsibility taken by shareholders and the fact that they rarely hold directors to account. This also means that the company general meetings tend to have little purpose. They should provide an opportunity for shareholders to have proper dialogue with the directors to understand more about the company and its operations, and its dealings with other stakeholders and the responsibility it takes as a contributor to society, but this opportunity is rarely taken. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

Question 4: What are the most effective forms of engagement?

Comments
The most effective form of engagement with shareholders is face-to-face meetings. These should be held on a regular basis, and not just at the AGM and private meetings between directors and particular institutional shareholders. We consider that there should be quarterly meetings between the directors and shareholders, most of which would also be attended by other stakeholders. Thus, many meetings would also be attended by representatives of the employees, major suppliers, customers and members of the local community. This would give an opportunity for shareholders to meet and understand concerns of employees and other stakeholders. At present, the various stakeholders tend to operate in their own interests to obtain the best financial and other return, rather than working together as a community in the interests of all stakeholders and society generally. Working together in this way and promoting relationships would in the long term make the company more sustainable and profitable. Attendance at meetings by local community representatives, where a company operates in a particular area, would encourage responsibility by the company to the community and promote greater interest by the local community in the company and therefore help to generate goodwill for the company. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

Question 5: Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?

Comments
We do not comment on this question.

<u>Question 6</u>: How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publically how they have voted?

Comments
Voting is clearly an important form of engagement but, as indicated above, we consider a much greater responsibility is called for by dialogue between stakeholders and promotion of relationships between the company and all stakeholders. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 7</u>: Is short-termism in equity markets a problem and, if so, how should it be addressed?

Comments
We consider that short-termism in equity markets is not in the interests of companies, their stakeholders, the local community and society generally. We believe there should be encouragement for long term holding of shares and greater involvement by capital providers (through those who invest on their behalf), individual direct shareholders and institutions in the welfare and operation of the company and relationships with all the stakeholders. This can be promoted in a number of ways including reward by, for example, additional shares for holdings of shares in excess of 3 years and a greater opportunity for face to face meetings between stakeholders. There needs to be a change of culture away from short-termism and a recognition that it is in the interests of shareholders for a company's future to be maintained on a longer-term sustainable and profitable basis. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 8</u>: What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

Comments
We do not comment on this in respect of decisions made by institutions but, as stated above, there are a number of methods by which longer-term holdings could be encouraged, for example an award of additional shares for holdings of 3 years or more. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 9</u>: Are there agency problems in the investment chain and, if so, how should they be addressed?

Comments
There are considerable concerns over the 'investment chain', in particular the financial and 'relational distance' between the original capital provider, whose funds are invested by investment managers or through a pension fund, and the companies in which the funds are invested. Individuals will have no knowledge of where their funds are invested and therefore will have no say or interest in the underlying business of those companies. The fund managers who invest in different funds and those funds themselves will generally be seeking a short-term financial gain and have no capacity or instructions to take an interest in the company and stakeholders' interests. Steps need to be considered as to how to reduce the length of this chain, or to seek instructions from capital providers as to how investments should be handled. Thus, capital providers should be asked whether investment funds should look at the long-term sustainability, profitability and interests of stakeholders in companies in which they invest rather than only the short-term financial return. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 10</u>: What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

Comments
More transparency would give an indication to capital providers as to the view taken by fund managers in the underlying company in which investments are made. This would give an opportunity for capital providers to seek funds for their money to be invested which take a broader view than purely short-term financial gain. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

Directors' Remuneration

<u>Question 11</u>: What are the main reasons for the increase in directors' remuneration? Are these appropriate?

Comments
The main reasons for the increase in directors' remuneration include the view taken by remuneration committees of listed companies of remuneration levels of directors in other companies in particular sectors, and equivalent tests for an increase in remuneration. There are concerns over the independence of remuneration committees and consultants who are appointed to advise (and who, of course, are paid by the companies in respect of whose directors' remuneration they are advising). Although there is the argument that market forces prevail, there is considerable concern about the impact on employees of a company if they see senior directors being awarded remuneration packages which increase the differential between the pay of those higher paid directors and themselves. There should be a greater focus on the impact on employees' loyalty and motivation of an ever increasing disparity of earnings between directors and employees. Shareholders should encourage companies to work towards a reduction in the differential level by controlling higher remuneration levels and increasing rewards to lower-paid employees, perhaps by awarding cash bonuses across the company. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 12</u>: What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

Comments
There may be arguments to include employees on remuneration committees, but overall there should be a change of culture so that directors and shareholders recognise that aligning the interests of the directors to the shareholders (i.e. remuneration levels increasing by increase in share price) is not a sufficient test by itself. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 13</u>: Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?

Comments
We consider that directors' remuneration packages should be subject to approval of shareholders each year. Although there is concern that this gives too much power to shareholders, there should be sufficient continuing dialogue and understanding between directors and shareholders that remuneration packages put forward will be acceptable. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 14</u>: What would be the impact of greater transparency of directors' pay on the:

- **linkage between pay and meeting corporate objectives**
- **performance criteria for annual bonus schemes**
- **relationship between directors' pay and employees' pay?**

Comments
Greater transparency of directors' pay and an understanding of the remuneration package and disclosure of what is the average pay of employees in the company and the pay of the lowest paid employee would lead to a greater understanding of the potential impact on the relationship between employees and directors of a high remuneration differential and how this can damage morale amongst employees. A high differential can engender a feeling among employees that they have little worth to the company compared with the directors and other senior employees. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

Takeovers

<u>Question 15</u>: Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

Comments
One of the major concerns about takeovers is that the decision by selling shareholders is driven by their short-term financial interests. It is for these shareholders to decide whether to accept the offer. There is little interest (in a hostile or recommended takeover) in the impact of the takeover on other stakeholders, in particular employees of the target company. Directors of acquiring companies should be encouraged to explain in detail what are the long-term prospects for the acquired company after the takeover and the impact of the new ownership on other stakeholders. The analysis should include the impact on the company of any debt taken on to fund the acquisition. Employees and other stakeholders in the target company should be provided with this information in order to give them an opportunity to speak to the shareholders in the target company about the impact of the takeover on stakeholders and on the future of the business. Institutional and other shareholders should take these factors into account and not just the immediate financial gain to be made by accepting the offer. For a further discussion on these issues see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 16</u>: Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

Comments
There is concern that in the long term the acquiring company and its shareholders frequently do not benefit from acquisitions of listed companies but we do not comment on whether acquiring company shareholders should be entitled to vote on the takeover bid. There would, however, be a distinction here, presumably, between a listed company being acquired and a private company acquisition or an acquisition of assets. In any event, under Listing Rules, significant acquisitions do require shareholder approval. For a further discussion on these issues generally see the attached paper prepared by Relationships Global and Relationships Foundation.

<u>Question 17:</u> Do you have any further comments on issues related to this consultation?

Comments
We consider that many of the issues raised in the consultation can be addressed by encouraging companies, their directors and shareholders to adopt a relational approach in the way that companies are managed and operated. Thus, there would be greater dialogue between shareholders and other stakeholders. By taking a more responsible attitude to their investment, shareholders would be encouraged to have longer term interests in the company, pay differentials would be reduced, debt would be kept to a minimum to encourage long-term sustainability and profitability, suppliers and customers would be treated fairly and with consistency, and employees encouraged to hold shares in the company and to be treated on a more equitable basis in remuneration levels with directors. The relational approach would lead in the long term to greater sustainability and profitability, as all stakeholders would be working together, regarding the company as a community rather than pursuing their own interests often in conflict with one another. This approach, through the mechanism of the Relational Business Charter, is based on the attached paper prepared by Relationships Global and Relationships Foundation. We would urge the consultation to consider this paper as a whole and request that it is discussed it with us in greater detail.

14th January 2011