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

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation should be received by 14 January 2011.

Completed copies of the response form should be returned:

Via email to: clgconsultations@bis.gsi.gov.uk

Via post to:

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

	Quoted company
x	**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

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

Comments
In our experience UK Boards do not have a long term focus. The short to medium term nature of markets drives this. The recent recession has demonstrated this short termism also. In addition, and in the SME sector particularly, the demands of investors for a quick return has resulted in Boards having to take a short-term view in order to achieve demanded RoI, rather than grow the business for the future benefit of the owners, employees and society. A short term outlook is partly to do with the ability to predict the business environment, to manage the risks that can be seen and understood as opposed to those that can't be seen or understood.

<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
Yes, based on the evidence of the number of mergers and acquisitions that take place. However, due-diligence is increasingly complex and promises made during the acquistion process need to be codified in contractual terms to prevent occurrences such as the Mars/Cadbury debacle in Bristol.

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
Based upon the evidence of the impact of recession on the personal, company and national wealth, stakeholders of all types will demand greater accountability and transparency through corporate governance processes. We are likely to face increased demands for employee and shareholder representation on boards – often a good thing - but will need to face down similar demands from single issue groups, be they environmental, anti-animal experiment or political.

<u>Question 4</u>: What are the most effective forms of engagement?

Comments
This depends entirely upon the structure of the organisation, its culture, the market(s) in which it operates, the communications and management styles and protocols used in the organisation and between it and stakeholders (including employees and other workers) and the wants and needs of shareholders and the timelines demanded by investors and the markets. For example, a research and development firm, a FMCG business, a professional services organisation, a regulated healtrh business and a multi-media company are all different in markets, structure, culture, styles and – not least – in the investors they attract. Hence, this apparently simple question has a complex range of answers. The short answer surely has to be that the most effective form of engagement is whatever most fits the business, the firm, the organisation and the market, including key stakeholders and regulators. One size does not fit all. For example, the stakeholders of John Lewis will value a particular type of engagement differently than say those of Barclays Bank. This is due to a different organisational culture and the messages and behaviours communicated from the top. Investor preference is both a result of such factors and a cause of them.

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

Comments
We do not believe that there is sufficient dialogue throughout investment firms; in fact a number of reports in the aftermath of the recession indicated that they continue to operate in silos. Corporate Governance is not at the core of their business values, but an “add on” a tick in the right box at the end of the process. We believe that the right corporate governance frameworks and principles exist already, the problem is that such not been embedded into the corporate way of working – in short, an overly compliance based, tick box and minimalist approach has been taken rather than a behavioural approach which puts governance (in the broadest sense) at the core of the business, the firm and trhe organisation. This failure gives rise to some and certainly allows far more questionable behaviour, moral flexibility, a lack of ethics and

short-termism.

<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 publicly how they have voted?

Comments
Voting continues to be a vitally important, democratic principle of shared ownership and giving everyone a voice. Without secret ballot the possibility of making difficult or controversial decisions would become increasingly stuck in an endless round of consultation, game playing and risk of manipulation.

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

Comments
Yes we believe that it is. There needs to be a greater balance between short, medium and long term prospects with a risk/reward ratio that is not entirely focussed on short term gain, but also on growth and stability. This does not argue for increased regulation but instead for a more ethical approach centred on what is best for the organisation's contributions to its owners, employees, stakeholders and UK plc as a whole.

<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
Greater tax-benefits from longer-term shareholdings. This could include differential tax on dividends accruing from longer-term holdings as well as beneficial capital gains and inheritance tax regimes. Likewise, corporation tax could be reduced for companies which have a significant proportion (say, 70%) of shareholders committed to longer-term investments – for example employees, pension funds and insurance houses. We consider, however, that increasing tax on short-term holdings and profit taking (e.g., bed and breakfasting) would be disadvantageous in that it would discourage investment and would also be difficult and costly to regulate.

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

Comments
We believe that this adds to the lack of clarity for stakeholders. Too many players in a process reduce transparency and increases costs. That said, we believe that the majority of longer-term investments will be made by employees (in our view, there is considerable benefit in all employees investing from the outset of their employment in the employing business), pension funds and insurance houses. Investments by the latter 2 will continue to be largely hidden from individual shareholders but we suggest that the investment strategy of such major players should suffice to ensure that those seeking to invest via such can have as clear an idea of the 'termism' of the

strategy as they do of the risks associated each investment.

<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

This is about measures that drive the “right” and the “wrong” behaviour. If stakeholders can see clearly what fund managers’ mandates are, what the risk/reward gearing looks like, and what the ‘termism’ strategy is, they can have a greater understanding of the real risk of investment and the likely/intended payback timescale. We believe that such improved transparency will reduce complaints, serve to increase confidence in the management of investments and trust in the managers themselves. The overall market for investment should, as a direct result, grow disproportionately.

Such benefical effects would, in our view, be increased still further if the costs of investments and the management of such are laid down transparently as a part of the defined strategy, so that investors could compare funds on a like-for-like basis.

Directors’ Remuneration

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

Comments

Justification has come in the form of influence and potential profitability. This is not acceptable in our view; there has been a disproportionate perspective on the worth of some job holders which has had an inflationary effect on the wider market for directors' remuneration. We believe that no investor can complain if directors' remuneration is directly and transparently linked to performance RoI over the term outlined in the strategy. It is, however, utterly unacceptable that some CEOs and directors have been rewarded with very significant bonuses when their companies' value (i.e., a negative RoI) has decreased. Hence, bonuses and all other forms of PrP must be tied clearly, contractually and transparently to owners to the delivery of sustained added-value over time.

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

Comments
We anticipate that the widening of the membership of remuneration committees, for example introducing worker representatives and/or a greater discussion about Total Reward would make these committees far more accountable, much less of the appearance of self serving entities. It would become increasingly difficult to pay inflated bonuses, and whilst we might still see large salary levels for senior people, there would be a much greater requirement to demonstrate the value delivered into the business by that person that makes them worth that salary.

Question 13: 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
No, Remuneration Committees are secretive and reporting happens after the event. All shareholders can do is complain bitterly when reports are published and they realise what directors have been paid; when they consider this too high all they can do is say so. As we know, it is extraordinarily difficult to remove salary once it has been offered or in payment. If shareholders are to have a voice in this area, they need to be involved before a person is appointed.

If there is to be stakeholder involvement in remuneration committees then it is appropriate to be discussing Total Reward, including all other aspects of the pay bill including incentives, bonuses, benefits and golden parachutes.

Further, we question the 'independence' and efficacy of current 'independent' NEDs on Remuneration Committees, and we believe that companies should be required to advertise openly and widely for truly independent NEDs from backgrounds other than that of the business.

<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 should deliver a greater correlation between Directors pay and corporate objective achievement, a clearer link between the underpinning targets of bonus scheme and corporate performance, a more meaningful differential between employee and directors pay.

We also think that senior salary (Total Reward) should be

- Subject to shareholder approval.
- With any PrP element held in trust, linked to performance over the term of the investment strategy of the company and be subject to repayment if subsequent performance falls below a defined level.

We consider that the ability of shareholders to demand repayment of bonuses, 'golden parachutes' and 'golden bowlers' for non-performance as defined and agreed contractually will on its own add greatly to investor and public confidence.

Takeovers

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

Comments
We saw from the example of Kraft And Cadbury that this cannot be the case. This clearly demonstrated the negative impact on employee, shareholder and wider community relations when the long term implications are not fully understood, assessed and communicated to all who have a vested interest in the future of a business.

<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 definitely scope for greater consultation, but this could make the process slower than it is already. Although shared information, better informed stakeholders, employees and communities would long term deliver a greater chance of better results, such could also provide competitors with too much leverage, with the result that costs would increase. On balance, therefore, we believe that shareholders ability as outlined in 14 above to remove (and reclaim) bonuses etc for takeovers that do not add value to RoI will be sufficient to ensure that more careful and holistic consideration is given to all factors in M&As, so that investors, employees and stakeholders are not disadvantaged.

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

Comments

It is our belief that there are already adequate corporate governance framework requirements and reporting in place in UK. The area for improvement is in the need to embed good governance behaviour into the normal way of doing business rather than seeing it as a regulatory or compliance requirement. Behavioural or cultural change is of course something that will only happen over a longer timescale, when markets are improving there is a very great risk that the bad times are forgotten and short termism again becomes acceptable behaviour.

Hence, we consider that:

- Better management education with a focus on good governance as a mechanism for increasing the likely success of business is needed.
- Improved approach to audit with a focus on systems, risk and behaviour rather than on compliance and tick box
- Reward schemes that drive appropriate behaviour, subject to the scrutiny and approval of stakeholders

will contribute to greater transparency and accountability for the benefit of all.

Finally, we suggest that a code of behaviour for managers (such as that used by the Charttered Management Institute) dealing with investments, M&As etc, would add greatly to public confidence.