BIS | Department for Business Innovation & Skills

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
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union

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11 January 2011

Our ref: 011695/JR/SD001032

Dear Sirs

A long-term focus for corporate Britain

We are pleased to be able to respond to your call for evidence on short-termism and market failures in UK equity markets.

BDO LLP are the UK firm of the world's fifth largest network of accountants and business advisers with over 230 partners and 2500 staff in this country. We act for a considerable number of public companies as auditors and for many more in advisory capacities. We are advisers to companies on flotations and other capital transactions on the London Stock Exchange and in other markets.

You call for evidence is broad in nature and we have, therefore, chosen only to respond to those questions, where we believe we have particular insight or comment to make.

1. **Do UK boards have a long-term focus - if not, why not?**

   We consider there is a tendency to short-termism amongst UK boards. We believe this is a response to the demands of equity markets, which have changed substantially over the years, as your call for evidence demonstrates. The increasing level of overseas investment and the competitive use of "benchmarking" by asset managers, together with the impact of investment decisions driven by financial modelling or by automation, have seemingly led to a lower average shareholding period. Inevitably, this will affect the focus of a board as they seek to maintain shareholder value by retaining demand for a company's equity. As remuneration structures for Boards increasingly comprise a significant equity element (in line with corporate governance guidelines) the short-termism trend is reinforced by the impact of equity market behaviour on pay.

2. **What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?**

   Shortened shareholding periods do not incentivise investors and companies to interact directly and therefore put a greater emphasis on information released by companies, such as annual reports and trading updates. We believe that the complexity of the current financial reporting framework and the shortcomings in the current level of narrative reporting, mean that investors suffer from too much information of dubious relevance and, at the same time, have little information on the real underlying opportunities and risks for their investee company. We believe this needs a radical reassessment, particularly led by engagement with investors themselves.

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The concept of stewardship becomes redundant if equities are trading stocks held for a quick turn. This flies in the face of much recent regulation. However, we do not believe that the current corporate governance regime should be rolled back in any way - longer term investment is to be encouraged - but care should be taken that further regulation brings benefit that outweighs its cost.

Restrictions on how information is disclosed to the market results in a tendency to boiler plate disclosures or rely on analyst coverage which tends to be focused on the FTSE 250 and not the 2,000+ other fully listed or AiM quoted companies. There is a conflict between attempting to perfect equality of availability of information and the supply of useful dynamic narrative based information from company management. If regulators concerned with insider dealing and perfecting markets become too dominant in setting the information disclosure agenda, the vast majority of UK companies will be forced to retrench to limiting disclosure to historic financial information and commentary. This will only serve to encourage short term equity holding strategies since investors, starved of useful information about business plans and prospects, have little reason to bet blindly on a company's long term prospects.

3. **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?**

   We believe that there ought to be transparency in the relationship between investors and an investee board and that the ultimate beneficial ownership of a company's shares should be disclosed to companies as a matter of course.

4. **What are the most effective forms of engagement?**

   We welcome the UK Stewardship Code published in July 2010 and believe that this should be given time, prior to any new legislation or regulation being initiated.

   However, we do firmly believe that annual general meetings are generally not a useful forum for investors and investees to interact in any meaningful way, and that exploration of electronic communication for voting should be undertaken.

5. **How important is voting as a form of engagement?**

   We believe that the ability to vote is central to what might be termed the balance of power between investors and investee companies, and would cite the unpopularity of non-voting shares in recent years as support for this. We do not believe that shareholders should have to disclose how they vote. In particular, we believe it is difficult to introduce such a system and restrict it to institutional shareholders only, without affecting the rights of private individuals. Anything that might act as a disincentive to private individuals investing in quoted companies is to be discouraged.

6. **Reasons for increases in directors' "remuneration". Are these appropriate?**

   We do also wonder whether there is a correlation between the increase in the remuneration packages received by executive directors and the intuitive feeling that their tenure has on average reduced quite considerably, and that a considerable element of the increase relates to increased risk.

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The establishment of remuneration committees over the last decade has led to a process of benchmarking pay, often unlimited by committees themselves, as they seek to establish best governance practice, and often utilising outside consultants.

Changing objectives and strategic aims can lead to a realignment of performance indicators, which boards wish to incentivise executives to achieve. This is encouraged by corporate governance best practice.

Rarely do companies want to pay less than average - therefore the average itself become greater over time by implication, irrespective of any commercial factors. Pay almost never reduces. There is also an intuitive feeling that executives have "missed out" if bonuses and target are not met, leading to some compensatory payments on occasion.

The mix of fixed and performance pay has been increasingly weighted towards the latter, but companies should consider whether to revisit this mix if it is felt that it encourages an unacceptable level of risk-taking.

7. **What would be the effect of widening the membership of the remuneration committee on directors' remuneration?**

It is difficult to see how the membership of the remuneration committee could be effectively widened, whilst remuneration remains a matter for the board. We do consider that there is merit in requiring the chairman of the remuneration committee to confirm that he has consulted with major shareholders prior to making any substantial adjustments to remuneration policy.

8. **What would be the impact of greater transparency of directors' pay?**

Remuneration reports are already extensive. We believe that the cultural makeup of a company and its board is likely to be more important in setting remuneration that is a fair reward than further disclosures or voting. Further disclosures will tend towards the boiler plate and we believe that consultation with major shareholders is likely to be more effective in putting the brakes on in appropriate remuneration policies than formal voting.

9. **Do boards understand the long term implications of takeovers?**

The tendency to short-termism in the behaviour of UK boards reflects the market dictum that shareholder value is all-important. This reflects the requirement for directors to act in the best interest of the company and its shareholders as a whole. Therefore, it is axiomatic that a significant bid premium will effectively force a company to cede its independence to a potential acquirer, if that premium is sufficient.

Directors are not required to do more than to take account of the wider public interest, and nor are shareholders when it comes to voting on proposals in relation to such transactions. There is, therefore, a level of disregard for wider stakeholders, including employees, suppliers and communities, of which corporates might be expected to be a part.

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10. 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?

Requiring an acquiror's investors to vote on bids would put the UK at a disadvantage, in what is inevitably a global market. Were foreign acquirers able to complete transactions more quickly, because they did not require shareholder approval, then that would tend to increase foreign ownership of UK business form an unequitable basis.

Yours faithfully

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