TULCHAN

The State of Stewardship report

November 2022

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This report is based on structured interviews with 35 chairs, 26 of which were from FTSE 100 companies, between June and September 2022, and nine follow-up interviews with senior representatives of major institutional investors in September 2022.

The interviews were conducted by **Andrew Gowers** and **Mark Burgess,** and the report was written by Andrew Gowers.

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Foreword

Mark Burgess, Partner, Tulchan Communications

On behalf of Tulchan Communications, I am pleased to present this report investigating sentiment in UK boardrooms. It confirms what has been clear for some time to those working in the London market: that relations between the boards of publicly listed companies and their shareholders are not as they should be. Interventions by shareholders and their proxies are perceived by boards to have become increasingly intrusive and it shines a light on the radically changed circumstances in which UK companies now have to operate — the internationalisation and fragmentation of the shareholder base and the pressures on the institutional investment firms that own the bulk of their shares.

Many of the chairs interviewed for this report conveyed a sense of deep unease at what they feel is a lack of alignment between their objectives and those of their shareholders. This matters because, perhaps now more than ever, the UK needs a competitive, confident and purposeful corporate sector to help steer its economy through the current headwinds.

Given Tulchan's expertise in giving strategic advice to boards and chairs, and my own 35-year City career, I was hugely impressed with the passion, the insights, and particularly the candour of those we spoke to. I was also pleased that some of the UK's leading equity investors and governance experts shared their insights on the state of the relationship.

The chairs care deeply about their responsibilities and the duty they owe their shareholders and stakeholders, but equally about the competitiveness of the UK market, and of a stock exchange that should be attracting vibrant new companies to help the UK grow and succeed. They are concerned that the number of public companies has been shrinking in recent years.

These problems strike at the heart of the market's raison d'être. The stock market exists because equity capital is the best way to finance long-term companies. Permanent equity capital allows company boards to take the appropriate long-term decisions. We have all seen the problems caused by excess leverage, including short-termist tendencies. Moreover, listed equity enables others to invest in and share in a company's success and creates a potential mechanism for alignment of interests between employees and owners.

But here is a paradox. Today, UK equities are less important to UK pension funds than they have ever been. Back in the 1990s when I was a UK pension fund manager, UK equities comprised some 55-60 percent of defined benefit pension fund portfolios. Today's weighting is just over 2 percent. Whatever the right level may be, surely the right match for real £ liabilities are real £ assets? If UK pension funds are not allocating to UK equities, it is scarcely surprising that UK equity asset managers are not devoting sufficient resources to oversee the appropriate governance of their investments.

Another troubling conclusion concerns the relationship between risk and return. These two concepts are, of course, inextricably linked: to make a return you have to take a risk, and you will sometimes make mistakes, and that is well understood by boards and investors. But what we heard expressed time and again by the chairs we interviewed was the feeling that in the UK, the constant focus is on trying to regulate and legislate all risks out of the system so that nothing can ever go wrong. The result has been to limit risk-taking and probably lower the growth prospects of companies and the underlying economy. Those with entrepreneurial aspirations as well as many participants in the governance process feel stifled by red tape and "box-ticking".

This report suggests an alternative approach: that we should recognise that boards are mostly constituted by good people trying to do the right thing for the good of their stakeholders, and invites shareholders overseeing them to start by assuming positive intent, placing accountability for stewardship where it belongs; in the boardroom and working together to improve conditions for growth.

I and my colleagues within Tulchan have a long history and deep experience of advising companies on how to improve their communication to and engagement with the capital markets and the investment community. We hope that this report, and the subsequent conversation that we hope it stimulates, will increase understanding of the issues and lead to better engagement, alignment and dialogue between boards and their shareholders.

I would like to conclude by thanking the individuals that took part in this project: the chairs and investors who gave up their time; Andrew Gowers, who undertook the interviews with me and wrote the report; and Andy Griffiths, CEO of the Investor Forum, for corralling some of the investors, and for working to help find a solution.

Names of participants
Chairs

Name	Company
Andrew Duff	Sage Group plc
Charles Berry*	The Weir Group PLC
Sir Donald Brydon	Tide Holdings
Annette Court	Admiral Group Plc
Gareth Davis	M&C Saatchi PLC
Philip Aiken	AVEVA Group plc
Sir David Higgins	United Utilities Group PLC
Stuart Chambers	Anglo American PLC
Deanna Oppenheimer	InterContinental Hotels Group
Ian Meakins	Compass Group PLC
Tommy Breen	HomeServe plc
Ruth Cairnie	Babcock International Group PLC
Cressida Hogg CBE	Land Securities Group PLC
Don Robert	London Stock Exchange Group plc
Philip Yea	Mondi plc
Paul Walker	Ashtead Group plc
Sir Douglas Flint CBE	abrdn plc
Paul Walsh	McLaren Group Limited

Name	Company
Michael Roney	Next Plc
Dame Louise Makin	Halma plc
Sir Jonathan Symonds	GSK plc
Tim Score	The British Land Company PLC
Paul Manduca	St James's Place plc
Robin Budenberg	Lloyds Banking Group plc
Paula Rosput Reynolds	National Grid plc
Sir Andrew Mackenzie	Shell plc
Mark Tucker	HSBC Holdings plc
Lord Stuart Rose	ASDA Stores Limited
John Allan CBE	Tesco PLC
Rick Haythornthwaite	Ocado Group plc
Richard Pennycook*	Howden Joinery Group Plc
Anita Frew	Croda International Plc & Rolls-Royce Holdings plc
Michael McLintock	Associated British Foods plc
Christine Hodgson CBE	Severn Trent PLC

And one other participant wished to remain anonymous
* Position held at time of interview

Names of participants
Investors

Name	Company
Andrew Millington	abrdn
Adrian Frost	Artemis
Rob Hardy	Capital Group
Richard Colwell	Columbia Threadneedle
Richard Buxton	Jupiter

Name	Company
Rupert Krefting	M&G
Andy Simpson	Schroders
Two other international asset managers	N/A

Introduction

Amid the tumultuous debate over the future of the UK economy and business environment, a topic that has thus far received little attention is the state of relations between company boards and their institutional shareholders. Accountability for good stewardship of companies and where this accountability resides sits at the heart of this issue.

It suggests that friction between the boards of large UK quoted companies and the asset managers who own most of their equity — the critical interface between corporate activity and investment — is growing. And it concludes that this presents a challenge to those who aim to promote growth, investment and a healthy stock market in the UK.

The chairs of a sizeable number of FTSE 100 companies initiated this survey out of a sense of frustration at what they see as a decline in the quality of engagement with their key shareholders in recent years. Whenever two or more of them have gathered together in the past year or so, it seems, discussion has tended to default to this topic.

They lament the fragmentation of their investor base; the disparate views of different funds and fund managers; the replacement of strategic shareholder engagement with an increasing burden of detailed reporting and compliance; the increasing number of occasions when a substantial minority — and sometimes a majority — of their shareholders vote against board resolutions without serious discussion of the issue at hand. Many of them worry that these trends — compounded with a massive increase in government regulation of business in recent years — risk distorting or undermining boards' stewardship of the companies they oversee, with negative long-term consequences for UK PLC.

Such concerns dovetail with other issues that have been the subject of frequent commentary in the business media and occasional government-commissioned reviews: a perceived decline in the competitiveness of the UK equity market versus international competitors; the relatively small share of fast-growing tech companies in the FTSE 350; the shrunken number of initial public offerings on the London market; and the disappearance of public listed companies into the arms of private equity funds.

These are complex issues involving a large number of important institutions, vested interests and ineluctable market trends. One of the most important and little-discussed of these trends has been the dramatic decline in the share of investment portfolios represented by UK equities, in part a result of the market adjustment to the end of defined benefit pension schemes, which drove pension funds to shift their focus from stocks to bonds and other asset classes. To illustrate the point, the latest reported numbers from the Pension Protection Fund show that whereas in 2008 UK pension funds had 24.4 percent of their assets in UK equities, the proportion has now fallen to a mere 2.2 percent.

Perhaps this fact helps to explain what could be described as a crisis of confidence in UK PLC: investors have less time and resources to devote to engaging with the UK companies in which they invest, and this has inflicted collateral damage on the quality of their decision-making and corporate stewardship.

Last year, various chairs became sufficiently exercised about the situation to start discussing what might be done about it — starting with a debate with institutional investors. To frame this, they felt it would be important to articulate and analyse the sources of their frustration, in a form that would resonate with the institutions. Tulchan Communications, which provides advisory services to many UK listed companies, proposed to produce a document with this objective, based on structured interviews with a substantial number of UK company chairs.

Between June and September of this year, 35 such interviews were conducted, 26 of which were from FTSE 100 companies, and the views expressed are summarised in Chapters 1 to 6 of the report. The chairs interviewed are listed at the end of the report, but their individual comments are recorded anonymously — both in the body of the report and in an appendix. They provide a rich, and somewhat disquieting, set of insights from some of our most important business leaders — many in charge of very large domestic or multinational companies — into the state of corporate governance and of institutional investment in the UK today. Having gathered and summarised their views, we spoke to nine leading figures from the world of institutional investment in order to obtain their response; their comments are recorded in Chapter 7 and then reflected, alongside those of the chairs, in Chapter 8 which draws conclusions and makes a simple recommendation.

The chairs' words are sometimes critical, but many of our interviewees emphasised that they see a range of quality in engagement with their shareholder base from outstanding to deeply frustrating; all were at pains to emphasise that their intention in raising these issues, some of which arise from structural changes in the asset management business, is constructive — namely to encourage more shareholders to embrace best practice in how they engage with their portfolio companies. They want to initiate a fundamental discussion with their investors about how to work together more effectively to serve the long-term success of their companies in the interests of all stakeholders. To judge by the responses from the investors we spoke to, they are pushing at an open door.

We hope that the report will be more widely taken in that spirit and will help to illuminate, rather than inflame, a debate which seems right now to be all too necessary.

Executive summary

Many chairs of UK listed companies perceive a deterioration in the quality of their engagement over matters of company stewardship with the institutional investors that collectively own their shares, and are looking for a reappraisal of the balance in their relationship with shareholders. That is the overarching conclusion from an opinion survey among 35 chairs of FTSE companies undertaken between June and September of this year.

This report summarises their views; the aim in publishing it is to trigger a constructive dialogue between company boards and investors about how they can work together more effectively to support the long-term success of UK PLCs and the interests of all their stakeholders.

The report also includes an initial response to this critique from nine leading UK and international institutional investors, indicating an openness to further discussion. The investors agreed that the character of shareholder interactions with UK companies has fundamentally changed in recent years. In part this is a consequence of the declining share of investment portfolios allocated to UK equities, the rise of "passive" index-tracking investment funds, and the resulting decline in resources and time devoted to engaging with portfolio companies. The upshot is a widening gap between those investors that maintain best engagement practices and those seen as falling short.

Almost all the chairs we interviewed felt the relationships between the boards they lead and their companies' shareholders are not working as well as they should. They complained of a blurring of responsibilities between the two sides that is creating unnecessary distractions for boards in their task of overseeing companies in an "effective and entrepreneurial" manner, as required by law. Some said these trends, compounded by an ever-increasing thicket of government regulation, are making it harder for public companies to compete with private ones for capital and talent, and contributing to the decline in the number of listed companies in the UK.

Our chair interviewees' common perception was that strategic engagement with shareholders about a company's strategy and performance is being eclipsed by a mechanical process where investors vote on board resolutions based on detailed, prescriptive rules on matters not always central to companies' long-term success. They felt the discretion in board decision-making set out in UK corporate governance codes under the motto "comply or explain" has been eclipsed by a narrow and sometimes adversarial focus on compliance. Their strong desire is to return to a more productive and thoughtful two-way interaction with investors focused on the most important factors determining long-term corporate success, and on ensuring boards are held to account to deliver.

A key focus of the chairs' concern is the role of third-party proxy voting agencies, which have grown in importance, as a consequence of these trends. They say that too many investors use such service providers to outsource decision-making on their portfolio companies in contravention of the Stewardship Code to which most have signed up. The problem is compounded, in their view, by the poor quality of the work delivered by the proxy agencies themselves, and by the difficulty companies experience in engaging with them, for example to correct errors in their reports or to explain carefully-considered board proposals, for example on executive remuneration. This amounts, they say, to a failure of corporate governance at the precise point where shareholders are supposed to be exercising their ownership rights.

Many chairs feel strongly enough about this issue to call for proxy voting agencies to be subject to regulation in the form of an officially supervised code of conduct. At the least, they say, shareholders should be required to explain why they use these agencies and how they arrive at their voting decisions — or, better still, to engage with portfolio companies before they cast a negative vote that can damage a company's reputation.

Another issue aired in this survey is confusion arising from the proliferation of ESG (environmental, social and governance) standards and scorecards against which companies have to report; a desire was widely expressed for greater consistency of investor expectations in this area.

But the main message from company chairs to institutional investors is that it would be in their own interest to refocus their attention away from the current "box-ticking" approach to the companies in which they invest and towards a more strategic form of engagement. This would entail investors delegating greater responsibility to boards as stewards of companies' long-term success, devoting in-house resources to monitoring boards' effectiveness — and where that is found wanting, voting to change them.

The investors we spoke to, while they did not agree with many of the specific criticisms voiced by chairs, recognised that there are issues to discuss, not least by way of fostering boardroom understanding of the underlying changes in the asset management industry and its decision-making framework. The conclusion is that these issues should be the focus of a structured high-level dialogue between a representative group of PLC chairs and a similar group of institutional investors, with a view to clarifying points of contention and seeking common ground.

The view from the boardroom

Chapter 1

Responsibilities, accountability and stewardship

Many chairs of UK listed companies see a deterioration in the quality of interaction between boards and shareholders in recent years. Responsibilities, they say, have become blurred and in discussing the performance and strategy of companies, broad principles have been replaced by detailed, prescriptive rules.

It is time for a return to transparent, two-way engagement on what really matters, and to a recognition of the primacy of boards in overseeing publicly listed companies.

Corporate and investor governance in principle…

On paper, at least, the respective responsibilities and obligations of shareholders and boards are clearly delineated. Section 172 of the UK Companies Act 2006 places a legal obligation on company directors to act in the way "most likely to promote the success of the company for the benefit of its members as a whole," having regard to "the likely consequences of any decision in the long term" and the interests of various stakeholders including employees.

More detailed guidance is provided by the UK Corporate Governance Code (2018). It states that "a successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society," adding that "in order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties."

The original version of the Code, published by the Cadbury Committee in 1992, was even clearer on the division of responsibilities: "Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place."

Subsequent iterations incorporated additional detailed provisions reflecting the increasingly complex environment in which public companies have to operate, and a number of corporate crises and examples of inadequate governance and misconduct. But the 2018 version is still careful to introduce this important caveat: "The Code does not set out a rigid set of rules; instead it offers flexibility through the application of Principles and through 'comply or explain' Provisions and supporting guidance. It is the responsibility of boards to use this flexibility wisely and of investors and their advisors to assess differing company approaches thoughtfully."

As for shareholders, many though not all have signed up to the Stewardship Code, whose latest version was published in 2020 and sets out a series of "apply and explain" principles for asset owners and managers to follow in pursuit of "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

It states upfront: "Asset owners and asset managers cannot delegate their responsibility and are accountable for effective stewardship. Stewardship activities include investment decision-making, monitoring assets and service providers, engaging with issuers and holding them to account on material issues, collaborating with others, and exercising rights and responsibilities."

…and in practice

The relationship between a company board and its shareholders is based on the interaction between these various responsibilities and obligations. This report considers how that is working in practice today. It finds significant concern among many, though not all, chairs of FTSE100 and 250 companies that the relationship is not working satisfactorily.

They complain of an over-prescriptive and formulaic approach to matters such as the environment, governance and executive remuneration on the part of some investors. They argue that too many shareholders do not take the time to understand the companies in which they have invested and delegate decision-making on important matters regarding those companies to third-party voting agencies. At worst, they say, this is creating confusion and distraction and thus hampering boards in their task of overseeing the companies in their charge.

An observable symptom of these tensions is a steady increase in the number of “protest votes” by shareholders against board resolutions and nominations at corporate Annual General Meetings, and accompanying negative media headlines. Another is the increasing volume of corporate reporting required on an expanding range of topics, which many chairs feel adds more noise than genuine insight to the dialogue.

Disquiet has been building for some time among public company board directors and to some extent among investors as well.

It was reflected, for example, in the warning earlier this year from a senior and experienced chair of the “danger” in communication between boards and shareholders:

“That quality gets sacrificed for quantity, and instead of a productive dialogue, all we end up with is an inflated and deeply frustrating box-ticking exercise. The long-term consequences of this will not be negligible, notably an increasing reluctance of companies to float on the stock market.”

In the next chapter, we record a number of comments from company chairs on this and other concerns about the balance of responsibilities and quality of engagement between boards and shareholders.

Chapter 2

Sources of board disquiet

It is worth stating at the outset that not every chair we spoke to believes there is a burning problem here.

Says one chair of a prominent UK PLC:

"I'm not in a panic zone in terms of the relationship between boards and shareholders. I think there are things that are less than satisfactory in relationships with some shareholders but I think in overall terms, the relationships are not bad, provided companies recognise that they have got their new set of responsibilities."

Says another:

"I'm not entirely sure what problem we're trying to solve here. I chair two companies and I'm pretty lucky our shareholders have been pretty pleased with what we've done. We work the shareholder community very actively and we get 70 percent positive votes, which I'm happy with."

Others emphasised that they saw a wide range of performance by shareholders in respect of engagement with portfolio companies, with some investors still engaging actively and thoughtfully, but others proving unresponsive or unprepared to undertake detailed discussion with boards about contentious issues.

"In my view, some are outstanding and no chair could ask for more," says one. "The very best consistently engage when a meeting is requested, listen, give their views and also, if they rate and trust you, ask for your views as they decide what their own policies should be on key topics. By contrast there are others that are simply hopeless. I can think of one (a FTSE 250 company itself) that doesn't even have the manners to reply to requests for meetings and has a board itself which fails most standards on director tenure, diversity etc. How can they vote on others with credibility?"

A substantial majority of chairs see serious problems

Notwithstanding some of these comments, a large majority of our interviewees felt that board-shareholder relations in "UK PLC" have become a problem serious enough to warrant something of a reappraisal.

Intensity of feeling on the topic covers a spectrum, from those who argue that the current state of affairs is an important impediment to effective stewardship of companies, to those who see it as a minor frustration but a fact of life.

Across the spectrum, however, there are several common areas of concern:

A change in shareholder approach: from broad principles to detailed rules

Some chairs feel that the quality of interaction between boards and shareholders has deteriorated so badly in recent years that instead of working together to create long-term success, they sometimes appear adversaries locked in a struggle over how a company should be managed. On this view, thoughtful engagement is today too often eclipsed by forms of shareholder aggression.

"There was a time when board accountability to shareholders meant agreeing on a broad set of principles for long-term value creation and other issues, and asset managers working on behalf of owners on a similar set of broad agreed principles," said the chair of a leading engineering firm. "Then boards were responsible for how these principles were met. The issue at the moment is that the shareholders themselves are much more focused on how things should be done. It's more and more about rules being set by shareholders and asset managers. Partly because of some big corporate failures, we've left behind the premise that shareholders and the company are on the same side. We're moving from a world based on trust and into a 'show-me' world where boards and management have to check against rules to show they have done the job."

A second, very seasoned chair put it this way:

"Boards are the stewards of companies and instead of diffusing the responsibility to investors, it would have been better to have strengthened the responsibility of the board and then the shareholders would have had a stronger responsibility to select members of boards and to get rid of members of boards who weren't performing. I think that piece in the jigsaw of how you manage the performance of boards has gotten lost altogether.

"There's a huge agency problem, and there isn't an easy fix to this. It's dysfunctional, but none of us have come up with a brilliant way of unlocking it. It really shows up strongly I think when you're in the middle of a bid and you've got a whole raft of shareholders or intermediaries, who have very different views and very different objectives."

Another strongly agrees that the corporate board, not the shareholder register, is the appropriate place to formulate and oversee the execution of corporate strategy and delivery for stakeholders. It all comes down, he says, to different understandings of the meaning of the word "stewardship", with investors having come to see the Stewardship Code as a prompt to intervene more actively in the detailed management of companies:

"In fact stewardship should belong to boards and boards should be accountable to investors for that stewardship. The problem is that investors are intervening too much in granular detail in the discharge of boards' responsibilities. It's gone too far and put a burden on investors themselves which they are not equipped to handle."

Investors do not take time to engage and instead, outsource decision-making

At the root of these complaints are a number of specific gripes relating to the feedback boards receive from shareholders, and the patterns of shareholder voting at their annual general meetings.

One, as indicated in the quotation immediately above, is that too many investors do not have the time to engage with or develop a deep enough understanding of the companies in which they invest — a problem that is especially acute for smaller FTSE companies.

"This is a basic issue of fiduciary responsibility in my view," says one very experienced chair. "How can you as an investor exercise your fiduciary duty to your ultimate client, if you're investing in a company about which you know little, other than some mathematical characteristics of the previous share price performance? If you didn't know what you were investing in, and hadn't done appropriate research, then you are failing in your fiduciary duty. There needs to be an atmosphere of obligation that investors need to know what they're investing in."

Some say that the problem is exacerbated by the proliferation of issues on which shareholders are expected to vote very regularly at AGMs. One chair felt it had been an unhelpful innovation to require shareholders to vote on re-electing the whole board every year:

"When you had to be reelected after a three year term, that meant only a third of the board roughly was being reelected each year, and then it was possible for the shareholders to focus on the people are up for reelection. Now, directors' reelection gets less scrutiny than it ideally should."

A second, related complaint is that investors, especially the "passive" or index funds whose share of the market has grown massively in recent years, outsource their analysis of companies' decisions and governance to third-party proxy voting agencies, without exercising judgment of their own when it comes to deciding how to vote on board appointments or resolutions. (see Chapter 4 for more detailed discussion of the role of proxy voting agencies).

"There are some shareholders who are subcontracting some of their relationship with a board to the proxy agencies, particularly around the time of an AGM. Proxy agencies read board resolutions and look at the performance of the company, then make blanket recommendations to shareholders. The problem is some of the issues in resolutions, particularly on things like remuneration, are quite complex, particularly when you're trying to attract and keep the best management."

3 “Box-ticking” and generic communications have become dominant features of shareholder input

Many chairs note the widespread resort by investors and their service providers to prescriptive rules on matters such as executive remuneration, corporate governance and environmental and social matters (lumped together as “ESG”). There are two problems with this, they say.

First, in the eye of some chairs, it creates a distraction from the core business of the board which is to oversee the governance and management of the company in executing its strategy.

“The public company model is broken,” says one. “You have a large group of very talented and dedicated execs and non execs getting together ten times a year and 70 percent of the agenda is typically governance and regulation. Directors have to worry about whether their gender pay gap has gone up or down and what that might mean, and what will be written about it in the Daily Express. That leaves little of the 35 days a year a non-exec normally devotes to a company to think about other things.”

The second perceived problem with the predominantly rules-based approach is that it makes insufficient allowance for the individual circumstances of companies or the specific reasons — usually carefully considered by the board — why they have proposed a particular policy on, say, executive remuneration. In this view, shareholders have become inflexible and reluctant to make exceptions to their rules even when they might be justified.

A number of chairs cited repeated examples of boards taking pains to explain a well-founded corporate policy to institutions, with investment decision-makers in those institutions expressing assent, only for the institutions then to vote against that policy at the AGM on the grounds that agreeing to it would set an unwelcome precedent. At worst, this makes a mockery of a corporate governance code that is supposed to operate on the basis of “comply or explain.”

Says one:

“It’s not comply or explain any more. It’s just comply.”

The problem is exacerbated when investors suddenly change their approach without consulting boards in advance or even informing them.

“A number of investors have now got stricter on the governance side of things in terms of number of mandates you can have as a board director,” says a chair with a portfolio of other directorships. “They reduced the number of non-executive positions directors should hold without telling anybody. So I have suddenly become accused of ‘over-boarding’ and voted against without any warning whatsoever.”

A related point, to some, is the increasing resort on the part of some investors to issuing generic “Dear chair” letters setting out a set of generalised concerns and consequent voting rules. These, say chairs, do more harm than good, and, when published in the media, can take on the appearance of public grandstanding.

4 Shareholders are insufficiently transparent, and are at times inconsistent

Many of our interviewees expressed the view that interactions between boards and shareholders are currently one-sided, and that shareholders appear to be reluctant to engage with portfolio companies on contentious issues before casting negative votes. They expressed a strong desire to see more transparency from shareholders concerning their approach to investee companies and in particular their voting intentions and rationale.

Many also said they would like to see more high-level guidance from shareholders as to their expectations — for example concerning ESG matters — and more flexibility concerning specific cases in relation to remuneration or numbers of board appointments an individual non-executive director holds. Accountability, in other words, should be a two-way street.

“I really think shareholders should do more to explain why they act in the way they do,” says one. “They do reveal how they voted, but generally too late and without explanation. If an institution is planning to vote against a board resolution or nomination, it’s all the more important for the board to be able to discuss that with them before the fact. But too often that is not possible, and it’s especially difficult when the proxy agencies are involved.”

Adds another:

"When discussions are balanced it's fine. But often public accountability and responsibility for boards is not balanced with accountability for shareholders as to how and why they vote. So we have public assessments by and feedback to companies but nothing from those who do the voting. Those who vote have accepted the accountability when signing up to the Stewardship Code, with its 12 obligations that require a lot of resourcing, notably for extensive engagement with investee companies."

A chair of a FTSE 100 company asked:

"All the big investors sign up to the Stewardship Code, but who's holding them to account as to whether they adhere to it?"

According to many of our interviewees, the problem is that shareholders tend to be secretive about their voting intentions vis-à-vis a company.

"Even in a consultation with a fairly long term shareholder, they'll say, 'yes we understand and thank you for bearing us in mind, but obviously, I can't tell you how we vote.' This is not engagement or consultation. I would respond that it would actually be helpful if you gave us an indication because we want to factor in your feedback and know, broadly, whether you will be supportive if we seek to accommodate enough of your interest. It's a right of secrecy that they take, especially in the corporate governance part, which is extremely unhelpful."

A further complaint is what could be termed investor incoherence.

"The fundamental issue is we face different ways with shareholders. We have conversations with the decision makers about strategy — that is to say the right long-term answer for the business – and some shareholders engage very seriously. Then we have governance relationships which require boards to supply a whole lots of detail. I wonder in all this detailed disclosure whether we have lost sight of what is really important."

"This is an institutional problem," says one chair. "Sometimes you hear one view on an issue from the portfolio manager of a given fund and something else entirely from that same fund's governance department. You could be owned by several different groups for different reasons in a single institution, and the governance people come in to make 'one size fits all' rules."

Says another:

"It would be highly desirable for each individual shareholding organisation to speak with one voice. And in the case of institutions with a significant stake, I think we are entitled to expect that."

Chapter 3

Engagement in a changing investment landscape

The chairs we interviewed readily acknowledged that the issues bothering them are a natural outgrowth of structural changes in the investment marketplace, not least the pressures of consolidation and cost-cutting among leading asset managers themselves, a diminishing share of UK equities in investment portfolios, and the ever-shorter median holding times for individual shares on asset managers' books.

These can be seen to exacerbate the ever-present tensions between short-term financial performance and the long-term interests of companies and all their stakeholders.

One trend highlighted is the rise of passive or index investment funds, which offer low-cost alternatives to traditional active asset managers and are by definition not resourced to devote much analytical effort or management time to engagement with individual companies.

A second is the relative decline in importance of the traditional UK long-only investors that used to be core shareholders in UK PLC and engaged fully and frequently with their portfolio companies. With the demise of defined-benefit pension schemes, UK investment houses have devoted decreasing proportions of portfolio money to equities and more to other asset classes such as fixed income.

Another relevant development is the rapid expansion of funds focused on ESG-friendly investments, which market themselves on their "green" credentials and reflexively take positions in company votes reflecting that.

One chair summarised the changing landscape as follows:

"Pension funds have switched to fixed income; with-profits life companies have shrunk and been replaced by tracker funds, the investor base is increasingly global, and DC pension plans and retail investment houses are more subject to fads and fashions."

All this makes for a much more complex environment for companies seeking to explain and seek support for their strategy from shareholders, or to consult them on important issues. One who has chaired several boards puts it like this:

"A much greater responsibility has gradually fallen on boards over the last decade prompted by the growth of passives and activists. The passives, in their battle for retail market share, tend to take governance positions that are not necessarily in the best interest of the company but which may be distinctive and support their brand. Unhelpfully, they also sometimes team up through the back door with activists. Thus as a board we are faced with a completely irreconcilable array of shareholder views and interests."

As a number of chairs pointed out, the preponderance of passive funds in the market make it harder for companies to disseminate their message, and indirectly amplifies the voice of "issue-based" investors and activists.

Says one chair:

"As a board, there are issues on which you really feel you would benefit from the detailed views of your shareholders but these are sometimes hard to obtain. Some investors have a full-time team on the case and that's fine. But if you wanted the views of the generality of your shareholders, that's more difficult. And quite often institutions hide behind the proxy agencies, who themselves speak about the ecosystem they represent but don't actually engage themselves."

So how in practice do boards go about engaging with this cacophonous investor base? The obligation on directors under the Companies Act, as we have seen, is to act in the way "most likely to promote the success of the company for the benefit of its members as a whole."

Says a chair already cited in this chapter:

"We have to accept that that is the ecosystem we have, and to engage with all that are out there – from increasingly adversarial active investors to the passives. You can and must engage with the passives, less for enlightenment and more to understand where their heads are. But in that case you will probably not be dealing with the fund managers themselves but with the governance people who are going to talk about their brand theme of the day."

The response to all this from many chairs is to reaffirm the role of the board in reconciling the various competing interests of different shareholders and stakeholders in the company's perceived long-term interest. Boards, in other words, must be prepared to step up and take decisions even if a significant minority of shareholders oppose them:

"It is inevitable and incumbent on us to take positions to support a subset of shareholders' beliefs and the company's best interests. Sometimes we have to say 'sorry, but we disagree' and get on with it. Ultimately it is for shareholders to hold boards broadly accountable for delivering on agreed objectives."

In the same spirit, many chairs express the view that boards need to be less sensitive to protest votes at their AGM, even if they lead to media headlines talking about an "investor revolt".

"If you're trying to do something you really think is the right thing to do and you have your main investors on board and well over 60 percent in favour, that should not be a problem. If shareholders are not happy with what a board is doing over a consistent period of time, they should vote out the chair."

This view is echoed by another experienced chair:

"I think boards need to get used to the idea that shareholder democracy means that the majority is a majority and we have to think about what a good majority looks like. The good old days of the chair being re-elected with 99.95 percent of the votes are over because there will always be a protest view about something. This then forces the company to provide a 'grown up' board, and engage with core investors more fully."

All our interviewees noted a divide between investors focused on income and the much smaller number focused on growth. This is both a cause and consequence of the relative paucity of high-growth tech stocks on the UK stock market.

"The growth community is less adversarial and their line of questioning is far more constructive. I find the best investor conversations I have are with investors in growth and also distressed debt."

Many emphasised the particular importance of careful engagement with shareholders when a company's strategy is undergoing fundamental change, pointing to notorious recent cases where boards have mishandled shareholder communications over important strategic moves and consequently — and embarrassingly — failed to achieve their objectives.

One chair of a major company who had recent experience of engagement with an activist seeking to change the company's course said that experience had been "cathartic for the company in many ways" as it prompted a much deeper engagement by the board with its top 50 shareholders.

"The activist was making all sorts of assertions about what our shareholders think, which was frankly a self-serving message," he says. "But we started to ask ourselves: do we really know the minds of our shareholders? Do we understand why they invest with us? So actually I reached out and spoke to our top 50 shareholders over the course of a few weeks. It really opened up how we communicate with shareholders, and we came back with a very strong mandate as to what our shareholders expected of us."

Others felt the role of activists is being given undue importance, partly because of the leverage they can muster by borrowing stock from institutional investors.

Several chairs called for a prohibition on stock lending which in their view acts as a distortion in the formation and expression of shareholder opinion on companies, especially given the reduced role of a core of committed and well-informed active investors:

"Stock lending has been a problem, and we need to change the rules on this. I don't think most end clients understand that their stock is being lent for a different purpose than the one they signed up to. This means people can build synthetic positions on your register. And frankly, the big institutions need to stop hiding behind activists for them to do their dirty work. It's the responsibility of shareholders to engage openly."

Chapter 4

The role of the proxy voting agencies

One problem raised by all of our interviewees, without exception, was the role of the proxy voting agencies — with views ranging from frustration and irritation at one end of the spectrum to militant hostility at the other.

As we have already noted, the importance of these third-party advisors such as Institutional Shareholder Services and Glass Lewis has grown massively in recent years as shareholders have devoted less time and effort into understanding their portfolio companies. Themselves under cost and resource pressures, many asset managers — and especially those running passive tracker funds — have come to rely on proxy agencies to guide their voting decisions at AGMs.

In this chapter we detail chairs' criticisms of the proxies and consider various proposals for addressing the perceived problems. Some, though by no means all, chairs understand why shareholders, that do not have the resources to follow all their investee companies in detail, use proxy agencies. But all are heavily critical of how the system works in practice. Perhaps the most vitriolic of many comments was one chair's description of the agencies as "somewhere between pointless and a grotesque waste of energy".

To illustrate the concern, one chair told this story about the role of a proxy voting agency in scuppering a new remuneration scheme for his company:

"We came up with what I think was a very well constructed scheme, which would actually penalise management for under delivery. We took away all of the downside reward opportunity for management and added significant reward for the upside. This was completely aligned with the strategy and performance emphasis of the company, and practically every shareholder said, yeah, we'd like this.

"Yet the entire consultation effort came down to a draft the agency report issued shortly before shareholders were due to vote. It was absolute gobbledegook and ISS had refused to talk to us in preparing it. We first saw the draft the agency's report the night before it was being issued. We had an opportunity between 7pm and 10pm on that night to change it; they published the next morning with a vote against and virtually 60 percent of our UK shareholders voted against driven by this agency. If we talk about accountability, responsibility and integrity, this is utterly broken. So it is actually a very real problem."

Specific and widely shared complaints

The criticisms can be broken down into a number of specific points:

1) Too many shareholders rely unthinkingly on proxy agency guidance

As we noted in Chapter 1, the Stewardship Code emphasises that: "Asset owners and asset managers cannot delegate their responsibility and are accountable for effective stewardship." Yet many chairs assert that this is precisely what is happening in practice. Many cite numerous examples where shareholders have told them that they voted against a board resolution or nomination purely on the basis of proxy agency advice rather than exercising their proper judgement.

"Accountability for the stewardship of businesses has already moved too far towards investors in my view. But when they outsource that further to proxy agencies, it seems completely inimical to good governance and strategy. There's one agency that votes 25 percent of the register on most FTSE companies. It would be better to return to direct dialogue between boards and investors."

Companies, say some, should challenge shareholders on how they use the agencies and what role proxy advice plays in their decisions:

"I think we should actually work harder and ask the question of those shareholders as part of business as usual. How much reliance do you put on them and under what circumstances would you just simply follow that guidance?"

2) The output of the agencies is not fit for purpose

Many chairs are fiercely critical of the agencies' work, which they say is prone to inaccuracies, and of their employees, whom they regard as frequently unqualified. To name one example, the chair of a leading financial institution said that a number of institutions downgraded his company's governance score on the basis of one particularly influential agency's advice that turned out to be factually incorrect.

"Companies do recognise there is a need for proxy advice: institutions with small holdings of a FTSE 100 need some guidance as they don't have the bandwidth to do all the research themselves, " says a FTSE 100 chair. "The problem is: the agency in particular, doesn't recruit the right people. I don't have a problem in terms of what they do but it would be helpful if they had people who were fit for purpose and were prepared to put effort into understanding the companies and sectors they cover."

3) They are inflexible and often refuse to engage with companies on critical issues

"You know how the process works," says one. "About three days before the AGM you get the draft report and it's riddled with inaccuracies, which you then face a crazy scramble to correct." Adds another: "It is incredibly frustrating for a company to receive the report on a Thursday afternoon, and be told, you have to respond in 24 hours."

Many are critical of what they see as an excessively rigid, inflexible approach by the agencies, which is seen to have fuelled the drift towards 'box-ticking' described in Chapter 2.

"They are too black and white in a world which is nuanced. They take some very absolute and militant positions in situations which are more complex. The heart of the shareholder relationship should be to 'comply or explain' but that is not the case if proxy agencies are involved."

These problems are then compounded by difficulty in engaging at the last minute with the agencies to discuss their recommendations or with shareholders minded to follow them.

Some chairs suggested that agencies which hold a large proportion of voting shares by proxy must be required to engage fully as if they were in fact owners of that proportion of the company.

Several chairs concluded by pointing to the damage to companies that can result from this process.

"These 'red-top' warnings and negative votes can be extremely prejudicial to a company's reputation. If there's a red flag, there is a general assumption of wilful mischief from the company, even when a lot of thought has been put into a board decision. Yet it's so difficult to change them: in my experience there's about a 30 percent success rate because so many investors say: 'I'm sorry, I take my lead from the proxy agencies'."

4) They are prone to unsupervised conflicts of interest

A number of proxy voting agencies also sell ancillary services including advice to companies about how to handle shareholders. Some of our interviewees likened this to the perceived conflicts of interest that have long plagued audit firms in respect of their lucrative consultancy divisions.

Michael Moritz, the leading US venture capitalist, detailed the conflicts in a recent article in the Financial Times:

"Along with its edicts on executive pay, ISS has sales people hawking reports on diversity, sustainable investing and climate policy to the very companies whose shareholders it courts. In another line of business it acts as a compensation consultant for the boards of fund managers. ISS also operates a ballot vote counting service and provides research for class action stockholder lawsuits. A cynic might say that ISS operates a protection racket in the full light of day."

Said one chair:

"Using ISS as an example, it was slightly staggering to me when they launched a consultancy arm in which they charged clients to come in and help you understand why you were voted against and what you could do to turn the vote."

Adds another:

"There is a perverse incentive with some of the proxy agencies who are selling advisory services too. This demands some kind of oversight."

Potential remedies

Many of our interviewees felt strongly enough about this issue to suggest ways in which the problem might be addressed. Broadly, they fall into three categories: better quality control by shareholders in their use of agencies; disclosure requirements for investors concerning the role the proxy agencies' guidance plays in their voting decisions; and regulation, either through establishment of a code of conduct for proxy agencies, direct supervision by a body such as the Financial Reporting Council, or both.

1) Enhanced oversight by investors

"There should be a mechanism whereby funds drive the proxy agencies to serve them better in terms of the nuancing of decisions," suggests one chair. "They need a better flagging system whereby important votes are brought to the forefront of investors' attention so they can get more involved in them. The current systems do not seem to be that detailed or helpful from their side."

Adds another:

"I think that asset managers simply ought to demand better quality, and be prepared to drop some of their providers occasionally. If the quality's not there, there has to be some accountability, but the accountability has to come from the customer, the asset manager."

Some chairs, however, doubt this will happen, and conclude that institutional investors should bite the bullet, dispense with the proxy agencies and bring their coverage of company votes in-house.

"I think the relationship between the proxy agencies and investors needs clarification. Many shareholders say to do what you feel is right, and we will sort the proxy agencies, however, it does not work that way in reality. For that reason I would rather see the fund managers bringing it back in-house."

If investors are unable or unwilling to properly resource the level of direct involvement in the stewardship of investee companies then it was suggested that they should either increase resources or, more sensibly, delegate greater responsibility back to the board.

2) Disclosure requirements

On one view:

"Investors could be compelled to say why they use proxy agencies and how it fits into their stewardship responsibilities. If an investor is relying wholly on a proxy agency to decide how they're going to vote at an AGM, they should tell us that."

Says another chair:

"Requiring shareholders to disclose service providers used in forming their view would at least highlight the outsized influence of the proxy agencies, "I think it would be great if the biggest money managers in the world had a duty to explain to the companies whose shares they hold how they go about voting,"

Some suggest that shareholders might be compelled to engage with companies ahead of key investor votes if they are planning to vote against the company in order to discuss how such a decision serves the best interests of the company.

"If you think that this proxy agency voting recommendation will send the total in favour below, say, 85 percent, then you should have a duty to speak to the company and understand why it is going in the direction it has chosen.

3) A code of conduct and regulation for proxy agencies

While chairs have mixed views about the desirability of adding to the burden of regulation on companies and shareholders, a significant number feel such measures are inescapable, since the current Stewardship Code's provisions on service providers are notably weak.

"A code of conduct regulating the proxy agencies would be extremely useful. Agencies like ISS have huge unregulated power in the marketplace. If they get things wrong — which they do — the implications for business is profound. Something like a FRC requirement to assess they are fit for purpose would be beneficial."

In summary, in the view of at least a third of our sample:

"They should be regulated and transparent, regulated for their decision-making processes."

Chapter 5

Understanding ESG

In recent years, the cluster of topics awkwardly clustered under the rubric "Environmental, Social and Governance" has obviously moved from the periphery of boards' and investors' consciousness to front and centre.

Almost all the chairs we interviewed agreed that this is as it should be — and indeed awareness of a company's environmental and social impact is nowadays part and parcel of its overall purpose.

"I believe the concept of 'ESG' is 10 years out of date," says one chair. "Today businesses need to have a purpose that works for the communities in which they operate. That purpose needs to be put before strategy and to be broader than making money for shareholders. Any company that does this will more than outperform ESG requirements.

It changes the debate from being a hygiene factor to being at the heart of what businesses do."

Many of our interviewees suggested that boards were ahead of their shareholders in terms of their understanding of these issues, especially the increasingly important environmental dimension:

"I think companies are actually more knowledgeable about ESG than many institutional shareholders, and they're working very hard. At the same time I think there's much more awareness of ESG among institutional shareholders, mainly driven by the fact that there is this wall of investment money searching for ESG friendly investment."

Our interviewees were more critical, however, when it came to the manner in which investors and boards engage on these topics. Their complaints are threefold.

First, that ESG reporting by companies has expanded in a way that generates little real insight — for example about how companies are managing their environmental impact and the trade-offs involved. Second, that companies find themselves compelled to meet a bewildering and ever-changing variety of environmental, social and governance standards and scorecards, many of them inconsistent with one another. And third, the ESG expectations of investors themselves are diverse and on occasion contradictory. There is a yearning for a simpler and more straightforward system.

Reporting: too much of a "tick box exercise"

"My own annual report has increased from 150 pages to 250 pages in the last 10 years — but the increase in reporting, especially on ESG, has provided no real benefits in clarifying the long-term success factors for the business," says one chair.

The important thing with reporting, according to the chair of a financial institution, is to keep it proportionate to the relevance of ESG to the business: "For example, there's a difference between a hard hitting, pithy, well-reported ESG agenda at BP and a report from a service company about having senior executives take fewer flights and turn the office lights off."

Proliferating standards: the "wild west"

ESG reporting has, of course, become a business opportunity — notably for providers of various thematic stock indices and scorecards, and consultants of all shapes and sizes. This has led to the distracting profusion of standards of which our interviewees complain.

"I think the proliferation of different sorts of standards is a complication and is unhelpful," says one. "It would be great if that could be rationalised. The big four accounting firms, of course, see it as the latest wonderful discovery because they're earning tons of money out of environmental consultancy."

Another compares ESG reporting to the wild west:

"Everyone uses a different index regardless of what you are doing and it can lead to very unfair comparisons."

In the eyes of many chairs, investors find themselves facing a contradiction here:

"I heard portfolio managers say, it's not really the standardised reporting of data that's important to us, it's understanding your intention: I need to know that your efforts to reduce the carbon footprint of your business are authentic and that you have real plans. I believe that's true. But I also believe that everybody's been swept up into this mania for consistency and for comparing things across companies, once again with the proxy voting agencies to the fore. So this is the ultimate contradiction."

Nevertheless, some see a degree of clarity emerging in this area.

"We are seeing some convergence and reduced reliance on these measures as everyone gets more sophisticated. ESG is just a part and parcel of every business nowadays, like financial reporting. We are moving towards a point where everyone uses the same words to mean the same thing."

Divergent investor expectations

One chair expresses frustration at the lack of a joined-up conversation between his company and its shareholders on ESG.

"I have sat in meetings with investment decision-makers where they say they agree with me about the company strategy, but their hands are tied by ESG. And the ESG people in the room are clearly not holistic thinkers, not thinking about matters such as shareholder return, and taking simplistic positions on highly controversial issues. There are many tradeoffs but these investors are trying to make the trade-offs for you and tell you what to do, on the basis of limited competence. At the least I would call to account what I would call bogus ESG based on virtue signalling."

A less extreme complaint voiced by a larger number of chairs is that as a group, investors are far from consistent in their ESG expectations.

"You have ESG specialists, you have impact investors, you have the corporate governance crowd. And they all have slightly different views, for example about whether to have more or less of an ESG element in your remuneration and so forth. It would be extremely helpful if institutional shareholders could speak with one voice on the subject."

Another chair is less sure that investors will be able to produce all-purpose guidance of this kind.

"I think it's really hard to get a benchmark — for example with regard to measurement of greenhouse gas emissions — because every industry is different and perspectives vary along the value chain. But it would at least be worth trying to get industry bodies to agree broad standards of how they're going to tackle it within their own industry."

Chapter 6

Competitive challenges for UK PLCs

The comments quoted so far in this survey beg an important question: do the problems they highlight represent a threat to the competitive position of London-listed companies or UK capital markets?

A number of media articles in recent months have highlighted the relative decline of the London equity market in recent years. Last year The Economist pointed to London's dwindling share of global IPOs, the 40 percent fall in the number of companies listed there since 2007, and the tiny proportion of UK market capitalisation represented by tech firms.

More recently, the Financial Times Lex column discussed the persistent lag between stock market returns in the UK and international peers, and the entrenchment of a historically wide valuation discount for UK-listed companies. It concluded:

"For investors, Britain is not just the sick man of Europe but of the world."

Many chairs we interviewed recognised these market trends as a problem for their own companies. In particular, and with varying degrees of emphasis, they highlighted three competitive issues for companies listed in London. First, the relative decline of active and committed long-term investors, and their replacement by passive tracker funds that are more interested in income than growth. Second, the escalating war over talent and investment capital between public and private companies, and between UK PLC and other markets. And third, over-regulation of companies and investments, that in the eyes of some has led to a worrying aversion to risk in the UK market.

The UK market does not adequately value growth

A number of interviewees cited the problem of relatively low PE ratios attributed to UK companies versus their US-listed counterparts, for example: as one said:

"I continue to hear from US investors that they are finding the UK market unattractive because of the raft of regulation and interference and that the UK market seems to have lost its ability to value companies properly."

Another formulates the problem this way:

"My company is a high growth business competing with international high growth companies for resources and talent, requiring the support of active investors. Yet the reality of the London market is that the active pool is not large enough. Passive investors are less interested in the risk return of a growth portfolio and they also tend to take a less engaged view of companies."

This chair went on:

"If you compare London in that respect with the much larger pools of active funds in the US, it shows how much harder it is for high growth businesses to grow and flourish in London. So it is critical to attract overseas investors, in order to access the larger pool of active capital than is available in London."

He, like a number of other chairs, drew attention to the pending decision by Softbank on where to IPO UK tech champion ARM Holdings, and the widely-trailed likelihood that it will opt for New York.

Yet others felt that to blame passive investors for this predicament is to miss the point.

"Yes, the motive for holding a particular company's stock is different as between a passive and an active house - passive investors are indifferent as to whether an individual share does well or badly, and their attitude towards a board's chosen actions is therefore subtly different when compared to an active investor. They are not vested to the same degree in a company's success, and I think this is the main problem. We should remember that in the US, tracker funds have a larger market share than here."

London-listed PLCs face a struggle for talent

In the recruitment market for executive and non-executive directors, London-listed public companies face two broad competitive challenges: the lure of private equity, where rewards (and risks) are significantly higher; and the task of recruiting executive talent specifically in the US.

Our interviewees expressed a wide range of views on the scale of the PE challenge. At the pessimistic end of the spectrum was this comment:

"It's difficult and becoming more so to recruit CEOs and chairs to London listed boards: it's not just the pay but also the scrutiny and second-guessing. Most CEOs after being CEO to a public company look to go into private roles where there is more freedom to implement and deliberate strategy over a long period of time and where the frustrations are fewer."

Another chair reflects that if he started his career again he would aim for private companies:

"I think now the demands on public company directors in relation to their compensation are quite high, and the risk-reward relationship in private equity is quite different. This is a real problem, and I think that the days of public companies are numbered."

Some said the remuneration question was acting as a disincentive to private companies to go public. On the other hand, few of our interviewees reported actual problems in recruiting executive or non-executive talent for most types of role.

"Most people in business still regard a position on the board of a public company as the desired summit of their career," was how one summarised the views of many.

Where recruitment becomes more difficult is in securing quality hires for senior roles in the US market, since it is all but impossible to fit competitive US executive compensation packages within the reward framework of a UK PLC. Chairs who have struggled with this issue blame, in part, the rigidity of institutional investors and their proxy advisors on executive remuneration in general.

"We have been trying to recruit a divisional president for the US but we've found it impossible to get close to the required compensation, within the UK pay restraints," says one. "This is a big problem because North America is our fastest growing and largest region."

"Remuneration is a real challenge,"

says another, who chaired a company with most of its competition in North America, yet its senior leaders were paid "the equivalent of a regional manager in Oklahoma."

Such experiences lead many chairs to conclude there is a need for a serious, joined-up discussion between boards and shareholders about revisiting the whole question of rules on executive remuneration.

Regulation and risk: time for a reappraisal

So what is to be done to address the issues discussed earlier in this chapter, and the other problems regarding UK competitiveness? Our interviewees were clear that some of the biggest challenges lie beyond the scope of this report and reflect fundamental questions concerning post-Brexit Britain and the role of government in the economy. They acknowledged efforts by the government and market authorities to improve London's international position by making the UK listing regime more user-friendly for growth companies.

They also paid tribute to the support provided to companies by investors and government during the COVID-19 pandemic, which showed one of the marketplace's strengths.

"London stood behind companies during the most difficult times during the pandemic. This might not have been the case without substantial, direct government support."

Nevertheless, the chairs also affirmed that London's competitiveness as an equity market could not be divorced from the overall climate for business and investment within the country.

The majority view of the latter was far from positive, with none seeing signs of a "Brexit dividend". A sense that business and investment have become over-regulated in the UK is central to that view.

Three issues stand out: the detailed requirements on boards that we have discussed earlier in this report; the never-ending debate about remuneration; and a general sense that as successive governments have responded to corporate failures by imposing new layers of regulation, sight has been lost of the basic concepts of risk and return.

As one chair who has served on UK PLC boards for more than 10 years put it:

"The conversation we all have all the time is, why is the UK not a good place to list? Because it looks like the US in terms of all the prescriptive rules, like the tyranny of Sarbanes-Oxley. But the UK is a much smaller market, and it's got more income rather than growth investors. And then you have your hang-ups on remuneration. We just have to hope that the next prime minister, or the prime minister after that, will have a serious look at the business of capital market formation in the UK, and whether it's time to re-examine, simplify and lighten up on it."

There is talk among chairs we interviewed of encouraging the Treasury to establish a Capital Markets Commission with the job of looking across the policy landscape and make recommendations to maintain and improve London's position as a leading capital formation centre. Corporate regulation could be on its agenda, as well as the factors shaping share trading.

"My sense is we are becoming a less and less attractive place for international capital, so we need to get some credibility back. Collectively as non-execs we could go to the government and say this is the regulation and legislation we need to keep this market healthy."

Chapter 7

Initial responses from institutional investors

When the interviews with chairs had been concluded, we shared a summary of key findings with a select group of leading international investors who are active in the UK equity market, highlighting the following observations:

1. Shareholders' approach has moved away from strategic engagement with boards to a focus on detailed, prescriptive rules and generic forms of communication.
2. Too many institutional investors do not take the time to understand and engage with portfolio companies and in effect outsource their decision-making.
3. Institutions are insufficiently transparent with companies about their considerations in arriving at voting decisions, and are at times inconsistent.
4. The role of the third-party proxy voting agencies needs scrutiny, as their work is of poor quality and they often fail to engage with companies on issues of concern.
5. Shareholders' expectations of companies in relation to ESG issues are characterised by "tick-box" reporting and proliferating and sometimes contradictory standards.

We subsequently interviewed nine senior executives employed by different institutional fund managers, in roles covering either investment management or governance.

Perhaps not surprisingly, none of our interviewees agreed that the above observations adequately described their own interactions with portfolio companies.

For example, all insisted that they were satisfied with their access to boards, that they took pains to understand portfolio companies, and would not dream of outsourcing voting decisions to third parties.

One stated bluntly:

> ***"I actually don't think that our relationships with companies are broken. We shouldn't think that just because we don't agree with boards from time to time on some points, there's a fundamental problem."***

At the same time, most recognised truth in at least some of the specific issues raised and admitted to a degree of familiarity with the boardroom frustrations they reflect. All agreed that these tensions had their roots in deep-seated structural changes within the asset management business in general and the UK equity market in particular, and some ventured that these changes may not be fully understood by corporate boards.

Two factors were cited by all our interviewees here. The first is the radically shrunken share of UK equities in institutional portfolios compared to 10 or 20 years ago, which means there is less talent within the institutions dedicated to engagement with individual UK companies on their strategy and performance — as opposed, say, to ESG issues. A second is competition within the asset management industry, and in particular the pronounced structural shift away from "active" fund management (stock-picking and long-term buy-and-hold investment) to "passive" investment in index tracker funds.

A majority acknowledged that, as one of them put it, something is currently getting "lost in translation" between UK boards and shareholders, and that an open discussion of the causes and possible solutions might help to clear the air. What follows is an attempt to capture points of consensus among investors as well as the range of views expressed.

Investors welcome strategic engagement with companies, but have less time for it

All the managers we spoke to expressed appreciation of their access to boards — as and when needed, if not in all cases on an annual basis — and stressed the importance to them of discussing corporate strategy as well as governance issues.

One international fund manager compared the ease of access to UK chairs with the obstacles he regularly experiences in trying to communicate with US board directors:

> ***"UK boards are receptive; it's much harder in the US to get past the general counsel and other lawyers."***

Large active investors insisted that their dialogue with portfolio companies is strategic and bespoke, rather than rules-based or prescriptive, but acknowledged that this approach is no longer by any means universal.

"We have a detailed agenda that we pursue in every engagement with a chair," said one large international investor. "And it is very much issues focused and not at all prescriptive: we don't have any set questions that have to be asked. But then we're extremely well resourced, with sector specialists, analysts and a well-resourced ESG team. Our ability to tailor engagements, rather than have a prescriptive format, is probably at the high end of what's possible in the market."

As this suggests, while expressing satisfaction with their own engagement, all interviewees recognised that as a whole the investor base of UK companies now has less time and fewer resources to devote to strategic engagement with individual boards. The result is a widening quality gap between the engagement practices of leading investors and those of a "long tail" of laggards.

"Something's clearly getting lost in translation between boards and shareholders," said one seasoned UK investor, suggesting that the shift in investor focus to governance issues may have caused some chairs to become "less proactive" in challenging management on strategy and performance and less alive to the concerns of long-term shareholders. "When it comes to capital allocation and company leadership, we're suffering from over emphasis on the governance and ESG side,"

"Because of the dramatic fall in the proportion of UK equities in institutional portfolios, equity teams on the buy side are by definition less focused on the UK market," said the representative of one leading UK institution which has just merged its UK and European equities teams. "They have reduced coverage and don't have the long, ongoing relationships with companies in the market that they might have done a few years ago."

Another said:

"It has been all too sad to witness, institutions have gone from engaging to not bothering. And this is especially perverse in the case of passive investors which by definition are going to own large company shares forever, unlike the hyperactive holders who may be gone tomorrow."

A third, however, argued that since they are invested in the entire index, passive investors have little incentive to engage with companies to improve their relative performance.

"That's why they end up just ticking all the boxes."

Various industry pressures have led to a more prescriptive, formulaic approach

These structural trends, combined with pressures from institutional clients, have driven a sizeable number of investors to adopt a more generic approach to portfolio companies. Our interviewees agreed this was a root cause of the friction described in this report, as in many cases investors have come to rely on set formulae — for example to govern executive remuneration — and no longer have the scope to give careful consideration to cases seen to be in violation of their rules or to set unwelcome precedents.

"There used to be governance teams solely focused on governance in the UK market, but over time those teams have morphed into ESG teams working with pan-European funds," said one manager.

"And clients are pressing for evidence of how our investment approach is promoting ESG. When operating at a portfolio level, it's inevitable that this leads to something of a 'tick-box' approach."

An executive with a large international asset manager agrees there is an industry trend "to build huge ESG teams that do their own thing and don't involve investors" and that "this can lead to a break in connectivity, where analysts and portfolio managers are not as closely involved with portfolio companies as they were."

Says another manager at a market-leading UK institution:

"I can understand that chairs are frustrated given the massively increased calls on their time. But our job has changed beyond comprehension, too. We have so many different masters — clients, NGOs, regulators to name just a few — all wanting us to do different things. We are now doing over 50 voting reports for individual clients, each of 30 pages, every quarter plus a 100-page report per year. That compares with a single one-page report six years ago."

The same manager admitted that this system created a kind of perverse incentive for investors to oppose some board resolutions — to demonstrate an independent approach to stewardship:

"We wouldn't want to get to the end of an AGM season without registering a vote against, because of the pressure we are under," he said.

Another senior manager at a major international institution said the expanding share of tracker funds means it is boards themselves that need to change their approach —accepting, for example, that they cannot persuade such investors to make exceptions to their rules:

"If you look at the largest UK corporates, 90 percent, sometimes more, of our holdings are in index funds. What that means in practice, is that in many cases there isn't a portfolio manager for boards to talk to. Instead it's our stewardship team that is speaking for our book of business, and voting on the basis of our published investment policies.

"I think it would be really useful for boards to come to terms with the fact that some of the largest investors in the UK market have a predominantly index tracking business, where the nature of conversation has to be somewhat different than with active managers. Sometimes I'm not sure board members have even read the published policies governing our investments. And I do feel many companies have a gap on the investor relations side where there needs to be better visibility over the policies of key investors."

Large investors have to make their own voting decisions

We asked our interviewees how they used proxy voting agencies, accused by many company chairs of issuing flawed guidance that exercises excessive sway over investors' voting decisions on board resolutions. All of them acknowledged subscribing to one or more of the agencies: some said they used them merely to execute voting decisions and did not read their recommendations; others said they used proxy agency reports to flag issues for discussion in-house; all insisted they make their own voting decisions. Further, when minded to vote against a board resolution, most said it was their standard practice to alert the company of that intention ahead of time and discuss the reasons.

Some investors agreed, however, that there are issues with the proxy agencies' role and these are exacerbated by the rushed timetable in which their recommendations are typically published, just before crucial shareholder votes.

"I do think that the proxy voting agencies need to be carefully scrutinised for quality," said one representative of a global fund management firm. "I think there is occasionally a lack of understanding of the broader picture. I have heard the criticism that they lack understanding or lack time or resource to be able to explore issues, so I understand where the chairs are coming from on that. We're certainly not governed by the guidance of the proxy voting agencies: it's an input for an internal process in which we try to come up with a decision balancing the interests of our investors and our engagement team."

To some, the increasing tally of negative votes on board resolutions is symptomatic of the declining quality of engagement between boards and shareholders.

"If you vote against something you have failed in your duty," was a view stated by two of our interviewees. "Engagement is the important thing, and the proxy guidance should have nothing to do with that. To me it's key that portfolio managers are involved in voting decisions, but that is far from a given in today's market."

Another said the sway of the proxy agencies had helped drive a general slide towards mediocrity:

"It's not really surprising that the UK stock market has become such a backwater: if you only do what the agencies say the whole time, then everyone essentially gets the same pay for the same job. Boards should call investors out more often, and chairs should not hesitate to write to CIOs when they see wrong-headed voting decisions, to make these things as public as possible.

"And on the agencies," this fund manager went on, "I think it might be helpful if we investors presented them with a more gritty face and said 'look, come on, we want to work together with you, but we need quality data and advice, good timelines and good debate.'"

A key fault-line for many investors is the division of views between portfolio managers assessing the value and future prospects of a company and the in-house engagement or governance teams, often focused on issues such as allegedly excessive executive remuneration.

"I've shared platforms with fund managers where effectively they are at war with their stewardship department," said one experienced fund manager. "There's no working together and there's obviously a debate as to who has the final say, which makes it all very political."

Most of the investors we interviewed said it was important to strike a balance, for example by fielding integrated teams at meetings with corporate boards, including ESG experts alongside portfolio managers, and by seeking a consensus within the firm. One large manager focused on tracker funds, though, said it was in the nature of its business to allow different funds with distinct mandates to vote in different ways.

There is a need for a more coherent and consistent approach to ESG

One complaint from our chair interviewees concerned the burden of reporting to investors, particularly in relation to a bewildering range of environmental standards and indices. Investors generally agreed, adding that a proliferation of reporting to clients and regulators was a problem for them, too, albeit one for which a solution was not immediately obvious.

"We work in a value chain where data has gone crazy, a long chain in which every link has to report, principally because our clients expect us to provide data evidence of engagement with companies on specific issues." said one.

Many were sceptical about the possibility of reducing the burden.

"We can debate whether it would be desirable but I think we can't because of the way that investors are now held to account for their engagement with companies and their voting records."

On ESG, investors expressed sympathy for the chairs' desire for greater coherence and consistency. One said:

"We are making this up as we go along, There is no single standard. But we have to hope a more coherent framework — an accounting standard for ESG — will emerge."

Added another:

"I think it just speaks to where we are in the maturity cycle of these factors. It reflects shifting societal expectations and how they are reflected through people that put money with us. I think we'll get there. It will just be a painful process."

Chapter 8

Conclusions and recommendations

If one message emerges loud and clear from interviews recorded in these pages, it is that engagement between UK boards and their shareholders is not working as it should. A substantial number of FTSE chairs believe it is time for a reappraisal of the relationship between their boards and their shareholders. Leading institutional investors agree that their interactions with UK companies have fundamentally changed in the past few years, and that there is a widening gap between investors maintaining best engagement practices and those seen as falling short.

Setting the parameters of debate

For the chairs interviewed in this survey, the overarching aim is to reaffirm the primacy of the board as the steward of a company's long-term success, as set out in section 172 of the UK Companies Act. Doing so would have two logical consequences. First, it would shift the dialogue with shareholders away from detailed rules and prescriptive formulae and towards the most important issues concerning the company's strategy and the board's success or otherwise in delivering long-term performance. Second, it would encourage shareholders to focus on direct engagement with portfolio companies on contentious issues, rather than relying on third-party advisors such as proxy voting agencies to guide their voting decisions at AGMs.

"In the last 10–15 years a lot of good things have happened, such as the focus of boards on mission and purpose and on values such as sustainability, reflecting changes in society's expectations around governance and stewardship," said one chair. "The board is where it all comes together — commercial strategy and economic returns, the tradeoffs and choices around long-term sustainability of the business versus short term returns, management of risk and employment."

Another underlined that companies' success depends very largely on the quality of people on boards, and that topic — rather than micro-management — was where shareholders would do best to focus their attention.

"People run companies, not rules, and boards succeed because their leadership is good," said this chair. "Chairs make a big difference as they strongly influence executive and other board appointments. So, shareholders should focus on the quality of chairs and boards, engage rapidly if they see something important going wrong — and ultimately if they still don't like what they see, fire the chair. If they took this approach, we could start building a more attractive and lighter-touch regulatory and governance system in the UK, rather than adding layer upon layer of micro-regulation which drives everyone towards mediocrity."

Institutional investors recognise the boardroom frustrations, but they come at the topic from a different perspective. To them, the changes that have affected the aggregate quality of their engagement with companies are linked to broader shifts in the financial industry, including the dramatic fall in the share of UK equities in institutional portfolios, the rise of "passive" investment funds, and the ever-growing expectations of asset owners on ESG. They argue that such changes will be difficult to reverse, and therefore deserve to be better understood by corporate boards.

But they are ready to talk. As one investor put it:

"If a large number of chairs say it's an issue, then by definition it's an issue." Or in the words of another: "I feel sure there is a significant core of long-term investors who would like to improve the overall quality of dialogue with boards, and who could establish substantial common ground with company chairs."

Time for a new dialogue between boards and investors

Our conclusion is that these issues should be the focus of a structured high-level dialogue between a representative group of PLC chairs and institutional investors.

Most of the 35 chairs we interviewed felt a discussion could help to clarify the points of contention between the two sides. As for the nine institutions we spoke with, while some were wary of the idea of setting up yet another discussion forum for UK PLC, all agreed that some kind of structured conversation of the issues could help to clear the air.

This could perhaps take place under the auspices of an existing body such as the Investor Forum, which might help address any anti-trust concerns, and could where necessary draw in other interested parties such as the Financial Reporting Council. At a minimum such an exercise would generate greater mutual understanding of the pressures institutional investors and boards are under. Beyond that, it might come up with proposals to address specific bones of contention.

Potential agenda items for this discussion forum are set out below.

1) The balance of responsibilities and accountability between boards and shareholders

The chairs' perspective on this is detailed in Chapters 1-3 of this report. One sketched the parameters as follows:

"We need to discuss, first, pushing back more responsibilities on to boards themselves, and second, whether it's possible to get shareholders to fulfil the obligations they have signed up to in the Stewardship Code, which will involve them devoting more resources to engaging with companies, and if not what the consequences of that would be."

Investors emphasise the structural constraints they are under, but are open to discussing how to strike the right balance between giving boards freedom to act on broad principles on the one hand and micromanagement on the other.

2) Engagement practices in a rapidly changing investment landscape

Topics here might include; "how to make best practice the norm", and "the implications for engagement of the growth of passive investment funds". Some chairs and investors consider it might be worthwhile for companies to call out investors when they experience unsatisfactory practices — for example when a shareholder votes against a board resolution without engagement or explanation. Concerning best practice, some active investors thought it would be helpful to try to establish common ground on engagement between them and company boards.

Tracker funds' voting practices are a particular focus of board concern. As one chair said: "There's no such thing as a passive investor: they all get to vote." Another suggested passive investors should be obliged to engage with companies if they are planning to vote against board resolutions.

Institutions running tracker funds, on the other hand, say it is not possible to offer the kind of strategic engagement that boards are looking for: it is thus inevitable that conversations between them focus on generic issues set out in the institutions' investment policies.

3) The role of proxy voting agencies and investor voting policies

As described in Chapter 4, chairs are highly critical of the role and operations of proxy voting agencies, and of the sway they are alleged to exercise investor voting decisions; some feel they should be regulated or otherwise held to account for the quality of their work.

Investors feel some of this sentiment is based on a misconception, and that rather than blaming the proxy agencies for shareholder voting decisions they don't like, boards should pay more attention to investors' published investment policies and the red lines set out therein. Some also feel, however, that the agencies need more critical scrutiny from their investor clients.

4) Co-ordination and consistency of investor views

The chairs are looking to simplify the business of ESG reporting and compliance (see Chapter 5) and potentially revisit the principles shareholders apply on such issues as executive remuneration.

"What companies are looking for is a broad framework that people can subscribe to, a consistent framework." said one. "That would reduce the burden and would constitute a big step forward."

"We need long term shareholders who are engaged and are prepared to back remuneration policies which pay for performance," said a second, who would also raise the issue of non-executive remuneration, and whether that could include company share awards as a way of reinforcing directors' alignment with shareholder interests."

Investors agree that it would be desirable to achieve greater consistency on ESG standards. Those with published investment policies setting out "red lines" concerning executive remuneration underline the limits to their room for manoeuvre.

This report has set out why UK company chairs see the need for a fresh start in their relations with institutional shareholders. The existing, necessarily more fragmented conversations between boards and shareholders have not addressed, and could not be expected to resolve, the broad issues it raises. Indeed, the absence to date of such a forum was cited as a key reason why such a head of steam has built up, over the last year, in boardrooms about the poor state of their investor engagement.

Even though there has been widespread awareness of a growing problem, chairs have tended to discuss it among themselves and have hesitated to raise it with investors.

All who participated in the preparation of this report were at pains to emphasise that institutional shareholders should understand it as an attempt to jump-start a constructive discussion on a matter of crucial importance to the future of the UK public capital market — and certainly not as a wanton or hostile act. The investors we spoke to largely received it in the same spirit.

In summary, one chair put it like this:

"It's about the future of the listed market. I think bigger shareholders have got to decide that they want a vibrant listed market to remain and that they're going to engage on what the right governance structure looks like. It is not in their interests to watch over the decline of the listed market and see everybody bought out by private equity. There are some great people in fund management but a lot of them have had too much on their plates to focus on this. Now we and they need to focus on our common interest in the creation of long-term value".

Appendix

Additional comments from chairs

Chapter 2

"It has become blurred and dislocated – if you compare it to 20-30 years ago when there seemed to be a meaningful and robust but helpful dialogue between big institutional investors, many UK based, and boards, and that loop was productive for both parties. I think that has changed radically during my time in the corporate world. it doesn't seem that that this is a communication channel is effective, at the moment. I very rarely meet a shareholder who has even read my chair's statement – which seems like a wasted opportunity."

"I think the responsibilities of boards have changed quite dramatically over the last 10 to 15 years, they're now more focused on recognising that it's a good thing for companies to have purpose. We have responsibilities for a whole set of stakeholders, not just shareholders. I'm not pessimistic about the current situation, or the future. Some shareholders will have eccentric views about the issues but I think we've got to engage with them and discuss with them and try and convince them that our view is right, and occasionally maybe their views are right and we were wrong.

"In terms of rules and regulations corporate governance has moved on, there are quite a few additional requirements on boards now, I happen to think most of them are actually highly desirable. If I can point to a personal one, the notion that chairs should stand down after nine years seems to me to be an extremely sensible and inexpensive innovation in terms of corporate governance and stops chairmen who are well past their best before date, clinging on by their fingernails to try to stay for an extra year or two."

"It's a fact of life when you're on a PLC board, this is the way the world works. I understand that we're here to serve an external audience to some extent and those who invest in us. There are things, that are on the margin that are very irritating and confusing, but that says as much about the structure of the fund management industry and the way it's changing as it does about relations between us and them."

"Shareholders are and always have been reasonable. It's all the box-ticking that makes it difficult."

"We seem to have forgotten about the concept of limited liability. In the UK market in particular, there's a tendency on the part of major investment houses to see themselves as founder/owners with unlimited liability. They want to have their cake and eat it — that is to say, buy and sell shares as they please, but when they're in, to tell boards what to do as if they were the owners. This is a big problem that needs to be discussed collectively between investors and boards. Investors need to be more thoughtful about how they make best use of a dialogue with a company chair versus their dialogue with the CEO. As things stand, they are subverting the system to exert control over companies."

"In the UK board structure it should be for the non-executive directors to represent the shareholders in supporting and challenging management in pursuit of the company's agreed objectives. Institutional shareholders effectively delegated that responsibility to the board; they obviously have the ability, at least once a year to make changes if they really want to."

"Sadly the governance side in many institutions is much more technical than judgmental and it's increasingly being informed by the proxy agencies who are accountable to nobody because it's quite difficult for shareholders to take a different view from theirs."

"Most boards and shareholders understand what the relationships require. And in many cases, it works fine and if the company's doing well, then there's usually very little problem. Problems tend to occur when the company's not doing quite as well as would be expected, but the main dynamic in this area is the proxy agencies that interface between board and shareholders.

"There should be greater confluence between the decision makers and the governance people, who are the key influencers on votes which are seen to be a measure of the support of shareholders. It seems strange that a single organisation presumably buying shares for a single reason does not have a unified approach across the different elements of that organisation."

Chapter 3

"It's not helpful that most people's registers have a smaller and smaller proportion of UK shareholders. The big US shareholders and tracker funds are very difficult to engage with. They are spread increasingly thin and most investors don't have the time and the energy to interact with boards, particularly if they've got small stakes and don't think they're really going to make a difference."

"I would think that if an investor takes a particularly critical view of a company they always have the option to sell the shares. The obligations of a board are long-term — that is, to future as well as current investors — while shareholder behaviour is often influenced by short-term activities such as hedge funds gaming the system."

"The intervention of shareholders if things aren't going to plan can be very inconsistent between different types of shareholders. That can be difficult."

"Boards are very clear what their responsibilities are. The problem is a lack of agreement from shareholders on what they require from boards, especially on issues that were once seen as peripheral and are now central, such as ESG. When you are asked by different investors to report in relation to climate change in 26 different ways, it all becomes a bit much."

"There are those who as a board we consider our core shareholders who are really engaged and then the others are just noise. There's no point engaging with those people on Remco or ESG issues as we know what the answer will be before going in. You start to segment the shareholder base between those who you can engage with and have a sensible discussion and those who are a waste of time. This is only a problem when it comes to votes — if all these passive people that you can't engage with are driven by their own internal procedures and voting recommendations, that's when it becomes an issue. I know some large investors really struggle with this."

"When a company I was chairing was involved in a contested takeover, our top 10 shareholders were split down the middle as to whether to accept the offer. Five wanted one thing, five the other, and the board rightfully had to decide. But then one of the shareholders who disagreed with our decision accused us of ignoring its views! At this point, I think one is entitled to remind shareholders that it's their right to be consulted but not to decide; and it's our right to agree or disagree."

"Chairs need to stand up for what they believe and they need to push back — just as much as shareholders sometimes want to push the other way."

"I think it's particularly difficult when you get into a situation where there's a lot of arbs in your stock, and you don't really know what's going on. There is little transparency and in this sense it would be helpful to ban stock lending in order to create visibility for boards on their true shareholder base. You'd get an outcry from the passive fund managers as it's a lucrative income stream for them. But for the other side, and activists in particular, it's just an easy way to gear up and maximise returns without actually having to expend much capital."

Chapter 4

"When I spoke to a leading international fund manager on the subject of proxy agencies, he went ballistic. He could not understand why any responsible shareholder owner would outsource the voting of the proxy to a third party, given the importance of such matters to the long-term future of the company. If it speeds in data collection, I think it's fine. But when the ultimate answers are delegated to 26 year olds, working in an offshore facility in someplace like Singapore, trying to tell our company secretary and head of HR a thing or two about remuneration, that's when we lose the plot. Then it's time for a proper revolt."

"I'm surprised how shareholders have delegated this responsibility to proxy agencies. They should do their own homework. The fact that too many don't is a pity; it's put a cloud between shareholders and boards."

"The institutions have got to be prepared to make their own mind up and not just say 'we're bound to accept blindly'."

"When you actually talk to proxy employees, you wouldn't employ any of them. This is not top talent. The institutions that use them have got to make sure that they do their job properly and raise the standards of quality."

"There is a real problem of bandwidth. Proxies feel compelled to take a position on every item on the ballot, which leads to a formulaic approach and inaccuracies."

"As things get more complex, it is inevitable that proxy agencies will sometimes misunderstand certain things in the annual report. But it's very difficult to get a dialogue to correct them."

"There is a frustration that many of the votes are cast by people that never meet the management, the passives that just follow the proxies. The fact they don't engage is absolutely wrong, they are advising just on the basis of a couple of documents. If BlackRock and ISS both decide to say no on a resolution it will get a 20 percent vote, and yet neither of those have necessarily met the company. I just think that is wrong."

"The time when you're trying to understand how they're going to vote is the busiest time of year for them and they don't want to see you; however, they then send you a 'red-top' which is completely inappropriate. If you're going to do that, then explain why and engage beforehand."

"Boards have found it impossible. Proxy agencies put up the shutters and say we're not talking to you."

"If the government really cared about this, they'd create a code of conduct for proxy agencies, because they have so much power now in the corporate world. We all outsource advice, pensions, remuneration, whatever it may be. But if you're going to outsource it like you do an audit function, there should be a duty of care from the provider, there should be a dialogue from the company, and they should stand behind the quality of their work. None of those things happen at the moment. There should be a standards body that holds them to account. We need some external referee— maybe the FRC."

Chapter 5

"For most investors ESG has become quite a detailed tick box exercise where the results are actually quite far removed from what shareholders should be looking for. And I think investors' understanding of the challenges that boards face is usually quite limited. The asset managers' ESG teams are increasingly divorced from the people that oversee their investments. It's just become very boilerplate now, and there is a risk as a result that ESG will become a weaker part of the board process when frankly, it shouldn't be."

"UK investors are not taking it as a strategic business issue, but rather a compliance issue. Of course there are compliance components to it, which are valuable. But I think we need to get some more strategic components into it — like what's the real impact of ESG on your business? What does it mean for asset values, cash flows, impairment, that sort of thing. And can you demonstrate how you build in ESG resilience into your business?"

"There's a whole industry around assurance against all these standards. The response of many companies is to set up sustainability committees chaired by a non-exec giving independent oversight of the assurance process. It's a lot of work."

"There hasn't been a structured conversation between owners of capital and managers of capital on this. It's a complete mess. Think of it this way: double entry bookkeeping was invented by Pacioli in 1492, and for the last 500 years we have tried to figure out how to measure a company's performance based on its accounts — but we still get it wrong. Now we come along with this bright idea of measuring things we have never measured before and that we don't have standards to measure. And not only are we going to put capital against those measures but we are also going to use them to incentivise management. It worries the hell out of me, quite frankly."

"Different shareholders are asking for different things. I think they should be much clearer about what companies are expected to produce, some minimum environmental guidance."

Chapter 6

"This market struggles to understand what a tech stock does. The bias of the UK investor base means it would probably be better for a tech company to be listed somewhere else."

"The most entrepreneurial business minds tend to gravitate to private equity and while they may still take on a PLC board role for reasons of prestige, their entrepreneurial talents tend to be much more directed to private equity. So that does say something."

"At one company I am involved with we had a real struggle to agree a remuneration package for a US-based senior executive. Given 70 percent of he company's business is in the US, we had to put in place a package that bridged the US-UK divide, had an EGM to get it supported. It went through and most shareholders moved on while others will continue to vote against until it disappears. For the big US investors this is an inconvenience and a distraction: why would you want to bring negative attention on one of your main investments? Yet the corporate governance people say, 'We understand but we're on a crusade and we can't make an exception for this company: even though we know it needs US based leadership, we're still going to have to vote against it.'"

"We should embrace and strengthen the standard that exists here around business judgement and the board as an arbiter of culture and strategy, by reducing the other regulatory obligations that are placed on boards today, including all the detailed assurances they have to provide."

"The hardest thing for government is not to intervene when something bad happens. The fact is that healthy capital markets need failure, and if the response to every corporate failure is a fresh raft of regulation, that can diminish the nature of the market. We should all remember that returns above the risk-free rate require the taking of risk in the first place."

"The UK is marked out by its lack of regard for the noble art of wealth creation. Also, other countries will recognise that their companies' home market is their springboard to build an international business, and they will go out of their way to make sure that you have the maximum chance of success. Here it is a struggle to succeed even at home. And the tone from the top regarding business certainly does not help."

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