5  THE ROLE OF SHAREHOLDERS

1 Background

5.1 60% of shares in listed UK companies are held by UK institutions — pension funds, insurance companies, unit and investment trusts. Of the remaining 40%, about half are owned by individuals and half by overseas owners mainly institutions. It is clear from this that, a discussion of the role of shareholders in corporate governance will mainly concern the institutions, particularly UK institutions.

5.2 Institutional investors are not an homogeneous group. They all have an overriding responsibility to their clients, but they have different investment objectives. The time period over which they seek to perform varies, as do their objectives for income and capital growth. Typically institutions used not to take much interest in corporate governance. They tried to achieve their target performance by buying and selling shares, relying on their judgement of the underlying strength of companies and their ability to exploit anomalies in share prices. Institutions tended not to vote their shares regularly, and to intervene directly with company managements only in circumstances of crisis.

5.3 Institutions' attitudes have changed somewhat recently. The proportion of shares which they own has increased, and it is more difficult for them to sell large numbers of shares without depressing the market. Some institutions now aim to match their portfolio to the components of a share index — index tracking — which they think may have better long-term results than an active trading policy. Where an institution is committed, explicitly or de facto, to retaining a substantial holding in a company, it shares the board's interest in improving the company's performance. As a result, some institutions now take a more active interest in corporate governance. They can do this by voting on resolutions in General Meetings, and informally through contact with the company.
Role of Shareholders

5.4 A major public sector US fund, most of whose investments are passively managed, has gone further and targeted a small number of underperforming companies.

5.5 Institutions are not normally experienced business managers and cannot substitute for them. But we believe that they can take a constructive interest in, and test, strategy and performance over time.

Pension Fund Trustees

5.6 Pension funds are the largest group of institutional investors. The trustees of the fund are the owners of the shares; but in many cases they delegate the management of the investments, including relations with companies, to a fund management group. In these cases the actions of the trustees and their relations with the fund manager have an important bearing on corporate governance. It is often said that trustees put fund managers under undue pressure to maximise short-term investment returns, or to maximise dividend income at the expense of retained earnings; and that the fund manager will in turn be reluctant to support board proposals which do not immediately enhance the share price or the dividend rate. Evidence to support this view is limited (particularly in relation to dividends), but we urge trustees to encourage investment managers to take a long view.

II Institutional Shareholder Voting

5.7 Several institutions have recently announced a policy of voting on all resolutions at company meetings. This has yet to be reflected in a significant increase in the proportion of shares voted, which has risen only marginally in the last five years and remains at less than 40%. The right to vote is an important part of the asset represented by a share, and in our view an institution has a responsibility to the client to make considered use of it. Most votes will no doubt be cast in favour of resolutions
proposed by the board, but it is salutary for the board to recognise that the support of the institutions is not automatic. We therefore strongly recommend institutional investors of all kinds, wherever practicable, to vote all the shares under their control, according to their own best judgement, unless a client has given contrary instructions; and our recommendation for the publication of proxy counts (5.14 (1) below) should encourage higher levels of voting by institutions. But we do not favour a legal obligation to vote. No law could compel proper consideration. The result could well be unthinking votes in favour of the board by institutions unwilling or unable to take an active interest in the company.

5.8 The ABI, the NAPF and a number of individual institutions and advisers have adopted voting guidelines. These have largely reflected the Cadbury and Greenbury codes, though some have gone further. Companies accept the right of institutions to adopt their own guidelines; but a number have pointed out that some of these include different and sometimes mutually incompatible provisions. With the best will in the world, companies cannot comply with them all. We do not see how in the last resort the rights of individual institutions to set their own guidelines can be circumscribed; but we strongly urge all those concerned to take account of companies’ very real difficulty, and to review their voting guidelines with the aim of eliminating unnecessary variations. We suggest that the ABI and the NAPF should examine this problem.

5.9 It has been suggested that institutions should make public their voting records, both in aggregate, in terms of the proportion of resolutions on which votes were cast or non-discretionary proxies lodged, and in terms of the numbers of votes cast and proxies lodged on individual resolutions. Institutions should, in our view, take steps to ensure that their voting intentions are being translated into practice; publishing figures showing the proportion of voting opportunities taken would be one way of doing
this. We therefore recommend that institutions should, on request, make available to their clients information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged. But an obligation on shareholders to go further and to disclose to the world details of individual votes cast could be a disincentive to vote in some circumstances; we attach greater importance to the casting of the vote than to subsequent publicity (see also 5.14 (b)) below).

III Dialogue Between Companies and Investors

5.10 Cadbury recommended that ‘Institutional investors should encourage regular, systematic contact at senior executive level to exchange views and information on strategy, performance, board membership and quality of management’ (report, 6.11). The idea of contact between companies and institutions was developed in 1995 in the report of a joint City/Industry working group chaired by Mr. Paul Myners and titled Developing a Winning Partnership. The main recommendations of this report included:

- investors to articulate their investment objectives to management;
- investors to be more open with managements in giving feedback on companies’ strategies and performance;
- improved training for fund managers on industrial and commercial awareness;
- improved training for company managers involved in investor relations;
- meetings between companies and institutional investors to be properly prepared, with a clear and agreed agenda.
These recommendations have been broadly welcomed by companies and investors, and we very much hope that they will be widely adopted and acted on, notwithstanding the limitations on shareholder action which we have already noted (1.19). We attach particular importance to improved business awareness on the part of investment managers the representative bodies concerned might consider how this can be promoted. But we do not recommend that either side should be required to enter into a dialogue; individual companies and investors must remain free to abstain from dialogue; and the sheer numbers on both sides will make comprehensive coverage impossible.

There is a risk that close contact between individual companies and shareholders will lead to different shareholders receiving unequal information. In particular, price-sensitive information may be given to individual investors, depriving them of the legal right to trade the shares, but some institutions have made it clear that they are willing to be made ‘insiders’ in appropriate circumstances. The guidance on the handling of price-sensitive information, published by the London Stock Exchange, is helpful, in particular the recommendation that companies should have a policy on investor communication, ideally communicated to those outside the company with whom it deals, stating how the company handles price-sensitive information.

The Annual General Meeting (AGM) is often the only opportunity for the small shareholder to be fully briefed on the company’s activities and to question senior managers on both operation and governance matters. We believe there is a real opportunity for the AGM to be made a more meaningful and interesting occasion for participants.
5.14 We have two main recommendations for achieving this:

(a) Some companies have adopted the practice of mounting a business presentation with a question and answer session. We suggest that other companies whose AGMs are well attended might examine the advantages of enhancing the occasion in this way.

(h) Companies should count all proxies lodged with them in advance of the meeting, and, without a poll being demanded, should announce the total proxy votes for and against each resolution once it has been dealt with by the meeting on a show of hands. This will indicate publicly the proportion of total votes in respect of which proxies were lodged, and the weight of shareholder opinion revealed by those proxy votes. Publication is thus likely to encourage an increase in shareholder voting.

We considered recommending that companies should put all resolutions to a postal vote, and announce the results of the ballot at the beginning of the meeting. This would avoid discussion of the resolutions taking place on the false premise that debate at the meeting, followed by a vote of those present, was likely to determine the outcome. But we concluded that this might be seen as a move to stifle debate, and that the time was not ripe for a radical change of this kind.

5.15 We are aware of a number of other suggestions for improvements in the AGM. We have grouped them as follows.
A Changes in the Law Relating to Shareholder Resolutions; the Rights of Proxies and the Appointment of Corporate Representatives

5.16 The DTI recently consulted on proposals to facilitate the circulation of shareholder resolutions at the company's expense; to relax restrictions on the freedom of proxies to participate in AGMs; and to permit the appointment of multiple corporate representatives. These proposals were widely welcomed. Greater flexibility in these areas will help both institutional and private shareholders to participate effectively.

B Procedure at Meetings

5.17 The practice of 'bundling' different proposals in a single resolution has been widely criticised, and in our view rightly. We consider that shareholders should have an opportunity to vote separately on each substantially separate proposal. We include in this separate votes on the report and accounts and the declaration of the dividend; but we accept that a proposal for a set of changes to the company's Articles should normally be dealt with in a single resolution. A rule to this effect might conveniently be included in that part of a company's Articles dealing with procedure at general meetings.

5.18 As well as allowing reasonable time for discussion at the meeting, we consider that the chairman should, if appropriate, also undertake to provide the questioner with a written answer to any significant question which cannot be answered on the spot.

5.19 Cadbury recommended that the chairman of the audit committee should be available to answer questions about its work at the AGM (report, Appendix 4, paragraph 6(f)), and Creenbury made a similar recommendation relating to the chairman of the remuneration committee: (codo, A8). It was suggested to us that the chairman of the nomination committee should make himself available in
the same way. We believe that it should be for the chairman of the meeting to decide which questions to answer himself and which to refer to a colleague; but in general we would expect the chairmen of the three committees to be available to answer questions at the AGM.

5.20 The directors must lay before the AGM the annual accounts and the directors' report (Companies Act 1985, s.241). Most boards propose a resolution relating to the report and accounts, though this is not a legal requirement. We recommend this as best practice, which allows a general discussion of the performance and prospects of the business, and provides an opportunity for the shareholders in effect to give — or withhold — approval of the directors' policies and conduct of the company.

C Preparation and Follow-up of the AGM

5.21 We endorse the recommendation of ICSA that the Notice of the AGM and accompanying documents should be circulated at least 20 working days in advance of the meeting — i.e. excluding weekends and Bank Holidays. This would significantly help institutions to consult their clients before deciding how to vote.

5.22 It was suggested that companies should circulate a record of the AGM to all shareholders as soon as practicable afterwards. We are reluctant to make a recommendation which would substantially increase companies' costs, but we suggest that companies should prepare a resume of discussion at the meeting (but not a full and detailed record), together with voting figures on any poll, or a proxy count where no poll was called, and send this to shareholders on request.

V Private Shareholders

5.23 Private individuals own only about 20% of the shares in listed companies directly, and only a minority of private
shareholders take an active interest in the companies in which they invest. So the impact of private shareholders on corporate governance cannot be great. But we believe that those private shareholders who do wish to exercise their rights actively should be helped to do so. Some of the improvement we have suggested in the AGM will contribute to this.

5.24 We also consider that, so far as is practicable private individuals should have access to the same information from companies as institutional shareholders. In time, as it become possible to communicate with shareholders through electronic media, companies will be able to make their presentations to institutional investors available to a wider audience more readily. For the time being, companies who value links with private shareholders cultivate them by, for example arranging briefings for private client brokers and regional shareholder seminars. We commend such initiatives.

5.25 The launch of CREST and the introduction of rolling settlement have made it more attractive for private investors to hold shares through nominees. This deprives the investors concerned of the right to vote and to receive company information, unless some special arrangement is made. A number of companies have established their own 'in-house' nominee and use it to restore rights to private shareholders. We commended this. The ProShare Code envisaged that nominees would extend such de facto rights to private investors generally but this code has achieved only limited support. A joint DTI/Treasury consultation document on the Corporate Governance of Private Shareholders, published in November 1996, discussed the adequacy of present arrangement and the need for the rights of private shareholder holding through nominees to be reinforced by statute. The Departments are presently considering the response to this consultation.