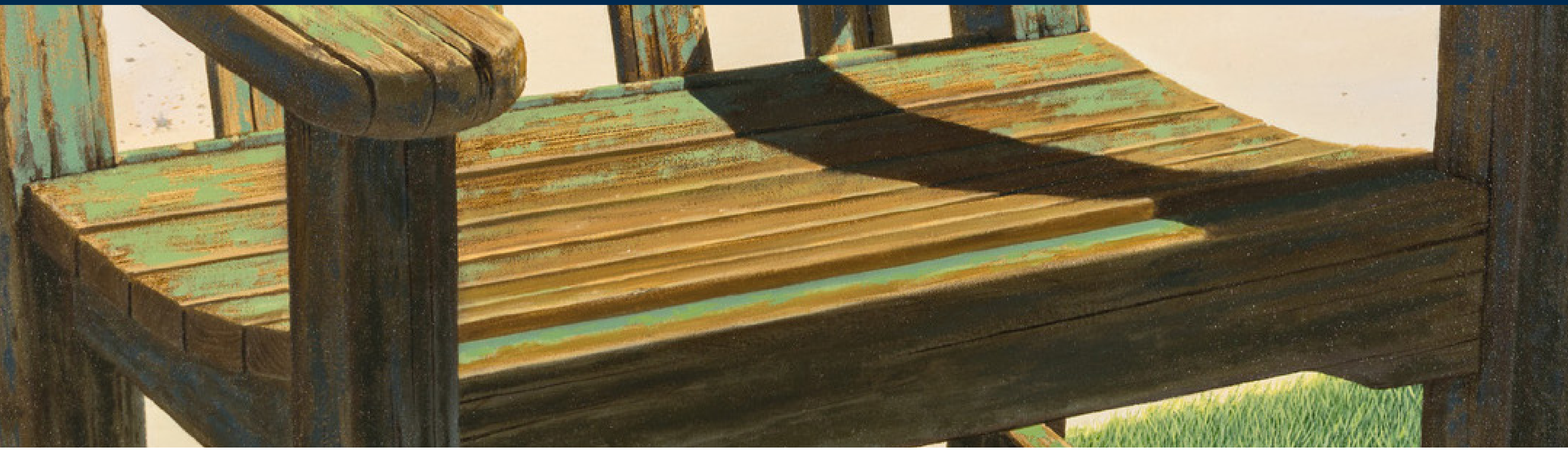



# SETTING THE BOUNDARIES ON STEWARDSHIP

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FIRST PUBLISHED 01 SEPTEMBER 2018

The movement to incorporate environmental and social issues into corporate governance has been gathering pace on both sides of the Atlantic. ESG issues feature regularly in shareholder resolutions at US companies, while UK governance codes and regulation include increasing reference to broader stakeholder interests.

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Peter Montagnon is one of the most influential figures in the corporate governance field. Former Chairman of the International Corporate Governance Network, he has served on the European Commission's Corporate Governance Forum for more than a decade and is visiting Professor in Corporate Governance at the Cass Business School of the City University, London. Montagnon is also Associate Director at the Institute of Business Ethics, which encourages high standards of business behaviour based on ethical values. He believes companies, investors and policymakers are in danger of misunderstanding shareholders' fundamental rights and responsibilities.

On one level, this development is right and proper. Voting rights give shareholders real power, so it is reasonable to expect them to use it conscientiously and responsibly. Shareholders should take an interest in the companies in which they invest, help to position them for long-term success and discourage them from reckless short-term risk. A danger arises, however, if they are pushed to go too far and become unpaid, unelected agents of public policy in a way that means the objective of corporate success is lost.

So in considering how to take stewardship forward, it is important to be clear about where the boundaries lie between very broad social duty and the health of a company, particularly because, while pressures from policymakers are growing, there is still no real consensus on what stewardship is supposed to achieve.

It is also difficult because the edges are naturally blurred. Companies that need to take long-term investment decisions require a stable social and economic environment. Since governments can no longer be relied upon to provide that, some stakeholders believe that corporations have to step in and fill the gap, for example by taking a more direct responsibility for the environment or education.

> *"A danger arises if shareholders are pushed to go too far and become unpaid, unelected agents of public policy in a way that means the objective of corporate success is lost"*

At one end of the spectrum, there are still those in both the corporate and investor communities who believe companies exist to make profits for shareholders. At the other end, there are those who believe that companies exist to serve a common good. They believe this is also the ultimate objective of every individual who owns their shares both directly and indirectly, even though this is well-nigh impossible to prove.

A close look at fiduciary duty seems a good starting point for reconciling these positions. The Companies Act 2006 says the role of directors is towards the company. In exercising this duty, they are expected to respect the interests of a range of stakeholders, while taking account of the need for high standards of business behaviour. Such an approach makes sense, because a company that wilfully tramples over the needs of its stakeholders and tolerates dishonest behaviour will not have a long-term future.

This is reflected in shareholder duty as it is currently understood. Meanwhile, the UK Law Commission reaffirmed in 2014 that investors can and should concern themselves with non-financial issues as part of their role in creating and preserving value for their beneficiaries. However, they should not allow themselves to use their voting power to reflect their own interest in policies that are not related to the long-term needs of their beneficiaries.

Current political pressures seem to be creating a danger of going beyond this. Shareholders face growing expectations to reflect society's views in their voting decisions, partly because companies and shareholders have, between them, made a mess of remuneration; partly because issues such as inequality and global warming are racing up the agenda; and partly because weak governments find it difficult to legislate.

> *"It is not the task of boards or investors to deliver social change based on the rather uncertain argument that this is what end-beneficiaries ought to want"*

This is problematic, since neither shareholders nor lobby groups trying to influence them are really in a position to say what society or indeed individual pension fund members really want.

The issue could be resolved by making every vote a popular referendum. This may appear a natural development in a world of defined contribution pensions where individuals "own" their funds, but it is hardly practical for all pension fund members to take a view on every situation and very hard for institutional investors to know what individual beneficiaries think. This is especially true in a world where plenty of people, armed with a political agenda, claim to have the answers and plenty of others see no harm in manipulating opinion.

> *"Corporate responsibility should be on the engagement agenda, but first, investors have to be clear that this is part of their drive to foster healthy companies"*

So companies and shareholders need a clear idea of the basis on which they operate. The essentials are already there. Boards are responsible for the stewardship of the assets that they control. Institutional investors are responsible, on behalf of their beneficiaries, for ensuring that boards exercise that stewardship effectively.

Corporate responsibility is an integral part of all this, but it is not the task of boards or investors to deliver social change based on the rather uncertain argument that this is what end-beneficiaries ought to want. It is too easy to forget in all this that

beneficiaries also want and need financial returns.

The ultimate objective of governance and stewardship should therefore focus on the company itself. Corporate responsibility should be on the engagement agenda, but first, investors have to be clear that this is part of their drive to foster healthy companies.

Second, they have to deliver results. The quality of dialogue between investors and companies has improved over the past few years, especially between businesses and the relatively limited group of investors who take their fiduciary duties seriously, but much of what passes for stewardship is ill-thought through and half-hearted.

The more that investors fail to deliver a coherent and productive version of stewardship, the more their rights will be called into question. The ability to hire and fire boards is critical for owners of equity capital, but the public see it just as much a privilege as a right. This is similarly so with limited liability, which the government itself describes as a privilege. These are not inalienable rights and they should not be taken for granted.



**This article is from Walter Scott's Research Journal 7 (September 2018)**

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