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 (i.e. 2022).

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.