Death of Voting? **By John Hunter, March 2016**

The shareholder ownership model has been essential for the wealth of developed countries. This very simple concept – for a type of organisation where those who put up the money on condition that they enjoyed the fruits of their gift (investors) had influence over how that money was spent (control) - enabled the expansion of enterprise. The combination of investment and control embodied *ownership.* The creation of a transferable legal basis for ownership - shares - and places where that ownership could be exchanged at a price - stock exchanges – was the final brick in the structure.

In 2001 Lord Myners published his seminal report 'Institutional Investment in the UK'. The report had considerable impact –he drew attention to the drift away from active ownership, to the increase in intermediaries, to the increase in voting capacity belonging to institutions who were custodians but not owners, to the various pressures that caused those institutions to allocate capital inefficiently. He adopted the memorable phrase 'ownerless corporations' to describe the status of companies that didn't, in fact, appear to be owned by anybody. And he made some suggestions on the future direction of travel. So where are we today?

Well, no further forward actually. In all the reams of regulation, consultation and discussion that I have read about corporate governance and the mechanisms for trading shares there were endless concerns for the 'efficient' trading of shares but not one for the appropriate transfer of voting rights.

Take, as one example, the practice of short selling. Think how much regulatory attention has been paid to it. Yet short selling is enabled by stock lending. 'Stock-lending' is a comfortable phrase that conceals what is in fact a 'sale and repurchase' agreement – the stock is sold to the short-seller against a contract to repurchase the stock later at the same price plus a financing adjustment. The short-seller owns the stock for that period and he owns the voting rights. I'll say that again slowly. The short-seller, who is betting on a price fall and therefore has a financial interest in encouraging corporate mismanagement and stupidity, has a voting interest in the company.

Isn't that outrageous? It's only for a short time, you say. Yes, but it's at the time that matters. Observe the growth of short interest during contested takeovers. Most takeovers are conceptually misconceived and financially misjudged and cause the share price of the bidder to fall. You can join the rest of the dots for yourself.

Then there's custodial ownership. By that I mean shares controlled by institutions on behalf of others, sometimes under trust conditions, sometimes not: for example funds, pension funds and the asset managers retained by those funds, pooled nominee accounts. These are not owners in the way I've defined it but they are experienced investment managers. Perhaps they are better placed than amateur owners to assert an owner's influence?

Unfortunately not! Part 2 of UKSA's booklet 'Responsible Investing', published more than five years ago, is still as good a place as ever to see why this is so. And it's no secret – the Walker Review of corporate governance in banking spelled it out and the Kay Review spelled it out again. In a sentence, a broad-based financial institution makes more money out of companies that are active, volatile, high-risk, aggressively financed and badly run than companies that are stable, careful, conservatively financed and well run. Even more seriously, modern remuneration schemes make this true of managers as well (this for another article – it's because asymmetric awards such as options are more valuable in a volatile environment).

Is not this outrageous also?

Maybe, the argument goes, but effective corporate governance requires demanding skills. At least these people are professionals, by and large honest, and capable of making the difficult judgements required. Ordinary investors are not.

Well, leaving aside that this is the classic argument promoting autocracy over democracy, it just isn't true. Like many, I sold my Tesco shares three years ago after I walked into a Tesco store and later in the week into a Lidl. It wasn't rocket science – didn't even need the straightforward and damning ROCE analysis that Terry Smith published after the Tesco share price imploded. Another example: most UKSA members, when the mining companies went on their debt fuelled acquisition trip several years ago, would have been capable of asking difficult questions about the balance of risk and reward at that point in the commodity cycle and voting accordingly.

The fight for the rights of private investors can sometimes appear to be a technical skirmish of minor interest except to the participants. In reality the absence of these rights is doing economic damage as well as impeding a valuable moral input to corporations. That is what we in UKSA, by example, must continue to promote.

There's nothing new in this. It's all there in Part 1 of 'Responsible Investing'.