Corporate Governance: what is the role of the private shareholder?

By Sue Milton

This is the first of two articles concentrating on the barriers to, but also identifying where we can enhance, our role. The second article will cover some practical ideas on how, despite the barriers, private shareholders can be a positive influence on companies.

The theoretical answer to my question is that private shareholders have the same role as any other shareholder but the combination of four reasons makes it much more difficult to exercise: a lack of expertise in corporate affairs, no influence over those affairs because the level of shareholding is insignificant, most of our shares are managed by institutional investors on behalf of the trusts and pension funds in which we have invested, and there being no guidance on how to enforce private shareholder responsibility.

Therefore, the role that stands out for me as a private shareholder is one of a moral guide covering corporate social responsibility not just in the charitable work undertaken but also in how companies treat individuals, whether private shareholders or their clients and customers. Private shareholders are closer to the general public than any other shareholder, as we are 'the public', so we should be holding boards to account on the public's behalf. Corporate ethics and behaviours, areas neglected in the past, are now high on the governance agenda.

The codes of good practice provide reminders of how boards should behave. The fact that so many guidelines exist shows that the right sort of behaviour and shareholder engagement remain problematic. Shareholders 'holding the board to account' is an over-simplification as it ignores the reality that private shareholders are too distant from the companies they own, their shares too thinly spread to make proper engagement possible and there is no recognised guidance available to assist private shareholders on how to enact their responsibilities.

There is no mandated role for shareholders. Because there is no mandated role it has allowed markets to turn shareholding into an easily tradeable commodity, removing any sense of ownership. It defaults private shareholding into passive shareholding. Without a sense of ownership, shareholders can care only about dividends, very different to wanting the company to provide long-term value to society.

Corporate governance codes encourage dialogue between investors and companies. This guidance is helpful in principle but inaccessible to many private shareholder because it is not written from their point of view. That made we wonder if we were too small in number to influence the way guidance has been written. If you look at the numbers, we UK private shareholders have grown slightly in numbers within quoted companies, standing at 12% in 2014 from 10% in 2010 but this is down from 13% in 2006 and way below the 54% private investors owned in 1963.

Corporate investors are lucky in having professional company secretaries and/or lawyers to help them understand their obligations and required actions. Interpretation and application of the governance requirements are therefore understood.

Sue Milton - Biography

SUE MILTON specialises in institutional excellence, providing practical advice and solutions to achieving practices that fulfil the spirit of good governance.

Sue works with organisations to improve corporate and board-level effectiveness by assessing internal frameworks against outputs, outcomes and expectations. The quality in both the design and execution of the governance framework, including an understanding of how shareholders behave and react, provides a basis for the level of resilience needed against strategic, economic, political and operational shocks. Sue is now an UKSA member.

The result is that those with the greatest shareholdings not only have the greatest influence but also the greatest understanding of shareholder responsibilities. This allows a better dialogue with the board, thereby increasing corporate investors' ability to influence, both a good and bad thing. The good part is that the good corporate investor will provide a beneficial influence, allowing the remaining shareholders to benefit too. The bad part is that the influence through dialogue plus the sheer number of voting rights, subsumes the opinions of private shareholders. Either way, corporate investor influence may well discourage the private investor from voting.

That said, private shareholders also have some great opportunities. For a start, it is our money companies are using so we are inherently motivated to holding the boards to account. We just need to find the best mechanisms for doing so. The first is to decide what is sensible to do, such as what is best left to the institutional investors. The second is to make use of proxy voting forms that inform boards better of our understanding, or lack of it, of corporate affairs. The third is to look at the moral tone of the company. That is all for part 2.

In the next edition, I will share with you what I believe is missing from good corporate governance: 'shareholder governance', and provide some practical and pro-active ideas to increase both our role and our influence on the companies we own.

Sue Milton

Sources

See the Stewardship Code, created for firms managing assets on behalf of institutional shareholders such as pension funds and investment trusts. https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

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