EXECUTIVE DIRECTOR REVIEW

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Executive Director
12 January 2021

There is no question that 2020 was one of the most challenging years that any of us can remember. As we reflect on the year that has passed our thoughts extend far beyond financial markets to every corner of our society and to the very real impacts that the virus has had on each of our communities.

2020 was a year when financial markets could not ignore real-world developments, when externalities became strategic threats and when the great pause in activity brought humanity in all its guises into full focus.

The re-set that will be required to address the impact of the crisis will create a new set of priorities for policymakers, companies, investors and individuals. The urgent need for renewal offers opportunity and hope.

As we look forward, the focus of those of us who work in financial markets will need to be much more inclusive.

In this our 5th Review we offer our practitioner's perspective on the:

- Value of public markets
- Impact of engagement
- Stewardship agenda

We also argue the UK has a unique opportunity in 2021 to lead the world by embracing a 'say-on-climate' ahead of COP26.

The Value of Public Markets

As a broader range of stakeholders find their voices and regulatory burdens increase, many companies have questioned the value of a public listing. Indeed, in our 2019 Review we argued that the quality of the dialogue between shareholders and companies was close to an all-time low. It is therefore encouraging to be able to report a much more positive dynamic this year.

In the midst of the Covid-19 crisis we saw a powerful demonstration of the value of public markets. As companies focused on survival, the dialogue with investors reached a new level of intensity. Public markets mobilised an unprecedented £42bn of capital to support UK listed companies in 2020 and £36bn of dividend payments were withheld, as companies prioritised financial stability.

The vast majority of that capital was raised through placings which provided rapid access to funds, with limited market risk, taking advantage of flexibility introduced by the Pre-Emption Group. As cash placings are undocumented deals, leading investors played a vital role in scrutinising recovery plans.

The extensive dialogue and challenge by investors in these cash raisings demonstrated how stewardship is now at the heart of investment decision making. Practical guidelines were established, capital was mobilised, a broad range of strategic and stakeholder issues were prioritised, and a clear basis was established to hold companies to account if behaviour falls below expectations or capital is allocated poorly. It was also particularly pleasing to see companies and advisors work hard to ensure that existing ownership interests were respected, and the spirit of pre-emption rights was upheld.

During these fundraisings, we clearly witnessed a broadening of the agenda, as companies sought to demonstrate to shareholders how the new capital would be deployed in a manner which would support a wide range of stakeholders.

This was an important evolution at a time when there is a healthy debate about the merits of shareholder primacy and alternative models of stakeholder capitalism. In 2021 we will partner with the LBS Centre for Corporate Governance to bring together a group of investors and academics to explore the practical implications of this evolution.

EXECUTIVE DIRECTOR REVIEW

The Impact of Engagement

It has become apparent to us is that the true value of engagement is not widely recognised. We have argued over many years that engagement is an important complement to voting and the primary mechanism by which investors can effect change at companies.

We built our platform in 2015 and have seen a steady increase in the volume and range of issues that we have been asked to engage on. It is therefore pleasing to report that we completed 11 engagements in 2020, bringing our total to 40 since we began engaging in 2015. The Forum's model for escalation is proven and has delivered meaningful stewardship results over a sustained period.

In 2020 our engagements delivered significant outcomes across a broad range of issues, by:

- Catalysing strategic change at Aviva;
- Encouraging ambitious climate commitments at Barclays;
- Reinforcing the need for change at Boohoo; and
- Creating an investor-led solution to conserve cash for SSP.

Unique to our approach is the deep experience of the team, and the underpin provided by the Collective Engagement Framework, which gives investors the confidence to work together. Our bespoke model ensures that we are able to maintain the support of members in sensitive situations, engage effectively with Board members and help develop solutions that can catalyse change. Ultimately what matters is the outcome – our track record demonstrates that escalation and constructive engagement can be a positive force.

We very much hope that the FRC Stewardship Code reporting will generate a transparent discussion around engagement activity in 2021. There is an excellent opportunity for investors to demonstrate their stewardship capabilities and provide tangible evidence of the value of engagement.

Who Benefits From Engagement?

In his 2012 review, John Kay wrote about the need to connect the investment chain – the link between asset owners, asset managers and companies. Since inception, we have been encouraged by the impact of a number of institutional asset owners, particularly with regard to climate, and a rising tide of retail investor interventions.

We believe it is vital that asset managers deploy a full range of stewardship competencies and that asset owners calibrate those capabilities when appointing and evaluating their managers. To make this case we published a paper with the PLSA in 2020 'Engaging the Engagers' to provide a practical guide to help enhance the effectiveness of engagement activity. We therefore welcome the DWP announcement in December of a working group to address stewardship barriers.

Stewardship Agenda

Our engagements in 2020 confirmed that Environmental and Social issues have moved out of the Corporate Social Responsibility departments of companies and into the boardroom, into the heart of investment objectives for many asset owners and retail investors, and increasingly into the core investment processes of investment managers.

If there was any question about the materiality of a broad range of ESG issues at the beginning of 2020, then companies from Barclays to Boohoo and Rio Tinto can testify to the importance that stakeholders attach to ESG issues, and the material impact they can have on a company's reputation.

In our experience it is rare that a material social or environmental issue can arise without an associated governance concern.

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EXECUTIVE DIRECTOR REVIEW

We believe that dialogue is the most effective way for investors to highlight material issues and to set out their expectations and priorities. In turn, companies can lay out pathways and roadmaps to address these issues. Such an approach recognises the complexity of many Environmental and Social issues and the need to deliver change over time. It offers a route to build confidence in the purpose of a company and its ability to generate sustainable long-term value not just exclusively for the benefit of shareholders but crucially for a broad range of stakeholders.

Investors continue to evaluate how directors discharge their section 172 duties and the new disclosures, along with external assessments of Board effectiveness, provide important insights and assurances. In parallel, the progress of Chapter Zero is one practical example of how NEDs are equipping themselves to respond to the climate challenge.

'Say-on Climate'

As the UK looks to take a leadership position on climate ahead of COP26 in November 2021, we believe that there is enormous value to be gained from giving investors a 'say on climate'.

The roadmap towards mandatory climate-related disclosure published by HM Treasury in November, the FCA's proposals to implement the new TCFD-aligned disclosure rule for premium-listed companies, and the forthcoming BEIS Companies Act consultation to mandate the proposed changes, provide an opportunity for investors to also make the case for a 'say on climate' on TCFD-aligned disclosure obligations.

To drive real-world impact, a non-binding shareholder vote on a company's climate policy would provide a powerful investor signal on the effectiveness of any mandated climate disclosures and ensure alignment between the substance and ambition of company disclosures and its strategic intent.

Such an approach would enable the investment community to take a leadership position in helping ensure that UK companies commit to advancing the UK's net zero commitments. It would provide investors with a mechanism to signal which companies are making good progress and those that are lagging. This systemic approach would align the focus of premium-listed companies with the UK's increasingly ambitious climate commitments.

Conclusions

The Investor Forum has been fortunate to enjoy the continued support of our 52 Members, for which we are very thankful. With this support, and the dedication, flexibility and commitment of the Investor Forum team, we have been able to deliver a series of meaningful engagement outcomes in 2020.

Notwithstanding the enormous challenges that society faced, in 2020 we saw tangible evidence of the value of stewardship and the positive contribution that engagement can make. We should all take confidence from the ability of public markets to respond to challenges when it matters most.

As we grapple with the implications of Covid-19, there is an opportunity for investors and companies to gain society's confidence. To deliver on this potential will require us all to think much more broadly about purpose – to help guide the behaviour of investors and company leaders alike.

Andy Griffiths
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