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Experts re-examine shareholder action

Engagement

The financial crisis has highlighted the need for better investor relations.

Mike Scott reports

Engaging with companies is one of the main weapons an investor has in trying to make them act more responsibly, but in the light of the financial crisis, is it time to re-examine the process?

Many people ask to what extent engagement can be taken seriously at all, when it comes from a financial services sector whose own behaviour has created many of the problems the global economy faces.

In fact, engagement is more important than ever in the current climate, many industry figures say. Alan Brown, chief investment officer of Schroders Group,

says: "Engagement is a question of fiduciary responsibility and trying to avoid spectacular blow-ups where there have been spectacular governance failures."

Indeed, the global economic slowdown has led shareholders to increase their focus on the potential risks to their investments. "The financial crisis should serve as a powerful lesson that the longer you ignore risk, the more difficult it becomes to deal with the consequences," says Emma Howard Boyd, head of socially responsible investment at Jupiter Asset Management.

When times were good, investors were happy to take the high returns on offer without asking whether they were sustainable, says Michael Mitchell, general manager of the Investor Relations Society, but "now we are seeing an increased thirst for knowledge both from institutions and sell-

side analysts. Most companies have had more questions from investors. It is a big opportunity for investor relations and for companies to set out their strategy."

Marc Jobling, assistant director of investment affairs at the Association of British Insurers, concurs. "Our members realise there is a once in a generation opportunity to redefine the way things work in areas such as executive pay."

Companies hit by the market drop need to tell investors how they are dealing with the situation, says John Wilcox, chairman of Sodali, a global consultancy, and an adviser to TIAA-Cref, the retirement specialist. The credit crunch has revealed the shortcomings of many businesses, such as the big three US car companies. "Sure, they have been caught up in a perfect storm, but their focus on short-term profits rather than long-term solutions has been exposed,"

he says. Part of the problem was that some shareholders were aggressively engaging with companies – but they were often focused on short-term returns.

"One reason there is so little shareholder engagement

Part of the problem was that some shareholders were often focused on short-term returns

and it has not been sufficiently effective is that it costs money," says Peter Butler, chief executive of Governance for Owners.

"Those that have found the money to be active have been hedge funds that frequently operate at the short end of the market, so the whole system has been distorted towards short-term rewards."

Companies increased their gearing under pressure from investors, who said they were not working the balance sheet hard enough, while the M&A departments of banks were coming to companies with offers they could not refuse, adds Mr Mitchell.

Now is the time to look beyond those short-term rewards and focus on more sustainable business models. Mr Wilcox says the market needs to move away from its culture of instant gratification, encapsulated in the focus on quarterly earnings. The pressure comes from investors who get angry if there is a quarter of under-performance. This leads to massive share price drops if the company underperforms by a penny, "but why? The company is no different than it was the day before the results".

This short-term focus is difficult to deal with on an individual company basis,

because companies will be reluctant to change unless their peers do. Investors are realising that many environmental, social and governance issues require solutions that only policymakers and regulators can deliver. "Responding to the current crisis demands an increased focus on engagement to address systemic problems and market failures as well as to improve individual companies and industry sectors," says Penny Shepherd, chief executive of Uksif, the responsible investment forum.

The United Nations Principles for Responsible Investment is also working to stimulate dialogue between investors and policymakers. "Investors have been silent in many policy debates and are now realising that many of these issues are systemic and need a regulatory and public policy response," says James Gifford, chief executive.