Appendix 3.08.2 Conflicting objectives of reports

Conflicting objectives of reports

Maximising profits, maximising shareholder value – such concepts make for neat economic and financial models. Easy to manipulate and obtain solutions. However, they are too simplistic for real life firms.

Many of the recent developments in financial and corporate reporting can best be explained as the outcome of a struggle between the proponents of different concepts of the function of the annual report. Apart from internal reporting systems which are incorrect or mislead or are inadequate (*à la* Carillion).

For example, the detailed directors' remuneration report is now an average of 19 pages long for the FTSE 100 (in 2017). And these reports are usually in small font/print and in triple columns. They are probably only going to be studied in detail by a handful of professional investors. Occasionally there may be a shareholder revolt of remuneration (as we saw in Chapter 3 and you can add GE to rejecting their auditor as well[1]). However, normally it goes unread except by the few analysts or a block of shareholders who feel executive pay is too much.

The length of the annual report

Over the past twenty years, the average annual report has more than doubled in length though the rate of change has slowed. This is despite repeated calls from all parties to reduce its length. Our interpretation of the situation is that the authorities have reacted to the demands for more information to meet differing objectives by agreeing to all possibilities without making a decision in favour of meeting the needs of any specific group. Average length of the FTSE 100 companies have increased from 70 pages in 2000 to 155 pages in 2017. Though the FRC also wants clear and concise reports. See Appendix 3.07.1 on the length of the annual report.
.

[1] over a third of shareholders at General Electric, an industrial conglomerate, voted against the reappointment of KPMG. Investors

Shareholders versus stakeholders versus directors

There is a struggle that has influenced the reporting requirements of companies: that of shareholders versus directors. This reflects the basic conflict between ownership and control that was identified by Berle and Means[2] over eighty years ago. Essentially the regulators, responding to pressure from shareholders and their representatives have sought to strengthen the position of shareholders vis-à-vis directors. In respect of the annual report, this has been achieved principally through the provisions relating to audit and to information on directors' remuneration.

- Audit. The effect of recent provisions is to prevent the auditor becoming too close to the company's management
- Directors' remuneration: This information takes up a very considerable proportion of the annual report (According to the 2017 Deloitte report the average number of pages of the (directors remuneration) report is now 19 pages of usually small font triple column print. This is clearly quite out of proportion to the materiality of the monetary amounts involved.

[2] See for example http://www.businessdictionary.com/definition/Berle-Means-thesis.html
Or
https://en.wikipedia.org/wiki/The_Modern_Corporation_and_Private_Property

The FT has run a campaign about widening the purpose and function of reports.
See: https://aboutus.ft.com/en-gb/new-agenda/
There are also a number of articles postulating a move away from profit maximising to a number of other objectives and goals[3,4,5,6]

The liberal capitalist model has delivered peace, prosperity, and technological progress for the past 50 years, dramatically reducing poverty and raising living standards throughout the world. But, in the decade since the global financial crisis, the model has come under strain, particularly the focus on maximising profits and shareholder value. These principles of good business are necessary but not sufficient.

The long-term health of free enterprise capitalism will depend on delivering profit with purpose. Companies will come to understand that this combination serves their self-interest as well as their customers and employees. Without change, the prescription risks being far more painful.

The long-term health of free enterprise capitalism will depend on delivering profit with purpose. Companies will come to understand that this combination serves their self-interest as well as their customers and employees. Without change, the prescription risks being far more painful.

[3] Barber, L., Capitalism. Times for a resent. This is the new agenda, *Financial Times*, 19 September, 2019
Available at:
https://aboutus.ft.com/en-gb/new-agenda/
Accessed September 2019.
[4] Editorial Board, Business must act on a new corporate purpose. Companies must realign incentives and define targets beyond profits, *Financial Times*, 19 September 2019
Available at:
https://www.ft.com/content/3732eb04-c28a-11e9-a8e9-296ca66511c9?segmentId=839af127-9a56-c30f-330c-43e43f9e73eb
Accessed September 2019.
[5] Foroohar, R., The age of wealth accumulation is over. Voters and politicians agree it is time to slice the economic pie more evenly, *Financial Times*, 4 August 2019
Available at:
https://www.ft.com/content/fd13020e-b502-11e9-bec9-fdcab53d6959?segmentId=56a414e9-1544-b801-9546-2d038c8b8694_
Accessed September 2019.
[6] Tett, G., Does capitalism need saving from itself?, *Financial Times*, 6 September 2019
Available at:
https://www.ft.com/content/b35342fe-cda4-11e9-99a4-b5ded7a7fe3f?segmentId=9d8c66e5-f845-1254-610a-f597ecc6b8b8
Accessed September 2019.

Conflicting objectives of reports

Conflicting aspirations for the annual report

The FRC expanded the front half and the narrative sections of the report. Gender and supply chain payments information were added via a government website. The FRC and its replacement ARGA are still pushing for more information to be disclosed in the annual report. These changes are just a wider part of the push for greater reporting – and the annual report as a main plank of reporting is expanding and changing.

Many of the recent developments in financial and corporate reporting can best be explained as the outcome of a struggle between the proponents of different concepts of the function of the annual report. Apart from internal reporting systems which are incorrect or mislead or are inadequate (*à la* Carillion and Patisserie Valerie). The theoretical model, as stated before, is that the company is run by management for the benefit of shareholders. However shareholders show little signs of interfering with management. For example, this article by David Cumming is chief investment officer for equities at Aviva Investors makes the case that institutional shareholders are more or less not engaged enough[7]. He argues that institutional shareholders need to be as agile and active as private equity in dealing with failures of leadership:

> After the recent surge in bid activity, culminating in a premium offer for Peppa Pig owner Entertainment One from the American toys giant Hasbro, investors must ask themselves why so many companies are being bid for now, what this signals and how they should respond in terms of corporate governance and portfolio positioning.
>
> Most of the recent bids have come from private equity (PE) players, which are focused on the longer-term resale value of the companies they buy. Companies are only attractive to PE when there has been mismanagement of their strategy, operations or balance sheet, or the market does not appreciate their long-term value prospects. Both these issues are failings of company leadership.
>
> The way forward is not to focus on tired solutions to public market short-termism and PE financial engineering, but for institutional shareholders to step up. Specifically, they must hold company leadership to account for poor performance, and push for more decisive and swift action in replacing chief executives, finance directors and chairmen when they fail to deliver. It can be argued that PE firms are good for public markets in the same way that activist investors help to create management and price discipline.
>
> However, institutional investors cannot rely on them to facilitate change. We have to be active ourselves.
>
> If a bid materialises, particularly from PE, the board and shareholders must be fighters, not quitters. Boards should look first to resolve internally the valuation issues that have been highlighted by the bid, engaging with their long-term shareholders as part of the process.

[7] Cumming, D., Investors must hold bad bosses to account, *The Sunday Times*, 25 August 2019.
Available at:
https://www.thetimes.co.uk/article/investors-must-hold-bad-bosses-to-account-qlh92qpgg
Accessed August 2019.

Conflicting objectives of reports/Continued
Conflicting aspirations for the annual report/Continued

However, it is obvious that both the institutional shareholders, their proxies and the NEDs are often painfully unaware of their duties or too lazy or just negligent.

Shareholder groups
Proxy shareholder advisory firms
If institutional shareholders do not fulfill an active role, it should be proxies that fulfill a more active role. Often they do but not always and in some cases, we think they provide misleading or biased advice. Not always though. In other ways they do act as a brake against some worst of management excess. Though failed in the Jeff Fairburn's CEO who was ousted after collecting a £75 million bonus after four months. His eventual receipts under the scheme exceeded a figure of £75m projected last year when Mr Fairburn and other executives accepted cuts to their payouts in the face of investor uproar[8]. We return to Persimmon later in this chapter.

So nowadays, it is the proxy shareholder advisory firms who yield more power. For example Public Investment Corporation's (PIC) had a hand in PSG's remuneration policy vote[9]. Another proxy advisor, Institutional Shareholder Services (ISS) told Pendragon shareholders that "there is little evidence on what he and/or the remuneration committee has done following the vote to address shareholder concerns; rather the company has simply implemented the plan without providing any further rationale"[10]. Pensions & Investment Research Consultants (PIRC) and Glass Lewis are two other active proxy advisers.

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[8] Evans, J., Former Persimmon boss was paid £85m in two years, *Financial Times*, 18 March 2019.
Available at:
https://www.ft.com/content/4c23d282-498e-11e9-8b7f-d49067e0f50d
Accessed March 2019.
[9] PSG had a small shareholder revolt over pay and the reappointment of PwC as the auditor. See for example:
Crotty, A., 2018, 'PSG to engage with shareholders after hefty opposition to its pay policy', *Business Day*, 25 June 2018
Available at:
https://www.businesslive.co.za/bd/companies/financial-services/2018-06-25-psg-to-engage-with-shareholders-after-hefty-opposition-to-its-pay-policy/
Accessed July 2018.
Also BT was preparing for unrest over the appointment and switch to KPMG after negative press reports on the quality of KPMG audits. See for example:
Kinder, T., 2018, 'BT prepares for rebellion over KPMG audit switch', *The Times*, 20 June 2018.
Available at:
https://www.thetimes.co.uk/article/bt-prepares-for-rebellion-over-kpmg-audit-switch-bvpxc3l0h
Accessed July 2018.
[10] Wilson, H., and Ralph, A., 2018, Shareholders revolt over executive pay packets, *The Times*, 2 May 2018.
Available at:
https://www.thetimes.co.uk/article/shareholders-revolt-over-executive-pay-packets-wxgg8n7ph
Accessed June 2018.

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Hedge Funds becoming more important

Since the 1990s, asset flows into hedge funds have surged, and the number of funds has expanded exponentially, with a variety of new products have emerged. Their power is now such that hedge fund management now can often control the policy of megamenu with a relatively small shareholding. Some hedge funds are extremely active. Two recent examples are give below.

Interserve, a rival to Carillion as an outsourcing company, ran into financial restructuring in 2019, after a weak financial performance. The Sunday Times reported[11]:

> The chairman of Interserve has urged the hedge fund trying to overthrow its board to engage in talks or risk a "really bad" outcome for the embattled cleaning and building company.
> Glyn Barker (previous UK vice-chairman of PwC and one of KB's former students) said its biggest shareholder, Coltrane Asset Management — which last week called a vote to replace most of the board — had refused to discuss its intentions, risking an even worse outcome for investors than the debt-for-equity swap that has been proposed.

The restructuring plan left shareholders with just 2.5% of its equity. Lenders, led by the rival hedge funds Emerald Investment Partners and Davidson Kempner, seized the rest under a debt-for-equity swap, converting £480m of loans into shares.

.

Whitbread is another example. This was pre Coca-Cola buying the Costa coffee brand and all its assets. We liked Whitbread's original strategy. We liked their annual report. We think they were doing well although the margins on hotel business are much higher than those on coffee (the Costa brand). Then along came two US based hedge funds – Sachem Head and Elliot Advisers (the letter mentioned by Wikipedia as a vulture fund[12]). The latter also built up a shareholding of 6% prior to a possible takeover bid. To us Whitbread was a healthy and growing company with an impressive long-term strategy. These funds usually look for a takeover, then split the company up, take on debt, repay themselves, and then a quick sale of the constituent parts. Though Whitbread eventually sold the Costa operations to Coca-Cola for £3.9 billion (agreed in 2018).

We feel the same will happen with the Melrose after the takeover of GKN in 2018. Any possible assurances given to the Minister for Business, Greg Clark, by Melrose are, in our view, really not enforceable and so not worth the paper they are written on. Redundancies are already being made as of May 2018. So much for any assurances to the government.

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[11] Collingridge, J., 2019, Don't destroy us, Interserve chairman Glyn Barker warns hedge fund Coltrane, *The Sunday Times*, 10 February 2019.
Available at:
https://www.thetimes.co.uk/article/dont-destroy-us-interserve-chairman-glyn-barker-warns-hedge-fund-coltrane-wrlsq05bjAccessed February 2019

[12] https://en.wikipedia.org/wiki/Elliott_Management_Corporation

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholder revolts over remuneration report

As management and director's salaries have soared in recent times, shareholders have started to protest. The detailed directors' remuneration report is now an average of 20 pages long for the FTSE 100 (in 2018). These reports are usually in small font/print and in triple columns. Our view is that they are probably only going to be studied in detail by a handful of professional investors and proxy advisers. Occasionally there may be a shareholder revolt over remuneration[13] or choice of auditor. This has been accelerating in recent times though is normally quite rare. And often any vote is then considered but ignored.

Recently in 2017/2018, Unilever, Inmarsat, Pendragon. Ocado, Riot Tinto and others all experienced disquiet over directors remuneration. Of course In the case of Rio Tinto it was only 10% of the shareholders whereas at Pendragon it was 58.5% (among other protects by shareholders)- but the Pendragon revolt was with the help of ISS proxy adviser. AstraZeneca[14] where 37% of shareholders vote against or abstain on a vote that included a £9.4m pay package for pharmaceutical firm's chief executive. Similarly, BT was hit by a shareholder's revolt (34.2%) over outgoing chief executive £2.3m pay as well as top management's total pay, bonuses and share wards of £21.5m – up by 23.5% from the previous year[15]. Liontrust, a boutique fund house also ran into problems16. Martin Sorrell, founder and former chief executive of WPP, also had a shareholder's revolt together with the proxy adviser Glass Lewis, had a total package in 2015 of £70m but his exit is thought to be worth about £20m[17].

[13] Recently in 2017/2018, Unilever, Inmarsat, Pendragon. Ocado, Riot Tinto and others all experienced disquiet over directors remuneration. In the case of Rio Tinto it was only 10% of the shareholders whereas at Pendragon it was 58.5 (among other protects by shareholders). See Wilson,and Ralph 2018, Op. Cit.
[14] Partington, R., 2018, AstraZeneca rocked by shareholder revolt over executive pay, *The Guardian*, 18 May 2018.
Available at:
https://www.theguardian.com/business/2018/may/18/astrazeneca-rocked-by-shareholder-revolt-over-executive-payAccessed December 2018
Accessed July 2018
[15] Kolleqwe, J., 2018, BT hit by shareholder revolt over outgoing chief's £2.3m pay, *The Guardian*, 11 July 2018.
Available at:
https://www.theguardian.com/business/2018/jul/11/bt-hit-by-shareholder-revolt-over-outgoing-chief-pay
Accessed July 2018
[16] Tasman-Jones, J., 2018, Liontrust reflects on shareholder revolt over pay, Portfolio Adviser, 25 September 2018.
Available at:
https://portfolio-adviser.com/liontrust-reflects-on-shareholder-revolt-over-pay/
Accessed December 2018
[17] Garrahan, M., and Marriage, M., 2018, WPP shareholders revolt over executive, *Financial Times*, 13 June 2018.
Available at:
https://www.ft.com/content/9beec208-6efc-11e8-852d-d8b934ff5ffa
Accessed July 2018

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholder revolts over remuneration/Continued

Persimmon was probably was an interesting example with a bonus award of £100m reduced to £75m to appease shareholders.

> Persimmon shareholders rebelled on Wednesday against a "grossly excessive" £75m bonus awarded to the housebuilder's chief executive Jeff Fairburn.
>
> In a vote at the company's annual general meeting, 48.5 per cent of ballots were cast against the pay deal while 30 per cent of shareholders abstained.
>
> Mr Fairburn's pay prompted widespread condemnation in December, after it was reported that he would collect more than £100m. After public outcry from politicians and shareholders, Mr Fairburn offered to cut the bonus by £25m and said he would donate a "substantial proportion" to charity.
>
> Finance director Mike Killoran saw his £77m pay packet reduced to £53m and managing director Dave Jenkinson's was cut by £2m to £38m.
>
> Euan Stirling, head of stewardship at Aberdeen Standard Investments, which owns a 2.3 per cent stake in Persimmon, said the reduction "did not even get close to acceptable"[18].

Lip service was paid to the shareholders though there was a lasting impact:

> The boss of Persimmon Jeff Fairburn has been forced out after a row over his £75m pay award.
>
> Persimmon said he left by "mutual agreement and at the request of the company".
>
> It said the issue was having a "negative impact" on the firm's reputation and on "Jeff's ability to continue in his role"[19].

Fairburn ousting a few month later was probably due an adverse a BBC TV interview which caused negative publicity rather than any shareholder revolt or activity – though shareholders did reduce his overall pay from £110m down to £75m. His replacement collected a bonus of £40.5m from the same incentive plan.

[18] Chapman, B., Persimmon shareholders revolt over chief executive's 'grossly excessive' £75m bonus, Independent, 25 April 2018.
Available at:
https://www.independent.co.uk/news/business/news/persimmon-bonus-jeff-fairburn-bonus-pay-shareholder-revolt-company-agm-2018-a8322431.html
Accessed July 2018.

[19] BBC, 2018, Persimmon boss to leave after 'distraction' over pay, *BBC News*, 7 November 2018. Available at: https://www.bbc.co.uk/news/business-46122407
Accessed December 2018.

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholder revolts over remuneration/Continued

The Royal Mail also ran into problems over the incoming chief executive[20].

> The directors' remuneration report was rejected by about 70% of shareholders in a vote, which is non-binding, at Royal Mail's annual meeting.
> New chief executive Rico Back is set to be paid £640,000 - £100,000 more than his predecessor Moya Greene.
> Royal Mail says it will consult further as it reviews its pay policy this year.

Though in the end the Annual Report showed the salary of Rico Black unchanged though it was claimed that the pension benefits would be substantially lower. Still the BBC reported that Royal Mail's remuneration committee chair, Orna Ni-Chionna, said:

> "We will consult very closely with them and with the shareholder representative bodies as part of our scheduled review of the company's remuneration policy. This is due to take place in the autumn." "We will consult very closely with them and with the shareholder representative bodies as part of our scheduled review of the company's remuneration policy. This is due to take place in the autumn."

Typically though a revolt is rarely over 50% of the shareholders. Therefore it is just a protest and management and the remuneration committee can pay lip service to the revolt but can and usually does ignore or only make minor adjustments. In Volume 1: *Disruption in the Audit Market: The Future of the Big Four*[21], Carillion's remuneration committee, headed by Alison Horner, who was also in a senior position at Tesco, was discussed presiding over growing salaries and bonuses at the top of the company as its performance faltered[22]. The Select Committee went on to criticise her:

> In her evidence to us, she sought to justify her approach by pointing to industry standards, the guidance of advisors, and conversations with shareholders. She failed to demonstrate to us any sense of challenge to the advice she was given, any concern about the views of stakeholders, or any regret at the largesse at the top of Carillion.

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[20] BBC, 2018, Royal Mail hit by shareholder revolt over bosses' pay, *BBC News*, 19 July 2018.
Available at:
https://www.bbc.co.uk/news/business-44884828
Accessed July 2018

[21] Bhaskar, K. et al, *Disruption in the Audit Market: The Future of the Big Four*, Routledge, 2019.
Available at:
https://www.amazon.co.uk/s?k=Disruption+in+the+Audit+Market%3A+The+Future+of+the+Big+Four&ref=nb_sb_noss

[22] Select Committee, 2018, House of Commons. Business, Energy and Industrial Strategy and Work and Pensions Committees. Carillion, page 35.
Second Joint report from the Business, Energy and Industrial Strategy and Work and Pensions Committees of Session 2017–19. HC 769. Published on 16 May 2018. by authority of the House of Common.
Available at:
https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf
Accessed July 2018.

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholder revolts over auditor

If anything it seems that Alison Horner was promoted at Tesco[23].
The other area apart from remuneration that shareholders are sufficiently concerned about that they can possibly object is the appointment of auditor. Investec (listed in the UK and South Africa) is a case in point as reported by the Telegraph[24]:

> Investec suffered a shareholder revolt against its decision to reappoint KPMG as its auditor, following a spate of scandals at the Big Four accountancy giant which have seen it haemorrhage clients.
> Just under 20pc of Investec's voting shareholders rejected the resolution to stick with KPMG as one of its auditors in South Africa.
> In response to the revolt, Investec said it had "spent a lot of time during the course of the year on matters pertaining to audit quality and auditor independence", and its decision to retain KPMG as one of its auditors "was not taken lightly".

So once again the revolt was more or less swept under the carpet and ignored.

BT faced a rebellion over the appointment of KPMG as its auditor. This was after

> the telecoms group ended its relationship with PWC following the discovery of a £500 million fraud at BT's Italian business. The fraud led the group to issue a profit warning that resulted in billions being wiped off its market value[25].

SIG plc shareholders actually voted down a resolution to reappoint Deloitte as their external auditor[26]. This was after accounting irregularities as described in an appendix to Volume 1: Disruption in the Audit Market: The Future of the Big Four[27]. The company's profit had been overstated. In the end EY was appointed as the new auditor. So this is a rare exception where

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[23] Uttley, H., 'Pay chief who helped dish out huge bonuses to bosses at Carillion is given a promotion at Tesco', *This is Money*, 22 May 2018.
Available at:
http://www.thisismoney.co.uk/money/markets/article-5754637/Reward-failure-Pay-chief-dished-huge-bonuses-Carillion-bosses-given-promotion.html
Accessed July 2018.

[24] Boland, H., 2018, Investec hit by shareholder revolt over reappointing KPMG as auditor, The Telegraph, 8 August 2018.
Available at:
https://www.telegraph.co.uk/business/2018/08/08/investec-hit-shareholder-revolt-reappointing-kpmg-auditor/
Accessed December 2018

[25] Kinder, T., 2018, BT prepares for rebellion over KPMG audit switch, The Times, 20 June 2018.
Available at:
https://www.thetimes.co.uk/article/bt-prepares-for-rebellion-over-kpmg-audit-switch-bvpxc3l0h
Accessed July 2018

[26] McCance, D., SIG shareholders revolt against Deloitte reappointment, *Economia,* 11 May 2018.
Available at:
https://economia.icaew.com/news/may-2018/sig-shareholders-revolt-against-deloitte-reappointment
Accessed June 2018.

[27] See the online companion volume to Volume 1: Disruption in the Audit Market: The Future of the Big Four:
http://www.fin-rep.org/wp-content/uploads/book2/Appendix-2.08.01-Recent-Cases-BHS-Steinhoff-SIG.pdf

the shareholders won.

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholder revolts over auditor/Continued

Earlier, Mitie also had a revolt though this time is was just 29% of the shareholders voted against the reappointment of Deloitte. Instead the mid-tier firm BDO was appointed in a tendering process. Economia reported[28]:

> Last month's decision to end its audit relationship with Deloitte followed an extremely challenging year for the business.
> The company lost its high-profile chief executive Ruby-McGregor Smith and its chief financial officer Suzanne Baxter, made a number of profit warnings and had to write down more than £50m in profits following an accounting review by KPMG which found a number of "material errors".

GE: shareholders did revolt unsuccessfully over the reappointment of KPMG[29]. This was lead by two proxy advisers: Glass Lewis and ISS. KPMG also avoided a smaller revolt (but led by Glass Lewis) at the US back Wells Fargo.

In Chapter 6 of Volume 2: *Financial Failures & Scandals: From Enron to Carillion*[30]
, Carillion rivals and outsourcing companies were examined. All of them had glossy reports with heavy front sections and much simulacra. All had low margins and the case for large additional equity funding could be made. The front section seemed to be composed of marketing documents - ready to handout as part of a presentation to win new business. The major thrust of many of those and the FTSE 100 reports were exhibiting their own self-important, proud and almost self-aggrandising. The least boastful and most honest report Krish found was Arcadia (Sir Philip Green's families group) and that was 2017. Unfortunately 2018 should the Group making substantial losses and that narrative changed. The report contains boilerplate remarks such as "we have some of the greatest brands…" and "We are already making good progress…" and "We are looking forward to expanding…" and We are also taking our digital channels to the next level…". Nothing about why haven';t management already done this in the face of declingin margisn and the online landscape.

[28] Fino, J., 2017, Mitie shareholders revolt over Deloitte reappointment, *Economia,* 28 July 2017. Available at:
https://economia.icaew.com/news/july-2017/mitie-shareholders-revolt-over-deloitte-reappointment
Accessed June 2018
[29] Fino, J., 2018, KPMG survives shareholder revolt at General Electric, *Economia,* 26 April 2018.
[30] Bhaskar, K. et al, Volume 2: *Financial Failures & Scandals: From Enron to Carillion*, Routledge, 2019. Available at:
https://www.amazon.co.uk/Financial-Failures-Scandals-Carillion-Disruptions-ebook/dp/B07QTB4DJ6

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholders and investors

The power of the shareholder and potential investors was also commented on by the various government and parliamentary reports. The select committee on Carillion was particularly damning over management's approach to the opinion of shareholders[31]:

> Major investors in Carillion were unable to exercise sufficient influence on the board to change its direction of travel. For this the board itself must shoulder most responsibility. They failed to publish the trustworthy information necessary for investors who relied on public statements to assess the strength of the company. Investors who sought to discuss their concerns about management failings with the board were met with unconvincing and incompetent responses. Investors were left with little option other than to divest. (Paragraph 113, page 50).

Our own evidence seems to suggest that management often ignore shareholders view unless the proxy advisers become involved or a hedge fund with a stake makes a push, Often the proxy advisers are ignored – as we have seen. But a potential takeover bid by a hedge fund can never be ignored lightly. Just the threat of the same changed Whitbread' management's view of their strategy.

The CMA published an update paper outlining serious competition concerns and proposing changes to legislation to improve the audit sector for the benefit of savers and investors alike[32]. In this report and in relation to audit appointment, the report commented that:

> Although the Audit Committee is meant to represent the interests of shareholders, in practice most stakeholders we spoke to suggested that investors have little engagement with audit matters. Several ACCs confirmed a lack of active engagement in audit matters by shareholders and other investors. (Paragraph 3.42)

And

> The investors we spoke to told us that this lack of engagement reflected a lack of transparency and information about the audit process. They said that often little information was provided about tender processes. Also, limited information is provided about issues and concerns raised by auditors, the reasons underlying the identification of key risks, and whether the Audit Committee believe the audit has been challenging and the auditor has exercised professional scepticism. Communications to shareholders are generic and often based on answers to questionnaires drafted by audit firms. (Paragraph 3.45).

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[31] Select Committee, 2018, Op. Cit.

[32] Government press release CMA, 18 December 2018, CMA proposes reforms to improve competition in audit sector: Improvements to the independence and the quality of audits are the focus of the CMA's market study update.
Available at:
https://www.gov.uk/government/news/cma-proposes-reforms-to-improve-competition-in-audit-sector
and the actual paper can be downloaded via:
https://assets.publishing.service.gov.uk/media/5c17cf2ae5274a4664fa777b/Audit_update_paper_S.pdf
Accessed December 2018.

Conflicting objectives of reports/Continued

Shareholder groups/Continued

Shareholders and investors/Continued

> The Kingman Report[33] in the review of the FRC made one of its recommendations as: Recommendation 50: In the most serious cases, the Review suggests it may be appropriate for the regulator to issue a report to shareholders suggesting that the company's dividend policy should be reviewed, or that they consider the case for a change of CEO, CFO, chair or audit committee chair, or for other strengthening of the board of directors. The Review believes that, where the severity of the facts merit it, the regulator should have the confidence to do this. Decision-making should rest, as now, with boards and shareholders. (Page 50).
>
> This demonstrates that the shareholders do not really exert this type of pressure – though hedge funds do as.

Shareholders versus stakeholders versus directors

Hence we consider that the struggle between the proponents of the primary purpose being shareholders or the alternative wider concept of stakeholders, has been won so far by the shareholders, with any information provided on matters of interest to the wider stakeholder being purely cosmetic – essentially a PR exercise. But, on reflection we feel that there is a second struggle that has influenced the reporting requirements/ts of companies: that of shareholders versus directors. This reflects the basic conflict between ownership and control that was identified by Berle and Means[34] over eighty years ago. Essentially the regulators, responding to pressure from shareholders and their representatives have sought to strengthen the position of shareholders vis-à-vis directors. In respect of the annual report, this has been achieved principally through the provisions relating to audit and to information on directors' remuneration.

- Audit. The effect of recent provisions is to prevent the auditor becoming too close to the company's management
- Directors' remuneration: This information takes up a very considerable proportion of the annual report (According to the 2017 Deloitte report the average number of pages of the (directors remuneration) report is now 19 pages of usually small font triple column print. This is clearly quite out of proportion to the materiality of the monetary amounts involved.

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[33]Kingman Report, 2018, *Kingman Report: Independent Review of the Financial Reporting Council,* Government, December 2018
Available at:
https://www.gov.uk/government/publications/financial-reporting-council-review-2018
Accessed December 2018.

[34] See for example http://www.businessdictionary.com/definition/Berle-Means-thesis.html
Or
https://en.wikipedia.org/wiki/The_Modern_Corporation_and_Private_Property

Conflicting objectives of reports

The breakdown and new awakening for reporting

Financial reporting and the wider corporate reporting originated in a way to account for stewardship to the owners, the shareholders. The western markets adopted the single objective of the firm as a profit maximising –maximise the value of shareholders wealth which or once interest rates are taken into account, maximising the net present value of the stream of dividends and other cash streams to and from the shareholders. The Japanese and some Asian markets (not so much Hong Kong and Singapore) interpreted this as long term growth. Of course Trumpian economics with the corporate tax cuts has led to many sums being returned to shareholders and/or a buy-back of the firms' own shares. It is not just dividends that are the only cash stream to and from shareholders.

Several events or conditions changed this of the UK and other western markets[35]:

> This year 's wave of high-profile flotations has some similarities. Uber, Lyft , Slack and the rest are not old as Ford was when it listed . But nor are they in the first flush of youth. New firms are staying private for longer. The number of public firms in America has declined by more than a third since the 1990s.

This decline in publicly listed firms has also occurred in the UK though may be comparatively younger as a trend than in the US with the growth of the private equity firms such as KKR, Blackstone, Apollo and in the UK CVC Capital (but now moved to Luxembourg). That said it is not just the private equity firms. There are

1) **Low interest rates**. Interest rates fell to an all-time low following 9/11, the global financial recession of 20017-2009, decade long attempts by the Japanese to stimulate their economy with negative interest and the ECB which has also experimented with negative interest rates. All actions couple with quantitative easing (increasing the money supply) with often questionable positive results. The effect of low interest rates is that it makes cash in the long term less valuable (in real terms) and this makes for cash now or short-termism.
2) **Delisting.** Avoiding the new regulatory controls on listed companies by going private. Many companies with significant shareholders (mainly non-institutional often family interest) want to avoid the rigours, announcements and short-termism of the institutional investors by delisting and being private.
3) **Rewarding growing companies and unicorns' founders with wealth.** All the large tech companies and many of the disrupting companies went public after their take off yielding vast wealth to the founders. Many not so profitable companies have performed similar listing with the wealth going to the founders. Sometimes this is a takeover as in the case with Autonomy – but in this case with both parties being less than satisfied (the original Autonomy management being indicted for fraud in the US and a long drawn out civil case in the UK).

[35] Buttonwood, The rise and rise of private capital, *The Economist*, 4 July 2019.
Available at:
https://www.economist.com/finance-and-economics/2019/07/04/the-rise-and-rise-of-private-capital
Accessed July 2019.

4) **Private equity.** Not least there is the growth of private equity firms who often takeover a company and then swamp it with debt to repay the new shareholders their purchase price and then sometime go for a quick sale.

Conflicting objectives of reports/Continued

The breakdown and new awakening for reporting/Continued

5) **The growth of other objectives apart from shareholders wealth.** For some time the environmental lobby has been growing (with justification) to measure the environmental impact of firms. More recently the collapse of Carillion and Patisserie Valerie has demonstrated that employees interests should not be ignored. And the Carillion collapse caused inconvenience to the Government, The switch from bricks and mortar's stores to online retailing has led to upwards of 5,000 stores clothing each year has underlined the importance of employment opportunities even though the UK has been at close to full employment.

The latter factor is being reported more widely[36]:

> A group of influential investors, academics and lawyers is pushing for big companies to publicly declare how they will "profitably achieve a solution for society" after a major US business group unexpectedly dropped its creed of shareholder primacy.
>
> The initiative, led by Oxford university's Saïd Business School, Berkeley law school and Hermes EOS — the investment manager's engagement and stewardship division — wants company directors to provide a one-page "statement of purpose", detailing the most important stakeholders and timeframes for evaluating strategy and how capital is spent.
>
> Their aim is to counter what they call the "misconception" that directors' only fiduciary duty is to shareholders.

This is not just a UK phenomenon. It is also being heralded in the US despite President's Trumps drive to roll back corporate regulations[37]:

> One of America's largest business groups has dropped the "shareholder primacy" creed that has driven US capitalism for decades, urging companies to consider the environment and workers' wellbeing alongside their pursuit of profits.
>
> The Business Roundtable has close to 200 members, including the chief executives of JPMorgan, Amazon and General Motors, which generate $7tn in annual revenue. A new "statement of purpose" from the BRT on Monday placed shareholders as one of five stakeholders, alongside customers, workers, suppliers and communities.

[36] Edgecliffe-Johnson, A., Companies under pressure to declare 'social purpose', *Financial Times*, 22 August 2019.
Available at:
https://www.ft.com/content/7ba44ea8-c4f7-11e9-a8e9-296ca66511c9
Accessed August 2019.
[37] Henderson, R., and Temple-West, P., Group of US corporate leaders ditches shareholder-first mantra, *Financial Times*, 19 August 2019.
Available at:
https://www.ft.com/content/e21a9fac-c1f5-11e9-a8e9-296ca66511c9
Accessed August 2019.

Conflicting objectives of reports/Continued

The breakdown and new awakening for reporting/Continued

> It is a significant departure from the bedrock belief that businesses serve the owners of their capital — a philosophy championed by Nobel Prize-winning economist Milton Friedman and which has driven corporate America for decades.
>
> Companies should "protect the environment" and treat workers with "dignity and respect" while also delivering long-term profits for shareholders, the BRT said.
>
> The change amounts to a call to reform capitalism in a time in which rising populism and concern about climate change have led politicians and shareholder activists to demand that companies consider their impact on the world beyond their balance sheets.

This indicates that there are at least several other objectives between these two articles.

a) Employee rights and welfare – and this is also being passed along the supply chain.
b) Environmental objectives and the new call to save the planet Earth.
c) The wider implications of society including consumers, the population at large, the local communities (where good and services are created) and the Government.
d) A move from the focus of short-term profits for shareholders to the longer term. Not just dividend growth.