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Corporate Governance — Beyond the Listed Company

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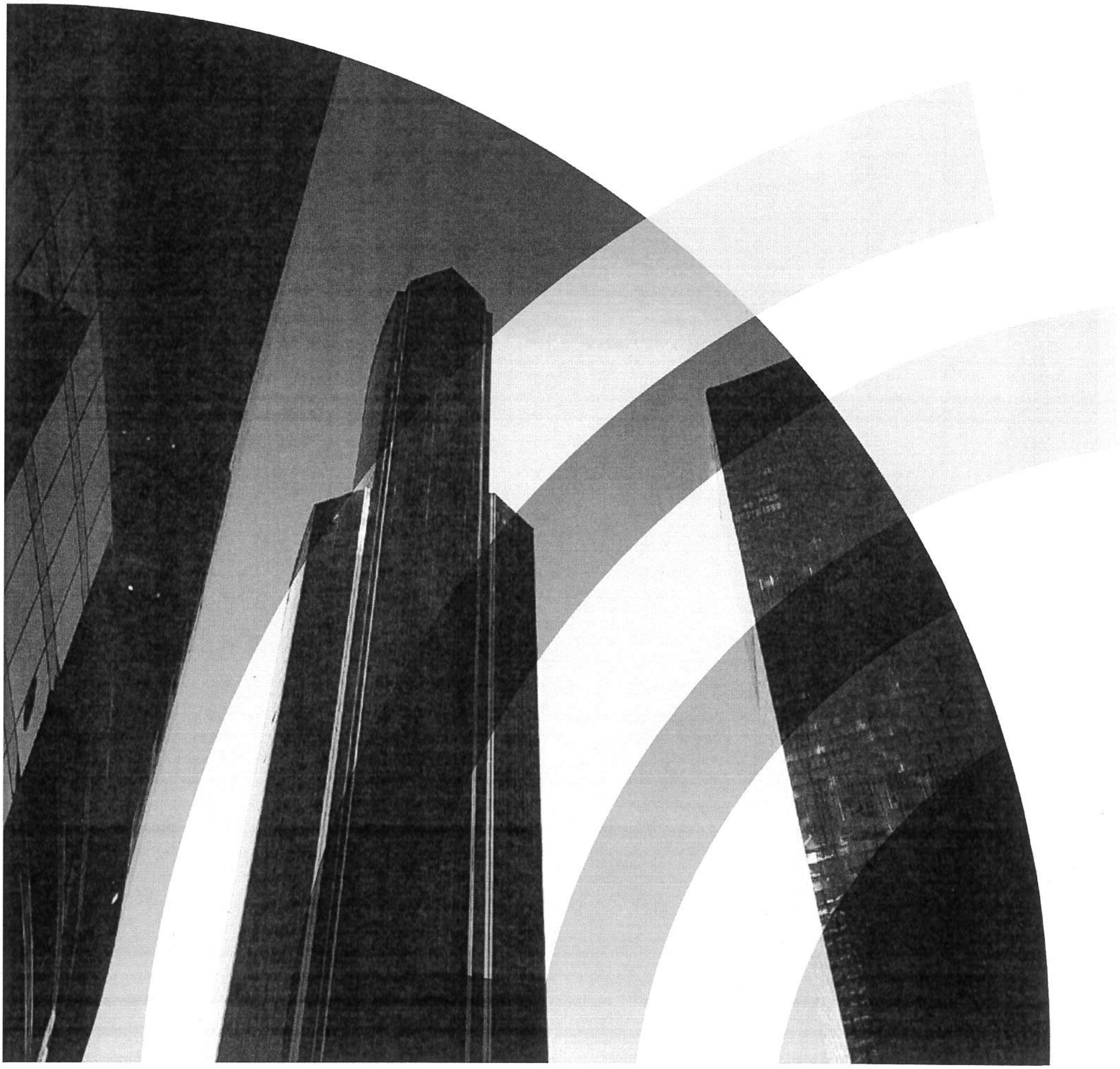

About The Chartered Governance Institute

The Chartered Governance Institute is the premier global qualifying organisation for professionals aspiring to become a Chartered Secretary and/or a Chartered Governance Professional. With over 125 years of history, we assist company secretaries, governance advisers, non-executive directors and others in the development of their skills, knowledge and experience. The Institute is an international organisation with nine local institutes in its network and 29,000 members living and working in over 80 countries. Most importantly, it brings its influence to bear on international trade bodies, governments, regulators, non-government organisations and companies to represent the views and current thinking of those involved in governance.

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Foreword

In September 2019, The Institute of Chartered Secretaries and Administrators changed its name to The Chartered Governance Institute.

This was not just a change of name. Far from it. In recent years, the importance of the good governance of listed and non-listed companies, non-governmental organisations, social enterprises, public authorities and statutory bodies to the economic, social and environmental wellbeing of society has become widely recognised and accepted. At the same time, the significance and breadth of the role of governance professionals has greatly increased. The Institute today is a professional home, not only for Chartered Secretaries, but for the entire range of governance professionals, including governance officers, risk managers, lawyers, accountants, board members and senior executives – in fact anyone who has an interest in the promotion of excellence in governance, wherever they work and whatever they do.

The vision of The Chartered Governance Institute is to be the leader in the practice of governance globally. We will be the best advocates, the best educators and the most active organisation in the promotion of good governance globally. As part of that mission, the Institute will facilitate the international sharing of governance ideas, practices and initiatives.

The 'Thought Leadership Committee' of the Institute is one of its platforms for the development and dissemination of ideas, insights and information on current and future trends in governance. This Paper 'Corporate Governance – Beyond the Listed Company' is an example of the Committee's work and how, drawing on the experience of governance professionals across the world, The Chartered Governance Institute can promote and stimulate debate on the future of governance and how evolution in governance can positively impact on the societies we serve.

Good governance is a journey, not a destination. The focus, standards and scope of governance must constantly be evaluated and revised to best suit the needs of society. In governance, 'more is not better' – 'better is better'. In that spirit, this Paper reflects on the implications of the relative decline of the number of listed companies, the rise of alternative structures connecting investors' capital with business needs and the growing recognition of the importance, not only of shareholders, but of stakeholders as a whole to effective and relevant governance regimes.

I do not expect readers necessarily to agree with all the thoughts developed and discussed in this Paper – our overriding aim is to promote and encourage thought and debate. In doing so, The Chartered Governance Institute and the governance professionals who are our members will be fully playing their role in the contest of ideas which will drive excellence in governance in the years ahead.

Edith Shih **FCG FCS(PE)**
International President

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Executive Summary

Since the publication in the UK of the Cadbury Report in 1992, the evolution of modern corporate governance has been characterised by a strong and sustained focus on the governance of listed companies.

This Paper looks beyond the present corporate governance regimes and standards applied to listed companies in two senses. First, 'beyond' in terms of the extension or application of such regimes and standards to other capital-raising structures. Second, 'beyond' in the way that corporate governance of both listed companies and those other structures will need to adapt to a world where the interests of stakeholders, as opposed to shareholders only, need to be acknowledged and respected.

This Paper seeks to draw extensively on actual experience and collected data, so that the views expressed are grounded in practice more than theory. It also takes examples and illustrations from a range of jurisdictions with the aim of identifying issues that span markets across the world.

The principal themes of this Paper are:

- the decline of a stock exchange listing as a preferred structure for raising capital from public investors;
- the loss of attractiveness of listed companies as a capital-raising vehicle, due to the heightened governance requirements imposed on them;
- the rise of alternative structures for fundraising, whether acting as intermediaries (such as private equity and venture capital) between businesses and public investors; or investing directly in those businesses, such as family offices or sovereign wealth funds. Some of these have been active for some time; others, such as crowdfunding, are more recent;
- none of these alternative structures is subject to a similar degree of governance disciplines as to those applied to listed companies;
- despite this comparative absence of governance discipline, non-listed companies are providing goods and services of similar importance and value to societies as their listed counterparts; and
- against a growing and accelerating trend to recognise that companies have duties to stakeholders, as opposed only to shareholders, there is no reason why the interests of stakeholders in non-listed companies should be treated differently to similar stakeholders in listed companies. Governance becomes the price of the privilege of limited liability, not just access to public capital.

This Paper concludes that, in corporate governance, more is not always better. We may even be approaching 'peak governance' for listed companies. In any event, a more measured and nuanced approach is required to the corporate governance standards imposed on, and expected of, listed companies. At the same time, greater attention should be accorded to the governance of alternative fundraising structures and, in particular, to private companies benefiting from the advantage of limited liability while providing stakeholders with goods and services which are substantial in scale, value and importance. Doing so would respect the hope expressed by Sir Adrian Cadbury, in the introduction to his Report (the Cadbury Report), of both listed and other companies aspiring to similar standards of governance.

Introduction

1. Corporate governance in its modern form can be said to have evolved from the publication in the UK of the Cadbury Report in 1992. In its origins and subsequent evolution, corporate governance has focused essentially on the governance of listed companies, with good governance being regarded as the price to be paid for the privilege of access to public investors.

2. This Paper considers whether this focus on listed companies now needs to be revisited and revised in the light of:

   a) the general decline of listed companies;

   b) the increasing connection between businesses and capital providers through other structures;

   c) the importance of other structures in the provision of essential social and economic goods and services to society; and

   d) the trend towards recognition of the duties owed by businesses, not only to shareholders, but to a much wider stakeholder group;

   and, if so, what might be the broad orientation for the evolution of corporate governance in the coming years.

The decline of the listed company

3. The 1992 Cadbury Report (Cadbury) *Financial Aspects of Corporate Governance* was prompted by an increasing lack of investor confidence in the honesty and accountability of listed companies. It was occasioned in particular by the sudden financial collapse of two listed companies – the wallpaper group Coloroll and Asil Nadir's Polly Pack Consortium. Reflecting its mandate and the circumstances in which the Report was commissioned, the Corporate Governance Code initiated by Cadbury was directed to the boards of all listed companies registered in the UK [Cadbury 3.1], while as many other companies as possible were encouraged to meet its requirements. The 1995 Greenbury Report (Greenbury) *Directors' Remuneration* followed Cadbury with a focus on listed companies, in particular larger listed companies. This orientation was continued through a series of other major corporate governance inquiries and reports in the UK: Hampel (1995) *Final Report – Committee on Corporate Governance* on the implementation of Cadbury and Greenbury; Turnbull (1999) *Internal Control: Guidance for Directors under the Combined Code* and Higgs (2003) *Review of the Role and Effectiveness of Non-Executive Directors*.

4. With this background, and the influence on other jurisdictions and markets of UK corporate governance thought and development, it is not surprising that over the past 25 years corporate governance has focused sharply on listed companies. However, the role of such companies as the natural or dominant home for public investors has changed markedly during that period, with a noticeable and widespread decline of the listed company. In other words, the years since the Cadbury Report have generally seen a substantial and ongoing increase in the reach of legislators and regulators into the workings of the governance of listed companies, while the same period has seen a significant diminution of the role of such companies in the wider economy, whether in absolute terms or relative to other forms of capital provision or business structures.

5. It is impractical and potentially misleading to describe the decline of the listed company by a single measure or statistic. The following may serve to evidence both the reality of this trend and that it is a widespread phenomenon:

   a) Between 1997 and 2012 the number of public companies in the US and the UK declined by 38% and 48% respectively (MWM Consulting, *Renaissance Directors: Reinvigorating Public Companies*).

   b) There were 3,600 companies listed on the US Stock Exchange at the end of 2017, down by more than half since 1997.

   c) The decline extends to second boards. The number of companies listed on the UK AIM fell below 1,000 in 2017 for the first time since 2004 – down by more than 40% from its peak in 2007 (*Financial Times*).

   d) In Germany, delisting contributed to only a 1.3% decline in the number of public companies between 1991 and 1995, but accelerated to a decline of 6.4% between 2010 and 2016 (*LSE Business Review*, 8 December 2017).

   e) 'De-equitisation' is a worldwide phenomenon. More shares are being pulled from markets through acquisitions and share buybacks than new shares issued. In 2016 global net equity supply fell into negative territory for the first time ever (JP Morgan, cited in *The Sunday Times*, 1 December 2019).

6. In addition to a fall in the numbers of public companies, those remaining on stock markets have been repositioning their reliance on capital provision through equity, as against debt. In 2008, US companies bought back a record US$1.1 trillion of stock, or 3% of the total market. The year 2019 is on track to exceed this (Bentley Reid, 2018). While share repurchases should not, in themselves, reduce market capitalisation (due to a corresponding increase in the price of those shares left in issue), it does illustrate a move from equity to debt. In its article of 1 December 2019, The Sunday Times in the UK noted:

Opinions are split on whether listed companies will swing back into fashion when the era of cheap money driven by quantitative easing comes to an end, or whether this is the start of an epochal shift in the way businesses are owned. It could be the slow death of the public equity markets.

7. Opinions do vary as to whether, in an economic or even wider sense, the decline of the public company matters. Jay Clayton, Chairman of the US Securities and Exchange Commission has called this 'a serious issue for our markets and for the country'. On the other hand, Bloomberg's Editorial Board has asked 'Where have all the public companies gone? Some businesses are staying private. Others are getting bigger. That's not necessarily a problem' (9 April 2018).

8. However, it is a problem if a large and increasing mass of economic activity now falls outside the corporate governance practices and policies that were established to address perceived failings in the traditional public company model and to protect the interests of the providers of capital. One particular area where the reduction in the role of public companies and the corresponding application of governance obligations does matter is that of disclosure. This has been one of the keystones of modern corporate governance regimes – the provision of timely, accurate and relevant business and financial information to protect shareholders and to enable existing and potential investors to make fully-informed judgments. One could argue that the diminution of these information flows, as businesses retreat behind more opaque structures, is irrelevant as the owners of private companies still have all the information they need available to them. However, it will adversely affect the understanding, knowledge and judgments of investors, not only about individual companies, but about wider economic sectors and investment choices. To the extent that the interests of a wider stakeholder group are relevant (see later in this Paper), the reduction in the publicly available information about business activity also impacts on the ability of such stakeholders, be they governments, customers, suppliers, employees or whomever, to make informed judgments on conduct which affects their legitimate interests.

9. Any discussion on the future of corporate governance in the context of the decline of listed companies needs to consider whether strengthening governance standards and their focus on such companies are actually contributing to that decline. Some observers see a direct link: 'The problem is that governance standards have become so demanding that lots of the best companies don't want to list' (Matthew Lynn in *The Telegraph*, 19 March 2019). Such views were expressed vividly, with great force and clarity, by Tim Martin, Chairman of JD Wetherspoon Plc, a UK-listed pub and hotel business, in its trading statement of 13 November 2019. In that statement, which is worth reading in its entirety, Mr Martin castigated the shortcomings and consequences of the UK's corporate governance regime for listed companies. In remarks prompted by the opposition of two institutional shareholders to the re-election of long-serving non-executive directors, Mr Martin criticised the inexperience of non-executive directors, the creation of 'almost unreadable annual reports, full of jargon, cliches and platitudes', the institutionalisation of short-termism, inexperience and navel-gazing, and the failure of investors and corporate governance advisers to apply to themselves the practices they imposed on listed companies. He concluded that 'The UK [corporate governance] system is up the spout – and is itself a threat to listed companies – and therefore the UK economy'.

10. There is anecdotal evidence that the 'cost of compliance' is also limiting the pool of listed company directors, as fewer individuals become willing to step forward, particularly those with more of their careers ahead of them and those who are, or have been, in positions or organisations which have not been subject to the demands and liabilities which accompany public listing. This reluctance can stem from the scrutiny of remuneration, which is absent outside the listed environment, as well as the risk from fall-out of listed company underperformance or failure. Directors tarnished by high profile examples will struggle to find future comparable roles, whether

as a director or even as a senior executive. This is not helped by the default reaction of governments and media, namely that these are entirely 'governance failures' without taking into account other factors (Thomas Cook being a recent example of this). That is an understandable comment in circumstances where, in the UK alone, there have been 14 corporate governance codes and reforms since 1992 – often, as with Cadbury itself, a reaction to a particular scandal or company collapse, rather than an orderly series of coherently structured reforms.

11. There is also evidence that sharp, substantial tightening of governance requirements can have a direct impact on listing behaviour. Within two years after the passage of the *Sarbanes-Oxley Act of 2002*, 370 publicly traded companies in the US delisted. From 2004 to 2005 the number of initial public offerings (IPOs) in the US fell from 260 to 221, while over the same period the number of IPOs in European exchanges rose by almost 40% – from 433 to 603 IPOs. (www.gcconsulting.com). A further factor is the fear of share price arbitrage (ironically, often by organisations whose governance cannot be scrutinised), particularly around M & A activity, to which public companies are exposed.

12. That said, whether corporate governance itself is a major contributor to, or a cause of, the fall in popularity of listings is uncertain. That is because it is extremely hard to disentangle this from other possible causes, such as low interest rates, tax treatment, overall trading conditions or a dislike of scrutiny. It is also difficult to separate the burdens of corporate governance from a wider dissatisfaction of boards with markets' judgments on the performance and prospects of their business. Further, part of this dissatisfaction may stem from the short-termism of equity holders (identified in *The Kay Review of UK Equity Markets and Long-term Decision Making*) and the misalignment between investors' short-term horizons and the longer-term development and successful outcome of the issuer's business model.

13. Perhaps a nuanced view is the most appropriate – that reinforced corporate governance requirements are not in themselves driving business away from publicly trading but, in choosing which business structure to adopt and retain, they will be a factor in the decision-making process. This is especially the case if other credible business structures are available which can provide capital without the accompaniment of comprehensive governance obligations. In the next section of this Paper we will examine some of those alternatives.

Providing capital to business — The rise of other routes

14. If listed companies are generally in decline, new routes must be opening up, or old ones increasing in importance, to link capital providers with businesses needing capital. This section of the Paper describes some of the key conduits, using two categories – those which intermediate between public investors and business, and those which directly funnel their own funds to business.

15. The first of these categories includes private equity, venture capital and crowdfunding. Some widely-diffused definitions might be helpful (see www.investopedia.com):

    Private equity – an alternative investment class that consists of capital that is not listed on a public exchange. It is composed of funds and investors that directly invest in private companies or that engage in buyouts of public companies, resulting in the delisting of public equity.

    Venture capital – financing that investors provide to start-up companies and small businesses that are believed to have long-term growth potential.

    Crowdfunding – the use of small amounts of capital from a large number of individuals to finance a new business venture.

16. The size and growth of each of those structures are immense. The number of private equity deals in 2018 has been assessed at 2,936, with a total buyout value of US$582 billion. The amount of private equity 'dry powder' or uncalled capital was estimated at US$1.2 trillion as at December 2018 (Bain & Co). McKinsey has calculated a seven-fold rise in private equity net asset value since 2002, more than twice as fast as global public equities. Growth on a similar, spectacular scale has been observed in the venture capital industry which trebled in size, in terms of invested capital, to US$160 billion between 2008 and 2017 (*The Telegraph*, 20 November 2018). The scale of deals, typically smaller in venture capital than for private equity, has also been eye-catching – in October 2018, challenger bank Monzo raised US$85 million from US venture capital investors with a total valuation of over US$1 billion. Crowdfunding, as a newer platform and a focus on smaller deals, reflects a similar pace of growth, but with a lower capital value. Transaction values for 2019 are forecast at just under US$7 billion for 2019 (Statista Market Forecast) and are expected to reach US$28.8 billion by 2025 (https://reports.valuate.com).

17. Of these structures, it may be that private equity presently poses the greater threat to the growth and sustainability of the listed company sector, particularly in the field of tech start-ups. This threat comes in two forms: start-up businesses forgoing listings and being sold directly to private equity and listed start-ups being bought out by private equity and taken private. For example, in October 2019, Sophos, a FTSE 250 cyber security firm, was taken over by US private equity fund Thomas Bravo for US$4bn and delisted. Sophos' CEO, Kris Hagerman, quoted in *The Telegraph*, 15 October 2019, was dismissive of the importance of maintaining a public listing:

    > Frankly, we're much more focused on how we can continue to take advantage of a US$40bn global cybersecurity market than focusing particularly on the geography of the stock exchange that we're listed in.

    The same article presented a different view from an investor's perspective arguing:

    > It's important that firms can go public in the UK to continue to grow. You want businesses to have all the right options open to stay independent if they want to. Right now the piece that's at risk is the initial public offering.

    The existence of that risk, and its relationship to the scope and nature of corporate governance regimes, is a key theme of this Paper.

18. If the first category of capital providers basically links underlying holders of finance with business, the second category, which includes sovereign wealth funds and family offices, acts more directly and less as an intermediary. Again, some definition may be helpful:

Sovereign wealth funds – state-owned investment funds which invest in real and financial assets or in alternative investments, such as private equity or hedge funds.

Family offices – personal investment firms that directly link wealthy individuals and families with investment opportunities.

19. Both are massive in growth and scale. According to Reuters, global sovereign wealth fund assets reached US$7.4 trillion by March 2018. The size and importance of family offices is, by their private nature, difficult to estimate. It has been suggested that they number somewhere between 5,000 and 10,000 and hold up to US$4 trillion of assets – more than hedge funds and equivalent to 6% of the value of the world's stock markets (*The Economist*, 15 December 2018).

20. In addition to their size and growth, all of these financing structures, many of whom operate through private limited companies, have a common characteristic. That is, freedom from the demands of the steadily reinforced framework of formal corporate governance structures, which have been applied to public companies over the past 25 years. They also have a further common characteristic – all of them, as with listed companies, play a significant role in the provision of important, sometimes essential, goods and services to the societies in which they choose to operate. In the next section of this Paper we will put this and some of its implications into context.

21. Before doing so, it is appropriate to note that some of the themes developed in this Paper, notably the link between limited liability and an obligation of good governance, as well as the connection between governance and effective stakeholder relationship management, can also apply to state-owned enterprises, non-governmental organisations and the so-called Fourth Sector. To maintain this Paper at a reasonable length, and its scope at a reasonable breadth, these are not tackled in the following pages.

The importance to society of goods and services provided by non-public companies

22. On 13 June 2019 it was announced that Axel Springer would be taken private by the US private equity giant KKR in a €6.8 billion deal. As a result, some of Germany's biggest newspapers, such as *Die Welt* and *Bild*, will come into private ownership – in common with Bertelsmann (the German publisher which owns Penguin Random House). If this deal goes ahead, this may or may not be a bad thing for the Axel Springer business and for its owners. But one thing is certain – henceforth that business will be shielded from the scrutiny of the public markets and liberated from the restraints, should they be so considered, of the German Corporate Governance Code (*Deutscher Corporate Governance Kodex*). Given the nature of the Axel Springer business, and the importance of its publications in Germany's media space, this does matter. Announcing the deal, Axel Springer's CEO said: 'KKR is a long-term focused partner who respects our commitment to independent journalism.' This may prove to be the case, but the values and ethics he describes will not be monitored, applied or disclosed through the company's existing corporate governance obligations.

23. The UK supermarket sector is a good example of the importance of non-public companies to the supply of goods and services to the economy – and of the differences between the business structures used. At present, all four of the UK's largest supermarkets (by market share) are listed companies – Tesco (since 1947), Sainsbury's (since 1973) and Morrisons (since 1967) are all listed on the London Stock Exchange (LSE); Asda was listed on the LSE until 1999 when it was acquired by Walmart (itself listed on the NYSE since 1972). As such, each of these supermarkets is subject to the corporate governance and reporting obligations which accompany listed company status. In contrast, two of their major and growing competitors – Aldi and Lidl (which, as of September 2019, together hold a 14.1% market share, with Aldi on course to replace Morrisons in the so called 'Big 4') do not. Lidl is owned by Dieter Schwarz through a German private foundation. Aldi, founded by the Albrecht family, is now in the hands of two private family foundations. Both owners, as is their right, are intensely secretive (even to a dislike of being photographed), but neither business is subject to structured and sustained public scrutiny in the same way as their listed competitors are. However, these are businesses with substantial economic and social impact – 13 million households visited Aldi in the UK in the 12 weeks to 24 March 2019 (*BBC News*, 2 April 2019).

24. In the private equity field, the ownership of British Steel, the UK's second largest steelmaker has been under recent criticism – particularly since steel is sometimes regarded as a strategic industry. Greybull Capital (Greybull) bought the assets for £1 in 2016 and the business was placed in liquidation in mid-2019. Greybull has been criticised for having amassed a questionable roster of firms that it bought for a song, only to walk away relatively unscathed after they eventually collapsed (*The Guardian*, 23 May 2019). Such criticism may or may not be justified – but the lack of the disclosure and transparency associated with a market listing, coupled with ownership of a significant business, invites misunderstanding and uncertainty. It also makes businesses and their owners less accountable – when Greybull acquired British Steel in 2016, one of its founders advised: 'What we bring to the table is a period of stable ownership for the business, capital and committed investors to growth.' There may be many reasons why this did not happen, but an effective corporate governance framework does mean that the directors and management of a listed company are more likely to be held accountable for the outcome of their business strategies and to be held to a higher standard of transparency and disclosure. Other recent UK examples of similar behaviours which were denounced (but with little practical

effect) include the sale and subsequent failure of British Leyland, and the depredations of BHS, a large UK high street retailer, and its pension scheme, in the hands of two successive private owners which provoked *The Wates Corporate Governance Principles for Large Private Companies* (see below).

25. Of course, the size of a business is not the only measure of its importance to an economy or to the community. Sotheby's, the leading auctioneer, and both a key component and bellwether of the London art market, was the object of a successful purchase by a Franco-Israeli private businessman in June 2019 – seeing Sotheby's become a privately held company for the first time in more than 30 years (joining its counterpart and competitor, Christie's, which was sold to Francois Pinault in 1998 and taken private). In response to the announcement, Hong Kong's *South China Morning Post* (SCMP) quoted one leading art dealer in the following terms: 'the volume and locations of transactions can now be kept secret ... Before, Sotheby's has been hemmed in by having to make its audited results, including its tax bill, public knowledge.' This led the SCMP to conclude that 'the deal to take Sotheby's private will throw a handy cloak of secrecy over sales earnings'.

26. To take another example, few businesses are as important to people as a football club is to its supporters. In August 2018, the sale of Arsenal Holdings Plc to Stanley Kroenke led to its delisting from the London Stock Exchange and move to ownership through a private Delaware Corporation, KSE. *The Guardian* commented that this should be of concern not just to those who follow Arsenal, but to football in general:

> [W]hat little transparency there has been up until now will be gone ... It will cast a veil over Arsenal and KSE can do what it likes with its asset. Any sense of ownership over a local asset will be dead.

Using the less constrained language of football fans, the Arsenal Supporters Trust considered that 'this news marks a dreadful day for Arsenal F.C. ... It is in effect legalised theft to remove shareholder scrutiny on how Arsenal is managed'.

In both the examples of Sotheby's and Arsenal F.C. the move from a public listing to private ownership was perceived as serving the interests of the new owner, but had direct implications on a wider stakeholder group, particularly though an immediate loss of transparency.

27. Looking beyond these specific examples, the broader picture of the role of private companies in national economies further illustrates their importance. In the UK the ten largest non-public companies by sales are Swire, Arnold Clark, Pentland Group, Dyson, Bestway, Sisters Food, EMR, JCB Bamford, Specsavers and Marshall Group, with annual sales between £2.6 billion and £10.5 billion and business ranging from car dealerships to food production to eyeglasses (*The Sunday Times*, July 2018). In the US the picture is even more striking – the ten largest private companies are such national and international names as Cargill, Koch, Mars, PricewaterhouseCoopers, Bechtel, Publix, Hogan Lovells, Ernst & Young, C&S and US Foods with sales from US$19 billion to US$109 billion and activities across key market sectors such as agribusiness, foodstuffs, accountancy and construction.

28. This begs the question whether non-public companies, because of their size and importance and because they represent the vehicles commonly used by capital providers, such as private equity, venture capital and family offices, should be subject to governance regimes analogous to those to which listed companies are subject. Part of the answer may be found in a judgment on the extent to which modern governance theory recognises that governance, and the responsibilities and accountability this carries, goes beyond the relationship between a company and its public shareholders to embrace a wider relationship between a company and its stakeholders, whether shareholders or not.

The scope of duties owed by business — Shareholders only, or a wider stakeholder group

29. In the years of intensive corporate governance reform since Cadbury, the relationship between shareholders and listed companies has also changed dramatically. This matters because it was the interests of shareholders, which corporate governance was initially and primarily designed to protect. In the early 1960s individual shareholders held around 54% of UK listed shares; by 2010 this had fallen to only 11.5%. In parallel, the average holding period declined from almost 8 years to just 7.5 months (*The Kay Review of UK Equity Markets and Long-term Decision Making*, 2012). For US stocks the corresponding period was 8.3 months at December 2016 (MFS Investment Management, Canada). In significant measure, shareholders are no longer long-term investment owners with an enduring and direct interest in a public company. Instead, they are transient, intermediate investors. Tracker funds will hold shares for a longer period, in line with the investee company remaining on the relevant stock market index. However, they are obliged to maintain that holding irrespective of governance standards and, as passive investors charging limited management fees, cannot be relied upon actively to enforce such standards. That burden may be left to a number of actively engaged investors, such as UK and US pension funds. Even so, within such investors and corporate governance advisers, the shareholder voice may be expressed through a governance oversight function which places a much higher emphasis on strict compliance with governance codes than upon the actual effectiveness of boards in setting and implementing successful business strategies.

30. If many investors possess neither the direct rights of ownership nor the will to exercise them, then corporate governance regimes which rely on the effective, informed and engaged commitment of shareholders to enforce or apply them (such as in relation to executive remuneration levels) will be undermined by the distancing and indifference of shareholders – and a tendency to exercise their right to sell out, rather than to remain and work for improvements in governance and business performance.

31. The introduction to *The UK Corporate Governance Code* in 2018 commented:

> Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity. To succeed in the long-term, directors and the companies they lead need to build and maintain successful relationships with a wide range of stakeholders.

However, the Code is only made applicable to 'all companies with a premium listing'. It is not obvious how the initial observation logically leads to that selective application, since the expressed importance of stakeholder relationships is not limited to listed companies.

32. The linkage between limited liability and stakeholder obligations, rather than between a public listing and those obligations, was well explained in the following terms in the introduction to *The Wates Corporate Governance Principles for Large Private Companies* issued in the UK in December 2018:

> Private companies benefit from the privileges of limited liability status, but are not subject to the same level of reporting and accountability requirements as listed companies. The traditional rationale for this is that private companies stem from private ownership and have no reliance on public equity markets to raise capital. However ... the economic and social significance of large private companies can be as great as listed companies and, when problems occur, there are comparable risks to as wide a range of stakeholders.

In other words, corporate governance obligations might once have been considered as the price to be paid for the privilege of access to investment by the public. Now they are becoming a price to be paid for the privilege of limited liability. This is all the more understandable given the importance of non-public companies to societies and economies.

33. The principle of a business owing duties to stakeholders, beyond only shareholders, is emerging, but not yet widespread. In the UK, s 172 of the *Companies Act 2006* obliges every director to act for the benefit of his or her company's members as a whole and in doing so to have regard to matters such as the interests of the company's employees, the fostering of business relationships with supplies, customers and others, and the impact of the company's operations on the community and the environment. India has gone further – Section 166(2) of its *Companies Act 2013* places the interests of stakeholders on the same level as those of shareholders, by requiring a director of a company 'to act in the best interests of the company, its employees, shareholders, the community and for the protection of the environment'.

34. Elsewhere, the recognition of a company's duties to stakeholders is, as yet, less robust, even if continental jurisdictions such as France and Germany have extended directors' obligations beyond those to shareholders alone. In Canada, the Supreme Court (in the BCE Inc and People's Department Stores judgments) has stated that directors may consider various stakeholder interests in determining whether they are acting in the best interests of the corporation including shareholders, employees, suppliers, creditors, consumers, governments and the environment. Other jurisdictions with a common law background, such as Hong Kong, Australia, New Zealand and South Africa, have not yet gone as far in recognising a corporate duty to stakeholders. These recognise the duty to shareholders and regard the fulfilment of any responsibility to wider stakeholders as being just one element in the effective discharge of the duty to shareholders.

35. The direction towards greater recognition of stakeholder interests, and a corresponding obligation on companies, in the conduct and governance of their business, to respect those interests, seems clear. For example, in the recent UK election, the Labour Party Manifesto included an intention to rewrite the Companies Act to enshrine directors' duties to other stakeholders. Beyond that particular political context, the British Academy's report of November 2019 on the future of the corporation, *Principles for Purposeful Business*, argued: 'The corporation has failed to deliver benefit beyond shareholders, to its stakeholders and its wider community'. In response, it proposed a new corporate purpose, namely 'to profitably solve problems of people and planet, and not profit from causing problems'. This line of thought also resonates in the US. In August 2019 the American Business Roundtable issued a new statement on the purpose of a corporation. This was signed by 181 chief executives who committed to lead their companies for the benefits of all stakeholders – customers, employees, suppliers, communities and shareholders.

36. Unlike glaciers, corporate governance tends to advance and never retreats. It can also move at faster than a glacial speed – often in response to some or other corporate scandal or collapse (for example, *The Wates Corporate Governance Principles for Large Private Companies*). It is to be expected that companies will face a growing responsibility to a wider stakeholder group. Since private companies can have similar stakeholder impacts to listed companies, the corporate governance frameworks originally constructed to protect the interests of public investors will gradually extend to that wider corporate domain. If they do not, the result will be that the interests of stakeholders in listed companies will be treated materially better than those of stakeholders in non-listed companies – even though the nature of the stakeholders and those interests is identical.

Listed and private companies — The corporate governance journey ahead

37. The relative decline of the listed company as a vehicle for public investment and carrying on business has at least two major implications for corporate governance thought. First, the risk that corporate governance regimes, no matter how well-intentioned, are wrongly disadvantaging listed companies relative to their private counterparts. Second, that corporate governance is focused on a declining form of business structure and ignoring the growth of other structures, which also play a substantial role as vehicles for investment by shareholders and the delivery of value to other stakeholders.

38. In a 2018 report (*Renaissance Directors – Reinvigorating Public Companies*) MWM Consulting (MWM) considered the challenges faced by public companies and concluded that 'Capitalism, democracy and societies need value-creating public companies to thrive. Yet while the model is far from irrevocably broken, real fault-lines are increasingly clear'. MWM argued that the answer did not lie in more prescriptive governance codes, but in boards leading a stronger mindset of ownership and value creation within their businesses.

39. Taking that point forwards, it can be envisaged that, at least in developed markets, we may have arrived at, or are approaching, 'peak governance' of listed companies. The reforms of recent years have often been driven and shaped by individual corporate downfalls and/or egregious behaviour. The examples of this are well-known and worldwide: Enron, WorldCom, Parmalat, Northern Rock, Steinhoff, HIH Insurance and others. The result of this has been that corporate governance reform has not always been structured and comprehensive. There has also been a tendency towards a view that, since corporate governance is a good thing, more is always better.

40. At least in more developed markets and jurisdictions, there may now be occasion to examine and slow down the pace of new corporate governance regulation. In any event, when reform and change are contemplated, as much critical consideration should be devoted to the reduction of existing requirements as to the addition of new ones. For example, the value of rules or code provisions on matters such as age limits, term limits and senior independent directors could reasonably be questioned in the light of market experience.

41. It might also be beneficial for the stakeholders in public companies, be they institutional investors, regulators, politicians or the business media, to adopt a more realistic and nuanced approach to the application of corporate governance code provisions and recommendations. Such codes commonly recognise that a 'one size fits all' model is not appropriate and that individual companies should adopt the governance model most suitable to them (and, under a 'comply or explain' regime, justify any departure from the code). However, in practice, stakeholder reaction to 'non-compliance' is frequently adverse – leading issuers to adopt what in effect becomes a single governance model. The role of international proxy advisers, giving guidance on code compliance, and the opportunity for listed companies at the wrong end of their opinions to get their 'explanations' across, merits scrutiny. By way of illustration, the Hong Kong Stock Exchange's most recent *Analysis of Corporate Governance Practice Disclosures* found that 94% of a sample of 400 issuers complied with 75 or more Corporate Governance Code Provisions (out of a total of 78). Of the sampled issuers, 100% disclosed compliance with 70 Code Provisions. This may or may not be truthful, but it is hardly desirable, as it displays an overwhelming move to 'one size fits all' governance. It is also probably unhelpful since, in governance terms, it makes all public companies look the same – which they are certainly not.

42. This Paper suggests that, while the corporate governance focus and weight on public

companies should be critically and objectively reviewed, a corresponding degree of added attention should be afforded the governance of private companies. The regulation of underlying investment structures and intermediaries, such as private equity, venture capital, crowdfunding, family offices and so forth, is outside the scope of this Paper (and a massive and challenging subject in itself). However, the private companies through whom and by whom such investors and intermediaries conduct business are a legitimate area of governance review. This is because the privilege of limited liability should be accompanied by a corresponding set of governance obligations and because of the importance of the businesses carried on by individual private companies.

43. In this context, *The Wates Corporate Governance Principles for Large Private Companies* offers three elements which might be capable of wider application, both in terms of geographical scope and the range of entities covered:

    a) A size threshold, in this case to companies with:

    - more than 2,000 employees; and/or
    - a turnover of more than £200 million, and a balance sheet of more than £2 billion.

      (Wisely, Wates avoids a single measure, which could easily be 'gamed' to avoid compliance.)

    b) Mandatory status through secondary legislation, overseen by the Financial Reporting Council.

    c) An approach which adopts broad principles with supporting guidance – with the intention of avoiding both a 'one size fits all' or a 'tick box' approach.

    This will require international cooperation. This has been a characteristic in the listed company space, both explicitly (for example, the convergence of UK and continental corporate governance models through membership of the EU) and implicitly, as a result of the increasingly international nature of investment and the recognition given by the authors of particular corporate governance codes to the terms of such codes in other jurisdictions (for example, the mutual acknowledgment of the similarities and differences between Professor King in Southern Africa and the Financial Reporting Council in London, and between both and the Japanese Corporate Governance Code implemented in 2015). However, the opaque, often cross-border, structures and international reach of the larger private businesses listed above will require national governments to work together through global organisations. Sadly, the likelihood of progress in this area appears to have diminished over recent years.

44. Softening the corporate governance requirements applied to listed companies, while at the same time reinforcing those applied to private companies, would recognise the changing financial, economic and social importance of each form of limited liability company and would go some way towards rebalancing the obligations associated with the choice of one legal structure relative to the other.

45. In 1992 Sir Adrian Cadbury issued a Code of Best Practice directed to the boards of listed companies, while encouraging as many other companies as possible to aim at meeting its requirements. More than 25 years later the convergence of best practice in governance which Sir Adrian contemplated has not occurred. If anything, public and private companies have followed diverging paths. The evolution of business models, the links between capital providers and business, the scale of economic activity in the hands of non-public companies and the substantial benefits of limited liability all suggest that the time has come for a more vigorous implementation of Sir Adrian's initial hopes.

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