Tomorrow’s Owners

Defining, differentiating and rewarding stewardship

tomorrow’s company

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HERMES

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Foreword

"The Tomorrow's Owners project envisages a capitalism built on accountability and a sense of common purpose. To achieve this worthy aim we need better ownership of public companies by pension funds and other long-term shareholders."
Colin Melvin, CEO, Hermes Equity Ownership Services

Tomorrow's Company has been thinking about the role and responsibility of shareholders since our formation in 1997. In 2004 we published *Restoring Trust: Investment in the twenty first century*, which identified weaknesses in the UK's approach to investment and financial services, and laid some of the foundations for the United Nations Principles for Responsible Investment (UNPRI).

In 2007 Tomorrow's Company published *Tomorrow's Global Company: challenges and choices*. In this, a group of global CEOs and others set out their agenda for a global business acting as a force for good. They also tackled the difficult issue of the purpose of a global company. They saw this as:

> *"To provide ever better goods and services in a way that is profitable, ethical and respects the environment, individuals and the communities in which it operates."*

But, we were asked, what about investors? How many fund managers would welcome this as a statement of purpose for one of the companies in which they were invested?

And so we were prompted once again to think about the role and responsibilities of investors. As it happened, our timing was spot on. Our report, *Tomorrow's Owners: stewardship of tomorrow's company*, was published on 8 October 2008, the very day that large parts of the UK banking sector were taken into public hands. This report made a distinction between the real economy, the financial economy and the casino economy. It described how ownership of shares was becoming more global, and derivatives had multiplied. It warned about the erosion of stewardship.

> *"If the activities of the 'casino economy' within the global economy grow to such an extent that they begin to dominate the system, they may undermine the ability of companies to create and sustain themselves over the long term, and to play their full role in addressing the problems that society faces".*

Since then there has been a welcome rallying of support for exercise of stewardship in the UK. Government ministers have talked about their shareholding of the banks in these terms. The interim report on the corporate governance of banks and other financial institutions by Sir David Walker accepted that investors should be guided by a set of "stewardship principles".

Our concern now is that this momentum goes beyond principle and is followed through in practice.

This report also relates closely to a growing body of work by Tomorrow's Company under the general theme of 'Tomorrow's Governance', building not only on our earlier generations of work on director's duties and corporate reporting, but in particular on the recently published report *Tomorrow's Innovation, Risk and Governance.* At the same time, we are also studying the Swedish approach to nomination committees and considering the potential for this approach to improve the stewardship of companies in the UK.

In developing the *Tomorrow's Company Stewardship Principles*, presented in this report, we have drawn on extensive discussions with all the partners in the project. These are drawn from a wide range of ownership types and their representatives have huge cumulative experience across family, employee-owned, private equity, and listed companies, pension funds and institutional investment.

All the project partners have been able to agree on the principles and have developed the first set of questions, to help identify to what extent stewardship is being practised in a particular company.

Here is the challenge to pension funds, asset managers, and boards. Do you aspire to be effective stewards? Is this how you understand stewardship? If not, what is your definition? How we answer these questions will largely determine whether we can effectively respond to the growing problem of *"ownerless corporations"* as described by Lord Myners.

Many of us as individuals are beneficial owners through our pensions and investments and we all need the system of ownership to reflect our concerns about how wealth is created in an age of sustainability. This document is intended to provoke the basis for radical thinking on stewardship solutions. We hope many companies, investors and policymakers will now join in this vital search.

Tony Manwaring

Mark Goyder

Tony Manwaring,
Chief Executive

Mark Goyder,
Founder Director

Tomorrow's Company

"There can be few people who do not ask themselves "what sort of a world are we going to be leaving for our children? The principles of stewardship give hope that the answer is 'a better one'".
Gerald Avison, Chairman TTP

"*I genuinely believe that good stewardship creates a substantial benefit for society in terms of helping businesses to be sustainable in the long-term. This is good for all stakeholders especially company staff and their families and the communities in which the business operates. From a personal point of view I am very interested in the stewardship project as the Wates Family, as owners, aspire to the highest level of stewardship and we will find it invaluable to be able to assess how we are doing this versus a stewardship scorecard."*
Tim Wates, Chairman Wates Family Holdings

Part 1:

Background

The world needs responsible businesses stewarded by responsible shareholders. Without this joint and sustained commitment there will be too few companies which confidently and fully undertake their vital role in creating wealth and helping to address the societal and environmental challenges that humanity faces.

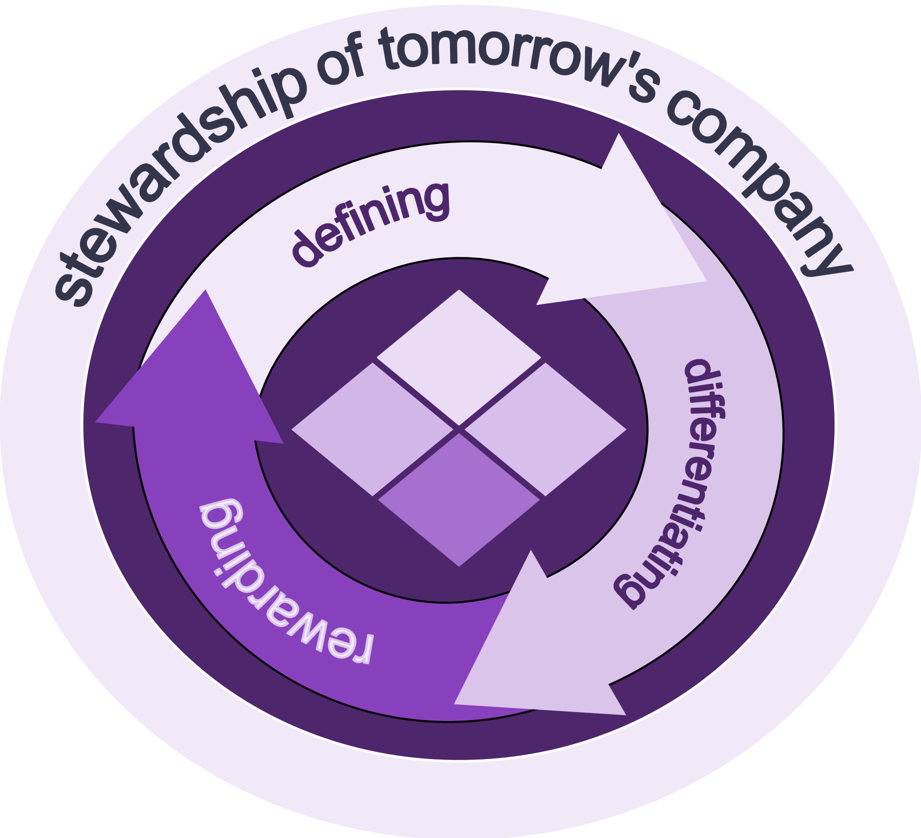
Examples of this stewardship can be found in the best private and family businesses, but become scarcer as shareholdings become more dispersed. If we do not put stewardship at the heart of business and investment, we will continue to see rudderless businesses diverted from the most important issues of long-term wealth creation by the influence of individual self-enrichment and short-term share price movements. These issues are set out in the *Tomorrow's Owners r*eport published by Tomorrow's Company in October 2008.

This project follows on from that initial work. It has been undertaken to help generate a demand for stewardship by savers, investors and directors, and to develop a clear stewardship agenda for take-up by boards, investment institutions and all those who influence them.

At the end of the two years of the project we want there to be an irresistible momentum of pressure and innovation for improved stewardship, and the first signs of a response by market participants, the media and policymakers alike.

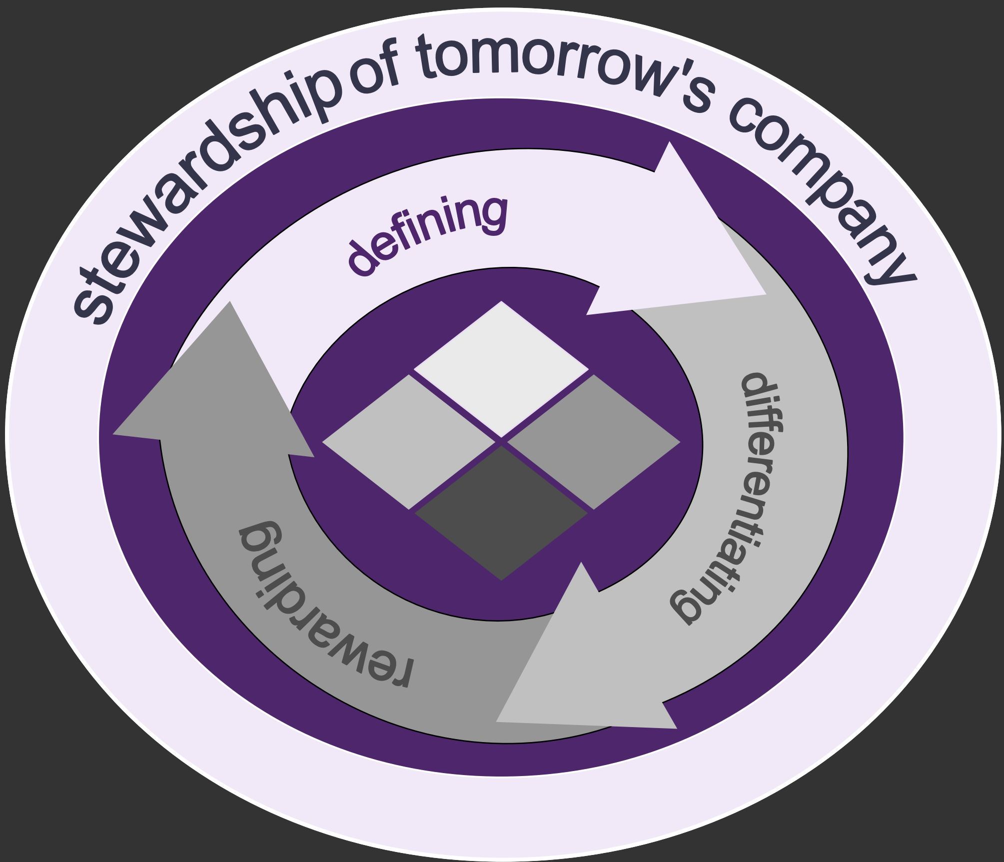
This report sets out our work in progress and in particular our suggested definition of stewardship along with the *Tomorrow's Company Stewardship Principles* and how these might begin to be measured.

Our thinking is captured in the diagram below and this is used throughout the report as a signpost so that readers can orientate themselves within the overall discussion.



Part 2:

Defining stewardship



Stewards are people who look after the resources entrusted to them. The concept of stewardship has a long tradition. It describes any situation in which people are looking after assets on behalf of others. For example, it is often used to describe the responsibility which human beings have to look after the natural assets of our environment. In the context of a company or of businesses more generally, we define it as

> *'the active and responsible management of entrusted resources now and in the longer term, so as to hand them on in better condition'.*

In other words, stewardship is the process through which shareholders, directors and others seek to influence companies in the direction of long-term, sustainable performance that derives from contributing to human progress and the well-being of the environment and society.

Stewardship is not a fair-weather phenomenon.

Stewardship is not a fair-weather phenomenon. Every owner wants to be part of a company that has the potential to grow and thrive. But stewards equally have a role in dealing with adversity. Whether a company is part of a growth industry or one that is in decline, it needs to be able to understand the opportunities and risks in the business environment and respond accordingly. In the extreme, stewardship is equally applicable in the case of a managed exit from an industry or of reinventing the company in a new sector.

Stewardship for directors and shareholders – same principles, different application

In any healthy process of wealth creation, it should be possible to define and identify the stewardship responsibilities of each link in the chain.

In any healthy process of wealth creation, it should be possible to define and identify the stewardship responsibilities of each link in the chain. While the principles of stewardship may be common, their application to boards and to investors and their agents along the investment chain will differ.

For directors, stewardship is a direct consequence of a director's duty to advance the interests of the company. For a shareholder, the stewardship responsibility is a consequence of the obligations taken on as an owner of shares in the company.

As our report *Tomorrow's Owners: Stewardship of tomorrow's company* expressed it:

> *"The rights and duties of shareholders give them a stewardship role alongside that of directors in protecting the long-term health of the company and promoting the long-term value of the investment. This idea that the core responsibility for stewardship is shared between shareholders and directors is, we believe, very significant, with many implications for the relationship between the two groups."*

A shareholder's stewardship responsibilities may also extend further than company stewardship. Investments in companies are made by institutions to generate returns so that the clients (pension funds, insurance companies or other investors) can meet future liabilities. The main resources with which institutional shareholders are entrusted are their client's funds. The client will be expecting its resources to be handed back with a positive financial return over the time horizon set in the mandate. Once the institution uses a client's fund to buy shares in a company this reinforces the shareholder's interest in the stewardship of that company. It also gives the shareholder an interest in the health of the system necessary for each individual company to prosper.

The growing importance of stewardship

Stewardship in business is all about creating long-term shareholder value – and doing so in such a way that can be sustained into the future. This involves making careful judgements between the immediate self-interest of beneficiaries and the longer term consequences. It is a shared responsibility between shareholders and boards.

Effective stewardship by boards and investors is essential in shaping our response to two of the biggest crises we face – how to avoid the permanent degradation of environment, climate and biodiversity, and how to avoid a recurrence of the recent financial crash. In both cases we are learning that a business risks destroying long-term shareholder value if it operates irresponsibly or disregards social and environmental consequences in the way that it operates.

In the UK there is now a growing recognition of the importance of stewardship. Many individual investors have been shocked at the lack of engagement by investment institutions. In February 2009, the government asked Sir David Walker to review the governance of banks and other financial institutions, including an examination of the role of institutional shareholders in engaging effectively with bank and other financial institutions.

Stewardship can be expected to become an increasingly important criterion for assessing the performance both of larger shareholders and of boards of directors.

Stewardship can therefore be expected to become an increasingly important criterion for assessing the performance both of larger shareholders and of boards of directors. On the international stage, the concept becomes even more relevant with the growth of sovereign wealth funds and state investment funds. These funds are now increasingly encountering criticism and challenge, and will therefore need to formulate the policies that accompany their international investment strategy in ways that reconcile their domestic motivation and their international responsibilities. Stewardship is a concept that naturally does this.

Following our 2008 report *Tomorrow's Owners: Stewardship of tomorrow's company,* we have been studying the approach to stewardship of different kinds of company and shareholder and has crystallised stewardship into four *Tomorrow's Company Stewardship Principles*, which can form the basis for evaluating the stewardship of a company by its board in partnership with its shareholders. In applying these principles, boards and shareholders will naturally take account of the specific mix of resources entrusted to them, including the relationships with customers, suppliers and authorities, the talent and creativity of the people and the culture in the business, and the quality of leadership and management.

But every company needs stewarding and if investors as a whole fail to take up their share of this responsibility, the management may not be called to account.

Many shareholders may never wish to exercise stewardship. This may not matter if other shareholders take a lead and exercise that stewardship. But every company needs stewarding and if investors as a whole fail to take up their share of this responsibility, the management may not be called to account.

There is now a growing discussion of the failure of stewardship. Lord Myners has repeatedly challenged the investment industry to take action to tackle what he has described as the phenomenon of "ownerless corporations". The Walker Report in July 2009 called for investors to have a set of stewardship principles by which they would be expected to abide.[1] In response, the Institutional Shareholders Committee (ISC) has come up with a new code on the responsibilities of institutional investors.[2]

These are welcome developments…but they will only start to mean something if stewardship is clearly defined,

These are welcome developments. But they will only start to mean something if stewardship is clearly defined, and if we are able to evaluate the efforts of different investors and boards in exercising stewardship. For example, while the new ISC code requires signatories to define how they will fulfil their stewardship responsibilities, it does not define stewardship. And the code is inherently reactive, only envisaging active dialogue with boards after monitoring has indicated such intervention is necessary.

In this document we describe the four principles and offer the first draft of the questions that could inform an evaluation framework or scorecard for assessing the stewardship of a company. In the next stage of our work we will be applying the same principles to the evaluation of stewardship in the context of a portfolio of shareholdings. In time, boards and investors could be publicly ranked on their success as stewards, leading to the development of a category of investors who are explicitly recognised as effectively exercising their responsibilities as stewards, and who gain competitive advantage for doing so. For example, a straightforward starting point would be to identify which of the questions are addressed by boards and by shareholders, how often they are discussed and the amount of time devoted to these discussions.

Scorecards and rankings can be powerful. We have started to explore how retail investors might be offered league tables that set out the stewardship of different funds on offer to them, and we think that in time stewardship should be assessed in this way as a valuable piece of market information. In the course of our development work we have also experimented with a stewardship league table for the UK's Premier League football clubs and found that this generated a wider interest in stewardship. [3]

But the first step is to test the concept in the context of the company. Hence this document.

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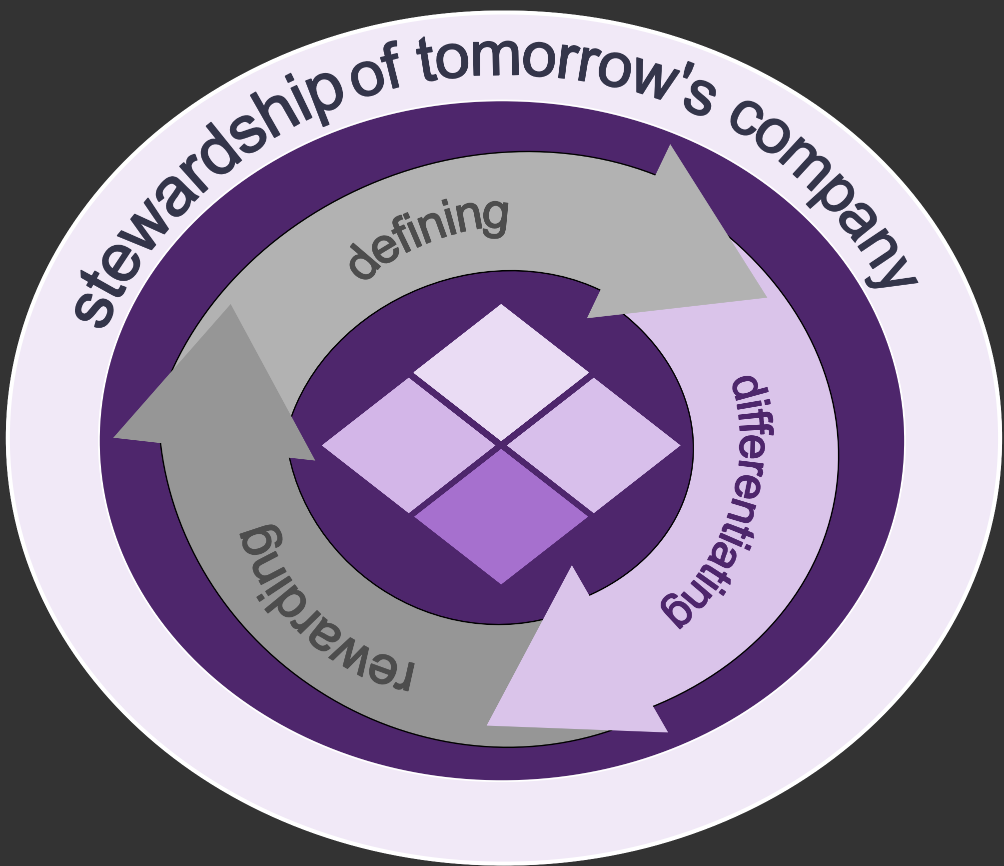
Part 3:

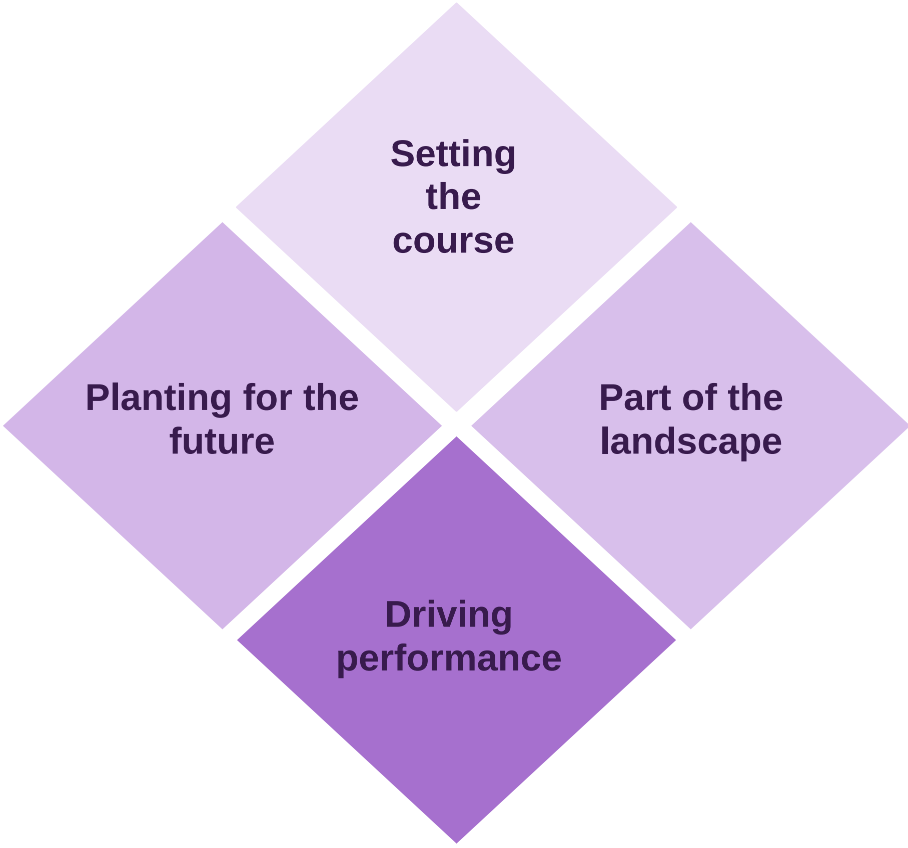
Differentiating stewardship

the Tomorrow's Company
Stewardship Principles



There are four key principles to stewardship. Good stewards set a course so that all those involved with the company know its purpose and their part in achieving this end. This sets the context for driving performance and seeking improvements, while positioning the company in the bigger picture and while fostering consistency and coherence between short-term actions and long-term goals.

The Tomorrow's Company Stewardship Principles



Principle 1. Setting the course: attention to clarity of purpose, roles and relationships

Stewardship exemplars insist on clarifying purpose and respective roles and relationships. This includes being transparent about what the organisation is for, what it believes, and to whom it is accountable. The focus is on the arrangements for accountability, and how the different parties which are needed to make stewardship effective will work together and whether they are investing sufficient resources to achieve this. This principle reflects the need to insist on clarity, transparency and consistency in how the company is run.

This means being involved, thorough, honest and uncompromising in upholding the importance of stewardship - defining and publishing the purpose and philosophy of the company, making a clear, public statement setting out the relationships between the owners, the company and its other stakeholders, and the roles and responsibilities of each party. And it means being both open about and faithful to these commitments, and being accountable for the long-term as well as the short-term health of the company.

Setting the course: questions for companies

- How similar are the views of the board and the shareholders about the future of the company's industry and the company's place in it, and what steps are taken to align these views?
- Does the board create opportunities for effective discussion between the board and shareholders about the company's strategy?
- What are the criteria for adapting the company's purpose and role and how have these been developed with input from shareholders?
- What are shareholders' criteria for the board being effective?
- Is the company clear about the characteristics of the stakeholders it wishes to engage with and the terms on which it will engage with them?
- Do shareholders have opportunities to have effective dialogue with the board?
- Do boards have opportunities to have effective dialogue with the shareholders?
- Are shareholders involved in nominating board members and overseeing remuneration arrangements?
- What mechanisms are there to hold the Chairman and board to account for their stewardship? Does the AGM fulfil this purpose?
- How clear are the executive directors about the different duties and responsibilities they have to the company and to shareholders as board members and as executives?

Principle 2. Driving performance: attention to performance and improvement

Unless an organisation gets the basics right, it will not survive. Stewards have an eye on the current and future operational performance, looking at the organisation's approach to all its relationships and resources and asking whether they are making the most of the opportunities available. They are making sure the organisation is as robust and resilient as it can be and that it is in a position to respond quickly to the unexpected. Good stewards are always looking for improvement – better products and services, better relationships, better suited to the environment. No matter how good things are there is a sense of confident restlessness.

Good stewards engage in uncomfortable conversations that challenge the status quo and the assumptions that underpin the business model. They insist on evidence. They encourage constructive challenges to current practices and adapt readily when required. Outstanding performance is a cause for celebration, but also for challenge, so that the underlying levels of risk are understood and managed.

Driving performance: questions for companies

- How do the board and the shareholders keep abreast of their customers' experience?
- In what ways do the board and shareholders keep their finger on the pulse of the workforce and skill base of the company?
- How does the board review the company's arrangements for dialogue with and learning from stakeholders?
- How do the board and the shareholders monitor the culture of and the behaviours in the company?
- How does the board keep abreast of risks in the supply chain?
- How are leading indicators built into business strategy, planning and reporting and over what horizon?
- What are the board's criteria for changing processes and procedures and how have these been developed with input from shareholders?
- How effective is the management information system at keeping directors and so shareholders informed of the company's performance and the changes that need to be made?

Principle 3. Part of the landscape: attention to the wider world

Good stewards look outwards. They act on the basis that they are a part of a system that can be influenced. They recognise that the success of the company is bound up with the health of its surroundings. Good stewards engage with key stakeholders, picking up external perspectives. Through this engagement they are aware early of new threats and opportunities that are emerging from the external environment. They handle challenges effectively, acknowledging that others have positive contributions and testing all perspectives for their impact on the future of the company. They see the connections between the prosperity of a company and its external context – in terms of training, talent, social stability, environment and all those other factors that affect its capacity to operate, and get involved in those issues. They safeguard the company by seeing it as part of something bigger and are clear of its place in the external environment.

This means achieving the company's objectives through paying attention to more than the narrow interests of shareholders, employees, or any other stakeholder. It means seeing the company as something more than the tangible benefits employees or shareholders take from it – and believing that the more you put into a company, the more you and all its stakeholders will get out. Some people would describe this principle as enlightened self-interest; others express it as 'we are all in this together'. Others have seen the company as a force for good. Whatever the label, this principle is not about the sacrifice of corporate interests to those of others: it is about the intelligent pursuit of self-interest through mutual advantage, and the fresh opportunities and improved risk management that come from a heightened peripheral vision.

Part of the landscape: questions for companies

- How does the board map the company, and its risks and opportunities, on to its wider environment?
- How does the board define value beyond just financial metrics?
- How does the board anticipate and deal with potential conflicts between different stakeholders?
- How does the board assess the significance of changes in public policy and the wider environment and the potential impact of these changes on stakeholders?
- What criteria does the board employ for engaging with public policy-making processes and how have these been developed with shareholders?
- What account does the strategy take of the opportunities and risks presented by the company's key relationships?
- How well are the key relationships identified, defined and monitored?
- What dialogue does the board have with shareholders or their representatives on these issues?
- Do board and shareholders pay as much attention to the spirit as to the letter of regulations, contracts and obligations?
- How effectively is the management of the company's relationships reflected in the remuneration and incentive scheme for the directors?

Principle 4. Planting for the future: coherence over time

While maintaining a relentless focus on the organisation's current health, good stewards balance this with a sense of its future potential and health. Short-term survival is a part of stewardship, yet there is a consistency and coherence between the actions taken in the short-term and the long-term objectives.

For boards, this can sometimes mean being robust in resisting the pressure from some investors for premature distribution of profits. For investors, this can sometimes mean supporting the directors' desire to invest in areas which may not immediately be linked to rises in the share price – like talent or leadership development, or health and safety. It may sometimes mean stimulating the company to grow organically or through acquisition, but it could also mean restraining the 'empire building' tendencies of acquisitive CEOs whose desire to run a bigger company may not be in the interests of shareholders.

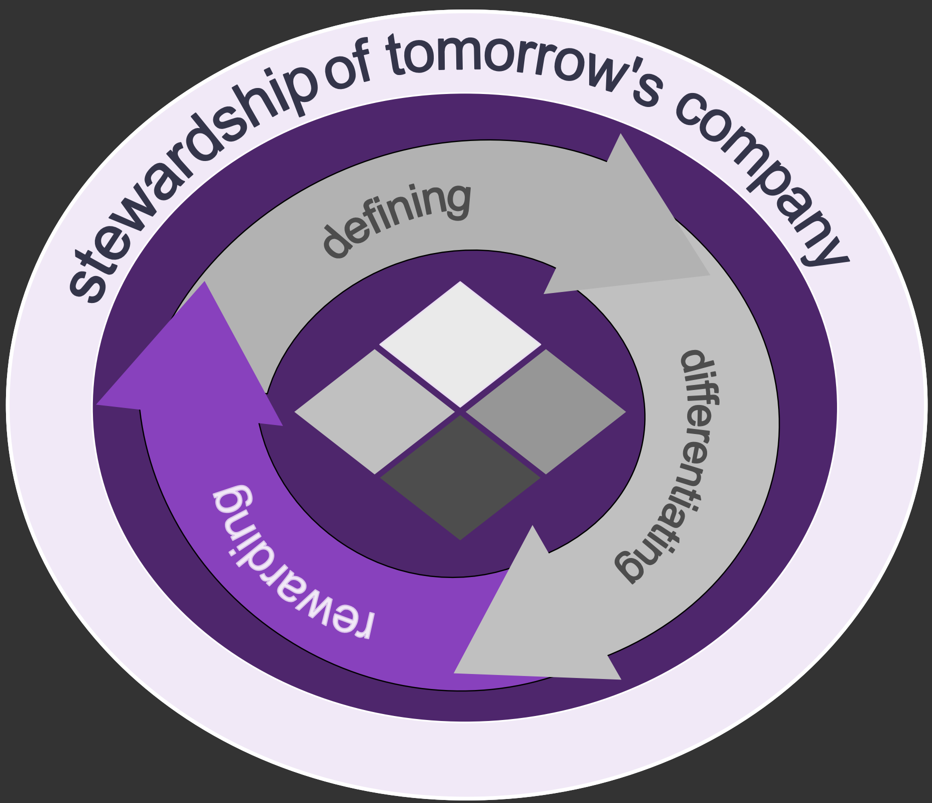
This is not about saying that the long-term is more important than the short-term. Companies and their boards need to balance both. This principle is about recognising that short-term and long-term success are both important, and ensuring an adequate focus on, and investment in, talent and infrastructure for the future without unduly neglecting the present. Stewards are aware that a series of short-term decisions can undermine a long-term objective and act to maintain the consistency between the short- and long-term.

Planting for the future: questions for companies

- What is the balance between the importance given to short-, medium-, and long-term performance indicators?
- Who decides this balance? Does it come from the board or from investor pressures?
- What steps does the board take to ensure that the short-term goals of the company and its shareholders are consistent with the company's long-term strategy?
- Does the board have a clear picture of its shareholders' expectations for the short, medium and long-term performance of the company?
- Is the company investing sufficiently in key building blocks that will sustain long-term performance?
- How effectively are the short, medium, and long-term objectives of the company reflected in remuneration and incentive schemes?

Part 4:

Rewarding stewardship



In practice, we may expect to see three levels of stewardship activity from shareholders – none, engagement along the lines of the Institutional Shareholders Committee (ISC) principles, as envisaged by Sir David Walker in his first report, and stewardship as described in this document. The implication of this is that in the future, it should become possible for those buying the services of asset managers to distinguish between them on the basis of their stewardship.

Like most of the important problems that the world faces, the erosion of stewardship cannot be reversed by any one group acting on its own.

Like most of the important problems that the world faces, the erosion of stewardship cannot be reversed by any one group acting on its own. This is a framework problem, of the kind identified in our earlier work on *Tomorrow's Global Company: challenges and choices.* In that report we showed how progress is usually made when leading companies start to collaborate to meet new stakeholder expectations. From this co-operation come voluntary codes or principles which in turn are taken up by others, refined and improved, and ultimately can be underpinned by national law and regulation.[4]

In the UK, the creation of these framework conditions will come about from a combination of factors, including the following:

- Competition among leading institutional shareholders to excel in stewardship, encouraged by kite marks and league tables;
- New mechanisms and initiatives for collaboration among institutional investors to reduce the costs of exercising their ownership responsibilities;
- Improved collaboration among asset managers;
- New mechanisms at the level of the individual company to strengthen and make more strategic the dialogue between boards and major shareholders;
- Pressure from individual investors, pension beneficiaries and the media for investment managers to be effective stewards and to call boards to account;
- New transparency requirements – including the requirement on pension trustees to have a clear policy on the minimum levels of stewardship they expect of their asset managers, and a requirement on asset managers to identify which of their funds comply with recognised stewardship principles; and
- New and concentrated pension investment funds (such as those evidenced in The Netherlands and in Australia) which by virtue of their scale are able to exercise stewardship at a relatively lower cost, and will increase the incentive for asset managers to apply the stewardship principles in the hope of securing their business.

Marketplace innovation

Good stewardship could begin to be a marketplace differentiator.

The *Tomorrow's Company Stewardship Principles,* which are described here, are currently only developed at the level of an individual company. The next step is to apply them at the portfolio level. This would offer a higher test of stewardship investing than has so far been offered by the ISC or anyone else. In time they could be used to distinguish those pension funds and asset managers which exercise good stewardship. This could then begin to be a marketplace differentiator, with an appeal to clients who want their money to be invested by asset managers who exercise stewardship in accordance with these principles. A kite mark could be awarded to those asset managers who qualify based on an assessment against the stewardship principles.

New mechanisms for investor cohesion at the individual company level

The development of a recognised class of stewardship funds in the listed company sector will create a subset among the total population of institutional investors with a declared interest in promoting the long-term health of the companies in which they invest. But by itself, this does not guarantee that a chairman or the board of a company necessarily has the opportunity of meaningful and challenging dialogue with an identifiable group of stewardship investors.

A notable complaint from companies is the need to spend a large amount of time in dialogue with different investors who have different expectations. Equally, in recent discussions with investors concerned about remuneration, they report a frustration among companies that 'say on pay' degenerates into a formulaic approach, with investors or the proxy organisations to which they have delegated authority ignoring the firm-specific context and demanding universal compliance.

What is needed is greater investor cohesion focused on the particular needs of particular companies,

What is needed is greater investor cohesion focused on the particular needs of particular companies, something that comes naturally in the private equity model. We are currently investigating the merits of the Swedish system of Nomination Committees, under which the largest investors are elected by the AGM to a committee. This reviews the current board composition in the light of the company's situation and makes recommendations to the AGM on who should be appointed and reappointed. The value of this approach would appear to be that it does not make investors 'insiders' or involve them in strategic discussions, but does make them far more involved and effective in influencing the composition and impact of the board. This offers a starting point for considering options to increase co-operation among investors and strengthening dialogue at the company level.

For example, a company which wants to generate more effective stewardship could form an informal committee from among its major shareholders. This would help ensure that a satisfactory dialogue with shareholders takes place, as stipulated under the Combined Code.[5] The annual report could then record which shareholders have been involved in the dialogue.

New mechanisms for investor cohesion at the level of the system

It would be myopic of investors to believe that the enhancement of shareholder value is achieved only on a company-by-company basis.

The stewardship responsibility of investors to their clients implies an interest in the health of the wider business environment. It follows that there is value in collaboration between owners at the level of the system as a whole. As the Walker Review rightly recognises, it would be myopic of investors to believe that the enhancement of shareholder value is achieved only on a company-by-company basis. The banking crisis has dramatically reminded us that the health of the whole system will affect the value creation opportunities for individual investee companies. In the longer-term, the scale of shareholder value that is now being put at risk by a neglect of environmental, social as well as governance factors will increasingly be seen as relevant to overall investment performance. From the International Corporate Governance Network (ICGN), through UNPRI to the Carbon Disclosure Project there are many notable collective efforts to mobilise the combined power of investors. The time spent by investors on such projects is justified as being in the longer-term self-interest of their beneficiaries. However, there is often a reluctance to give sufficient resources to ensure the success of these efforts. The creation of a class of investors who have defined stewardship mandates opens the way to the continuance and extension of these vital activities.

Public policy opportunities

The public is entitled to feel confused about the role of institutional investors. Whenever the government is asked to do something about an issue of public concern – for example excessive remuneration – the historic response from ministers has tended to be that this is the job of shareholders. But, as the reaction to the Walker Review has demonstrated, many asset managers regard that job as an expensive and unattractive burden. The public have in effect found that they cannot take it for granted that the asset managers managing their money are taking any steps to engage in this way.

In the absence of effective action by institutions, sooner or later a UK government will feel compelled to act.

Stewardship and engagement may or may not adequately repay those exercising these responsibilities, and there will be free riders who do none of the 'heavy lifting' and yet enjoy the benefits. But if stewardship is not exercised, as we have seen in relation to our banks, the public pays a heavy price. So stewardship and engagement are, at least in part, public goods. In the absence of effective action by institutions, sooner or later a UK government will feel compelled to act. The most effective action that government could take would be to facilitate future competitive advantage on the basis of stewardship, rather than try to impose stewardship.

The first step to resolving this problem is to have some clarity. Not all market participants will want to take on a commitment to stewardship, so each asset manager offering its services to the public, or to pension fund trustees, should be required in law to define their intentions in terms of whether they intend to practise engagement (as defined by ISC) or, stewardship (as defined by the T*omorrow's Company Stewardship Principles*), or neither.

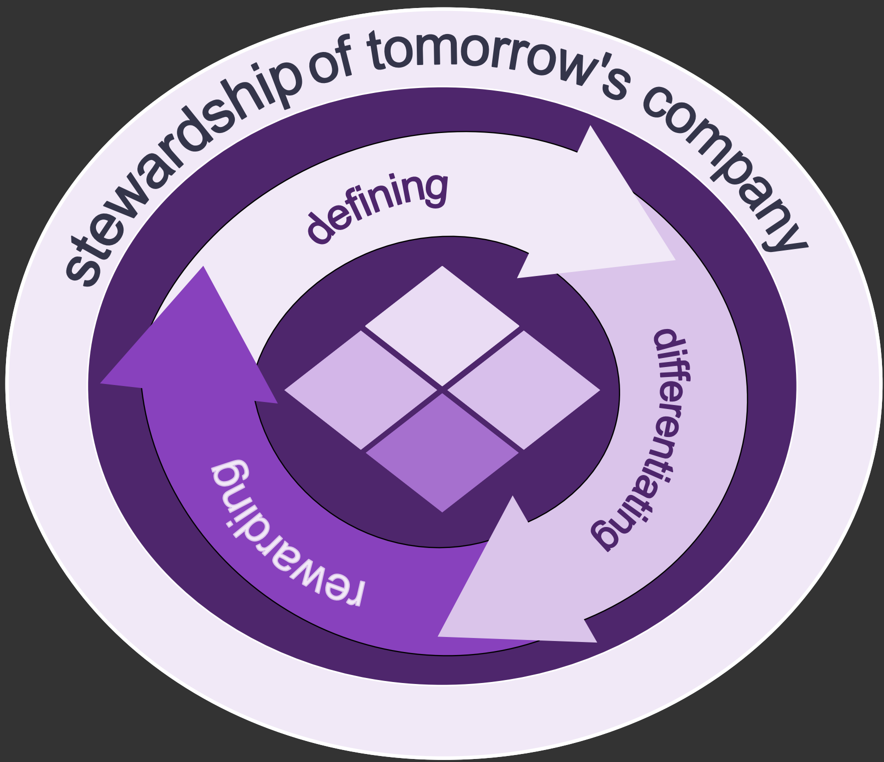
In the longer term asset managers who want to be described as stewardship investors could be required to comply with such a newly developed set of stewardship principles. This would then be the subject of an official kite mark, which assured the public about the rigour of the stewardship being exercised.

There are likely to be higher costs involved and ways may need to be found of helping those who do take on this responsibility.

Pension funds could be required to declare their policy on stewardship as they are already required to declare their position on the very different issue of socially responsible investment. This may not be a binary choice. A fund may choose to commit 30% of its relevant funds to stewardship mandates, 30% to ISC-compliant mandates, and 40% to neither. There may be some who feel that their fiduciary duty does not allow or encourage them to become involved in this way. However recent analysis has shown that trustees may be in breach of their fiduciary duty unless ESG are taken into account. In addition the interpretation of actions that fall within fiduciary duty has evolved over time, so if necessary the government could assist the adoption of stewardship by providing guidance on the implications of fiduciary duty in the current circumstances.

There are likely to be higher costs involved and ways may need to be found of helping those who do take on this responsibility. Lord Myners has suggested the use of differential voting rights to those with longer shareholdings.[6] An alternative, suggested by Peter Butler, of Governance for Owners, is a levy system linked to company listing, where a small proportion of the costs of listing is contributed towards the costs of stewardship by listed companies and their investors, and helps to pay for the exercise of stewardship by those investors willing to commit to it.[7] The other public policy opportunity has been set out by the RSA which recently published *Tomorrow's Investor – pensions for the people,* a report written by David Pitt Watson.[8] In this report, the RSA proposed the changes that would be needed in the design of the new automatic enrolment pension system which is due to be introduced following the recommendations of the Turner Report in order to create the basis for a new low-cost civic pension institution. One helpful change would be a requirement for the administrators of the system to show a clear commitment to stewardship.

Conclusion and Questions



Stewardship is at the same time a marketplace issue and a public policy issue. It will in time become a more important global issue. There is on all sides an anxiety about an impersonal global economy. The very sophisticated mechanisms that allow the impersonal pursuit of investment returns in liquid markets are not delivering the kind of ownership behaviours that companies and societies need. The answer to this concern is not to reject the relentless drive for efficiency and investment returns that comes with efficient capital markets. It is rather to build on the understanding of what it means to grow businesses and create enduring value. Savers and investors as a whole will only get a solid and enduring return on their investments when a sufficient proportion of their money is invested in the stewardship of healthy and well-run companies, which properly balance the present and the future, and properly hold the executives to account.

The aim of the first year of the Tomorrow's Owners project has been to meet two of the conditions that are needed if stewardship is to flourish. First it needs to be robustly defined. Second, there needs to be a clear framework and criteria by which good stewardship can be indentified and celebrated, and a lack of stewardship can equally be highlighted.

In the next phase of our work we are looking for opportunities and allies with whom we can work to further develop the principles, and their application. We would therefore welcome readers' answers to the following questions.

Defining Stewardship

- Do the Tomorrow's Company Stewardship Principles capture the essence of stewardship?
- Do you agree with the definition of stewardship? Do you agree that there is a need to encourage the exercise of stewardship by boards and shareholders? Do you agree that this needs to go further than the ISC code?
- Do you agree with the idea that we need to develop clear stewardship principles which shareholders and boards could both follow?
- What are the implications of this in an increasingly global capital market?

Differentiating Stewardship

- What would you change in the current set of questions for evaluating the stewardship of companies?
- How would you construct a scorecard to assess the stewardship of companies at the individual or portfolio level?
- What questions should be used to assess the stewardship of:
    - Asset managers
    - Pension Funds
    - Investment Consultants?
    - Sovereign wealth funds and other international investors?

Rewarding Stewardship

- What steps would you like to see taken to promote stewardship and reward those who practise it? In particular what can the following usefully do:
    - Boards
    - Asset managers
    - Pension funds
    - Those who represent institutional investors – ABI, IMA, NAPF
    - UK Government and regulators?

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