An Analysis of the Impact of UK Stewardship Code on UK Asset Managers:

Financial Performance and Quality of Engagement

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DECLARATION

This thesis is submitted to Oxford Brookes University in fulfilment of the requirements of the degree of Doctor of Philosophy. This thesis represents my original work towards this research degree, conducted under the supervision of Dr. Samantha Miles, Dr. Sandra Einig and Dr. Rebecca Hawkins. It contains no material which has been previously submitted for a degree or diploma at this university or any other institution; except where due acknowledgement is made. I certify that all information sources and literature used are specified in the thesis.

Samaneh Elmi

Abstract

The aim of this thesis is to investigate the application of the UK Financial Reporting Council's Stewardship Code and evaluate the outcomes reported by signatories, thus providing evidence to determine whether the Code has been successful in delivering its proposed aims. The UK Stewardship Code (2012) was published to enhance the quality of engagement between investors and companies. The FRC proposed that effective stewardship would benefit companies, investors and the economy as a whole.

A mixed methods approach has been adopted, initially collecting quantitative data to explore the statistical relationship between stewardship activities (e.g. exercising voting rights, monitoring the investee corporates) and the financial performance of asset managers. Interviews with UK asset managers explored the non-financial benefits observed from applying the Code.

The quantitative and qualitative results provide a thorough understanding of the application of the Code, illustrating that the implementation of the Code has not influenced the financial performance of asset managers significantly. Furthermore, applying the Code has not enhanced the quality of engagement between signatories of the Code and their investee corporates. Overall, this study concludes that while the Stewardship Code has been successful in some areas, it has not achieved the aims initially set out.

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Chapter 1

1. Introduction

The first version of the UK Corporate Governance Code defined Corporate Governance (called CG for here on in) as "*the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. Shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place*" (Cadbury, 1992, p.5). According to the latest version of the CG Code (2018), companies need to promote a high standard of CG to achieve long-term and sustainable success. A central issue that can lead to weak CG in companies relates to agency problems, indicating a distance between managers (i.e. agents), who act as stewards over the investments of the owners, and shareholders (i.e. principals) or owners of the assets under the agent's stewardship (Smith et al., 1976). This distance may make directors act against the best interest of the shareholders. The agency problem is central to the reformation of CG in the UK and other countries, explained in the next section.

1.1. Reformation of Corporate Governance

In modern times, CG reform started in the UK with the formation of the Cadbury Committee in 1991. The aim of this committee was to address three main concerns that were negatively affecting the CG of UK companies during the 1990s. The first was related to the application of creative accounting that could mislead the audience about corporate performance or the true shareholder value of the companies (Vladu and Matis, 2010; Whittington, 1993). The second related to autocratic CEOs who were able to hide financial weaknesses of companies, leading to corporate failures. The final was over the rapid growth of executives' remuneration, which was not correlated to the financial performance of companies. To address these concerns, the Cadbury Report was published in 1992. It aimed to enhance the accountability of executives, specifically towards shareholders and encouraged shareholders to play an active role in the organisations in which they invested (called investee corporates from here on in). According to the Cadbury Report (1992, p.48):

"Shareholders have delegated many of their responsibilities as owners to the directors who act as their stewards. It is for the shareholders to call the directors to book if they appear to be failing in their stewardship, and they should use this power. While they cannot be involved in the direction and management of their company, they can insist on a high standard of corporate governance and good governance is an essential test of the directors' stewardship".

1.2 Shareholder Engagement

Historically, active engagement in the decisions of investee corporates has not been a primary concern of UK shareholders. An indication of poor engagement levels is the very limited extent to which shareholders have historically voted at annual general meetings (AGMs). In fact, voting levels of shareholders in their investee corporates was as low as 11% during the 1970s (Midgley, 1974). When the Cadbury Report was published, institutional investors were recognised as dominant shareholders in the UK, holding the majority of UK-listed company shares. According to the Office for National Statistics, share ownership of UK financial institutions, including pension funds, insurance companies, unit trusts and other financial institutions increased from 29% in 1963 to 60.4% in 1992, at the time of the Cadbury Report. Unsurprisingly, institutional investors were asked by the Cadbury Committee to use their voting rights to influence the standards of CG in their investee corporates (i.e. adopt an active holding strategy), rather than selling their shares (i.e. adopting a passive exit strategy). The Cadbury Report's recommendations for institutional investors were not new. Instead, they were a restatement of the guidelines that were already published by the Institutional Shareholder Committee (ISC) on the responsibilities of Institutional Shareholders in the UK (1991).

In addition to the Cadbury Committee, other associations formed to discourage passive ownership behaviour among institutional shareholders, including the National Association of Pension Funds (NAPF), which represents the largest group of UK institutional investors. In line with the Cadbury Committee, this association recommended that all institutional investors should exercise their voting rights at the AGMs of their investee companies as well as developing voting policies within their institutions (NAPF, 1995).

1.2.1 Lack of Shareholder Engagement

After the modern CG reform and, despite the call from Cadbury committees (1992) and other associations (e.g. ISC and NAPF), engagement levels among investors did not change considerably. ISC (1993) reported that among the 20 large UK listed companies, on average, only 34% of all voting rights were exercised. In addition, the Hampel Report (1998) found that there was no significant increase in the proportion of shareholders who voted after the Cadbury Report, which remained below 40%. Hampel added that most of the votes were in favour of resolutions proposed by the Board. On the other hand, Hampel did report that several institutional shareholders published their voting policies, indicating that investors partially followed Cadbury's recommendations.

A number of different reasons were proposed for the low level of shareholder engagement during the 1990s. Short and Keasey (1997), who investigated institutional investors' voting in the UK, argued that voting could be costly and time consuming. Supporting this view, Çelik and Isaksson (2014) proposed that the low level of voting activities could be due to monitoring costs, specifically for shareholders with a highly diversified equity portfolio. While emphasising on the low level of institutional voting, Short and Keasey (1997) explained that some external fund managers might have to consult pension fund trustees before voting. This might make voting a complicated procedure for shareholders. According to Short and Keasey (1997) the minimum notice period for an AGM is 21 days. This notice period would make it difficult for an external fund manager with many clients to attend AGMs and vote on all matters for each company in their portfolio. Moreover, Coffee and Black (1994) found that institutional investors might follow other strategies to influence the CG of their investee corporates, such as private intervention. Therefore, the low level of voting does not necessarily indicate that the investors are not interested in the CG of their companies but that the cost of doing so, or the complexities of procedures may be prohibitive.

Crespi and Renneboog (2010) suggested a lack of monitoring expertise and the fear of being considered an insider (and therefore in breach of insider trading regulations) as the reasons behind passive ownership behaviour among UK shareholders. Reisberg (2015) identified the free-rider problem in which activist shareholders bear the costs while all shareholders enjoy the benefits as a reason for passive ownership behaviour. They added that uncertainty over the outcome of engagement as well as difficulty in measuring the return on engagement, were factors that could discourage active engagement between shareholders and their investee corporates.

Share ownership of UK institutional investors decreased to around 39% of UK listed companies shares by 2006. By this time, UK institutional investors were the second largest group of shareholders after foreign investors. As a result, there were high expectations among academics and policymakers that institutional investors would actively engage in their investee corporates to protect the value of their investment (Roach, 2011). Such expectations did not materialise as shortly after the financial crisis of 2008, institutional investors were partially blamed for the failure of companies and financial institutions for not playing an active and informed ownership role in their investee corporates before the crisis (OECD, 2009). The OECD Report (2009, p.47) asked the audience "*if boards have not functioned well in overseeing risk management and remuneration systems, and have neither been objective nor independent, then isn't the shareholder at the end of the day at fault?*". Hence, the OECD accused shareholders of failing to call Boards to account properly for actions.

The OECD provided limited evidence from the Investment Managers Association (IMA) that some shareholders have played an active role in their investee corporates. According to the IMA (Investment Management Association) (cited in OECD, 2009), institutional investors (i.e. their members) began to exit the banking sector in 2005 because of concerns about strategic direction. The IMA claimed that their members engaged effectively with the financial institutions which went bankrupt after the financial crisis, including Bradford and Bingley and the Royal Bank of Scotland. In more detail, the IMA stated that 11 of their members had a total of 55 meetings with the Board of Bradford and Bingley (since nationalised), and 18 firms collectively had 59 meetings with the Royal Bank of Scotland. Although these members of IMA appeared to undertake effective engagement, this cannot be generalised to all institutional investors given that membership of the IMA is voluntary and the membership are more likely to consist of those investors with a commitment to engagement. The OECD declared that this evidence was inadequate to conclude that institutional investors played an active role in their investee corporates before the financial crisis. The OECD proposed that the level of engagements was too low to make a difference and stop failures of financial institutions. In line with this, Manifest (2009) could not find any evidence of shareholders questioning banks over risk management until 2008, when the damage had already occurred. During 2008, the level of submitted resolutions against the banks was as low as 10 per cent (Manifest, 2009). In addition to the OECD, a review published by Walker (2009), which examined CG in UK banks and other financial entities post-financial crisis, concluded that failures of the Boards of Directors might have been addressed effectively if major investors had acted as responsible owners and had been engaged in their investee corporates.

The financial crisis led to an intensified scrutiny of the role of investors in the banking crisis. This led to a realisation that institutional investors, specifically fund management groups (pension funds, insurance companies and mutual fund groups), were in part to blame for not holding Boards to be more accountable (Masters & Burgess, 2010). Consequently regulators and politicians raised concerns over whether institutional investors were exercising their voting rights and engaging with their investee corporates effectively (Mallin, 2010; Myners, 2009; Reisberg, 2011; Walker, 2010). This passive investment strategy led to institutional investors being described as absentee landlords. Notably, the blame was not focussed on institutional investors alone: CG guidelines were also criticised for their failure to familiarise investors with their ownership responsibilities, particularly failure to encourage an active engagement role in their investee corporates (Tilba & McNulty, 2013; Walker, 2009).

1.3 UK Stewardship Code

The lack of engagement by institutional investors in their investee corporates during the financial crisis combined with the ineffectiveness of CG guidelines stimulated the publication of the UK Stewardship Code by the Financial Reporting Council (FRC). The origin of the Stewardship Code goes back to a statement called the "*Responsibilities of Institutional Shareholders and Agents: Statement of Principles*", which was first published by the Institutional Shareholders Committee (ISC) in 2002. Largely as a result of the financial crisis, this statement turned into the Stewardship Code in 2010. After the publication of the

Walker Review (2009), the FRC was asked to take responsibility for the ISC Code. The FRC is responsible for regulating auditors, accountants and actuaries, and setting the UK's Corporate Governance Code (call CG Code from here on in).

The general aim of the FRC is to promote transparency and integrity in business. The FRC, as the responsible policymaker published the first version of the Stewardship Code in 2010. The first revisions were published by the FRC in 2012, although this did not change the spirit of the 2010 version. It should be noted that the latest version of the Code was published in January 2020, which occurred after the data collection for this PhD research. The FRC encourages all institutional investors, including asset managers, asset owners and service providers to follow the guidelines of the Stewardship Code and publish a stewardship statement on both the FRC and their institution website. According to the FRC, reporting of stewardship activities is beneficial for three groups:

1. Companies which are trying to understand the expectations of their major shareholders.
2. Those providing mandates to asset managers to make a better decision.
3. Asset managers who are trying to understand the expectations of their clients.

The FRC website informs readers that the "*UK Stewardship Code aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders*" (FRC, 2019, para.4). The 2012 Stewardship Code contains seven principles asking institutional investors to "*publicly disclose their policy on how they will discharge their stewardship responsibilities, have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed, monitor their investee corporates, establish clear guidelines on when and how they will escalate their stewardship activities, be willing to act collectively with other investors where appropriate, have a clear policy on voting and disclosure of voting activity, report periodically on their stewardship and voting activities*" (FRC, 2012, p.5). These principles should be applied based on a comply or explain basis. Comply or explain approach allows "*those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship*" (FRC, 2012, p.4). The aim of these principles is to guide UK institutional investors on how to perform their stewardship activities, including exercising their voting rights, monitoring, and, having a purposeful dialogue with their investee corporates.

According to the FRC website, "*since December 2010 all UK-authorised Asset Managers are required under the FCA's Conduct of Business Rules to produce a statement of commitment to the UK Stewardship Code or explain why it is not appropriate to their business model*" (FRC, 2019, para.7). At the time of this research the number of signatories of the Stewardship Code reached 282 institutional investors. As a signatory asset managers are required to publish their stewardship statements on the FRC website, to review their stewardship policies annually and update their statements when necessary to reflect any changes. In addition, the FRC as the responsible regulator reviews the application of the Stewardship Code regularly through examining a sample of signatories' statements.

The Stewardship Code is the first in the world that principally focuses on institutional investors, encouraging them to act as responsible owners in their investee corporates (Micheler, 2013). Other countries such as Malaysia, Japan, Canada and South Korea have since been inspired to publish similar guidance for their investors.

According to the FRC, effective stewardship, through following the principles of Stewardship Code benefits companies, investors and the economy as a whole. It should be noted that the FRC's proposition that effective stewardship will benefit investors and companies is more assumed than proved by previous studies as academic evidence has not reached a consensus about the real outcome from the ownership role of institutional investors. For example, some studies found positive impacts on corporate governance and financial performance from shareholder activism on their investee corporates (Bebchuk, 2005, 2007; Becht et al., 2009; Brav et al., 2008; Dimitrov & Jain, 2011; Greenwood & Schor, 2009; Klein & Zur, 2009, 2011). Other studies found no link between shareholder activism and performance (Black, 1998; Carleton et al., 1998; Gillan & Starks, 2007; Karpoff, 2001; Karpoff et al., 1996; Prevost & Rao, 2000; Smith, 1996; Wahal, 1996; Welker et al., 2011). A detailed review of these studies will be provided in chapter three.

1.4 The Aim of the Study

At the time of writing nine years have passed since a significant number of institutional investors signed up to apply the Stewardship Code, with associated commitment to contributing resources and publishing their stewardship statements. Now, it is the right time to determine the success or failure of this guideline in reaching its proposed aims. There are two primary resources to review for this purpose. The first resource relates to the reviews conducted by FRC. Since 2011, the FRC has published six reviews on the application of the Stewardship Code, available on the FRC website (FRC, 2019). These reviews mainly report on the quality of stewardship statements published by institutional investors. However, the success of the Stewardship Code in reaching the proposed aims (i.e. to enhance the quality of engagement of the investors as well as improving their financial performance) has not been explored in the FRC reviews.

The second set of resources available to evaluate the success of the Stewardship Code in reaching its proposed objectives are existing academic studies. A small number of studies were found which investigated the effectiveness of the Stewardship Code (e.g. Çelik and Isaksson, 2014; Cheffins, 2010; Micheler, 2013; Reisberg, 2015; Tilba & McNulty, 2013,). All of these studies questioned the success of the Stewardship Code in enhancing the quality of engagement between investors and companies. For example, Reisberge (2015) benchmarked the achievements of the Stewardship Code against arguments which were advanced before this guideline was published, as well as an assessment of implementation issues. Reisberg (2015) concluded that the Stewardship Code was unsuccessful in achieving its proposed objectives. In addition, Cheffin (2010) examined the potential impact of the Stewardship Code by reviewing the existing resources including reports by relevant associations such as NAPF (National Association of Pension Funds) (2009), IMA (2009), the ISC (2009) and the FRC (2010). In line with Reisberge (2015), Cheffin (2010) doubted any significant transformation in the engagement behaviour of institutional investors through the application of the Stewardship Code. In conclusion, these studies could not find adequate evidence that the application of the Stewardship Code had enhanced engagement between signatories and their investee corporates. Despite providing informative outcomes regarding the success or failure of the Stewardship Code in general, the impact of this guideline for its signatories is still not very clear. Furthermore, these studies explored the Stewardship Code without applying primary data. Namely, the sources of information used in these studies were generated either by FRC or other institutions, not representing an independent point of view on the application of the Stewardship Code. This might affect the reliability of the findings by these studies.

To address the issues detailed above, the main aim of this study is:

To investigate the application of the Stewardship Code to determine its outcome for the signatories of this guideline (i.e. institutional investors), both financially and non-financially.

Being the first study to investigate the proposed subject there is a lack of research data to enable the specification of detailed research hypotheses. Instead, answering the following exploratory research questions will help to reach the main research aim:

1. *To what extent has applying the Stewardship Code provided financial benefits to its signatories?*
2. *To what extent has applying the Stewardship Code provided non-financial benefits to its signatories?*
3. *To what extent has the Stewardship Code been successful in enhancing the quality of engagement between investors and their investee corporates?*
4. *To what extent has the Stewardship Code been successful in achieving the aims that are proposed by FRC?*

To study the Stewardship Code, a mixed methods approach is followed. First, the financial benefit of applying the Stewardship Code will be investigated quantitatively through regression analysis. This is then followed by a qualitative approach in which interviews with signatories of the Stewardship Code will be undertaken to investigate the non-financial benefits of applying the Stewardship Code and the quality of engagement between investors and their investee corporates. Interviews will provide in-depth understanding of motivations for engagement that should help to interpret the quantitative findings further.

The findings from this study will contribute to knowledge in a number of ways. Firstly by informing understanding of the role of the Stewardship Code in changing the financial performance of UK asset managers and in improving the behaviour of institutional investors in their corporations. Secondly, the finding of this study will add to the existing knowledge around the outcome of shareholder engagement by determining the impact of effective engagement for the investors themselves, given that existing studies which investigated shareholder engagement mainly focused on the outcome of engagement for the investee corporates. Thirdly, the researcher is not aware of any empirical research which has applied mixed methods to investigate shareholder engagement. The use of a mixed method approach enables a more thorough, in-depth understanding of shareholder engagement. Fourthly, given that agency theory has been a popular theory adopted by scholars that have investigated shareholder engagement, this study will provide a theoretical contribution by exploring whether agency theory can adequately explain the relationship between shareholders and their investee corporates. Fifthly, the finding of this study contributes to the existing literature by illustrating the impact of voluntary guidelines on the behaviour of signatories. Finally, the results of this study would be valuable for policymakers, including the FRC, who are responsible for developing and reviewing the CG guidelines.

1.5 Outline of the Study

The rest of this thesis is structured as follows: The second chapter presents the reviewed literature on CG, shareholder engagement, and the Stewardship Code. The third chapter explains the research methodology of this study. The findings are presented in the fourth chapter, with the results discussed in more detail in the fifth chapter. The sixth chapter presents the conclusion along with the limitations faced in this study as well as providing recommendations for the future studies.

Chapter 2

2.1 The Development of Corporate Governance

The CG can be broadly defined as " *the institutional structures, legal rules, and best practices that determine which body within the corporation is empowered to make particular decisions, how the members of that body are chosen, and the norms that should guide decision making*" (Bainbridge, 2012, p.2). Since the 1990s, CG has become a popular subject among social science researchers as an important emerging discipline. After the financial crisis and failure of some well- known companies, such as Lehman Brothers and Royal Bank of Scotland, policymakers and academics emphasised the need to implement high quality CG to prevent such failures. According to the Walker Review (2009, p.23), "*the role of corporate governance is to protect and advance the interests of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this*". The financial crisis revealed widespread CG system failures in which shareholder interests were not adequately protected. After the crisis, a number of reviews were conducted to investigate the reasons behind these CG failures (e.g. OECD, 2009; Walker Review, 2009), which suggested a combination of factors. These included the existence of an unskilled Board of Directors, inappropriate (excessive) remuneration systems, ineffective risk management, and low quality shareholder engagement. After the financial crisis, the existing CG guidelines were reviewed to address inherent CG weaknesses. This resulted in the publication of a revised version of UK CG Code and the UK Stewardship Code in 2010. It sought to provide a framework through which to better engage institutional investors in the decision-making processes of their investee corporates.

In this chapter, CG is defined and discussed in more detail before a summary of the development of CG in the UK is presented, from the formation of the Cadbury Committee in 1992 to publication of the Stewardship Code (2020).

2.1.1 Definition of Corporate Governance

CG has existed as long as trade has existed. The phrase "Corporate Governance" came to use in the 1980s, at which point it referred to the process of exercising power over a company. There are a range of definitions of CG and the way in which it is interpreted varies according to the values, institutions, culture and objectives of the organisation (Clarke & Branson, 2012). Definitions can be classified according to whether a narrow or broad perspective is taken. Studies that define CG using a narrow view restrict CG to the relationship between a company and its shareholders to the exclusion of other stakeholders (Solomon, 2013) . One example of a narrow definition can be found in Bainbridge (2012, p.2), who considered CG as a system which "*consists of the legal rules that both create and seek to constrain the principal-agent problem inherent in the public corporation's structure*". Likewise, Denis and McConnell (2003, p.2) defined CG narrowly as "*the set of mechanisms - both institutional and market-based - that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximise the value of the company to its owners (suppliers of capital)*". The purpose of CG mechanisms according to the narrow view is to align the interests of agents (i.e. managers) and principals (i.e. shareholders) in order to protect and enhance the value for shareholders (Donaldson, 1990; Shleifer & Vishny, 1997).

Within the broad view, CG is understood to include the web of relationships that exist between a company and all of its stakeholders (Solomon, 2013), not just shareholders. Perhaps the most influential broad definition can be found in Blair (1995), who defined CG as the whole set of legal, cultural and institutional arrangements that determine what corporations can do, who controls them, how that control is exercised and how the risks and returns are allocated. Based on this definition, Blair concluded that the purpose of CG is to determine "*how decisions are made about spending resources on building organisational capabilities, and how management and employees are evaluated and compensated*" (Blair, 1995, p.17). A broad perspective was also incorporated in the OECD report (2004, p.24) which defined the CG as "*a set of relationships between a company's management, its Board, its shareholders and other stakeholders*". This perspective aligns with "Stakeholder Theory", which purports that corporations should be accountable to a wider group of stakeholders, including shareholders, employees, suppliers, customers, creditors, communities near the company's operations and the general public (Freeman, 1984).

According to Solomon (2013), there is no consensus about an appropriate definition of CG among researchers. This is in part a result of the recent studies in this field. As more research is conducted, more issues and opinions emerged and academics formed different interpretations of the data and opinions. Despite these differences, Solomon (2013) argues that generally, CG definitions share the same characteristics. One of those characteristics is "accountability". Solomon (2013, p.14) defined CG as "*the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their shareholders and act in a socially responsible way in all areas of their business activity*". Solomon emphasised that accountability to all stakeholders is the only way of meeting the shareholder interests and achieving long-term corporate success.

2.1.2 UK 's Corporate Governance Model

According to Solomon (2013) each country has a unique CG system, which is determined by internal (or domestic) and external factors. The internal factors include ownership structure, economy, the legal system, government policies, culture and history. External factors include the global economic climate, cross-border institutional investment and capital inflows from abroad. Among these factors, Solomon proposed that the way companies finance themselves and corporate ownership structures prevalent within an economy are the main determinants of a country's CG system.

A popular broad categorisations of CG system, developed and discussed by Mayer (1994) and Short et al. (1998), categorises the CG system of countries according to the "insider/outsider" model. It should be noted, however, that whilst these authors delineated "insider" and "outsider" forms of CG, in reality, most CG systems fit in between these two models, having some shared characteristics. The insider-outsider model is summarised in table 2.1

Table 2.1 Characteristics of Insider-Outsider Model

Characteristics	Insider Model	Outsider Model
Ownership	Owned mainly by insider shareholders with control over the management system.	Owned predominantly by outside shareholders.
Concentration of Ownership	Concentrated ownership	Dispersed ownership
Agency Problem	Rare as there is little separation of ownership and control	Significant due to separation of ownership and control
Control on Management	Excessive control by a small group of ‘insider’ shareholders	Moderate control by a large range of shareholders
Investor Protection	Weak investor protection in company law	Strong investor protection in company law
Shareholder Engagement	Majority shareholders tend to have more ‘voice’ in their investee companies	Shareholding characterized more by ‘exit’ rather than by ‘voice’

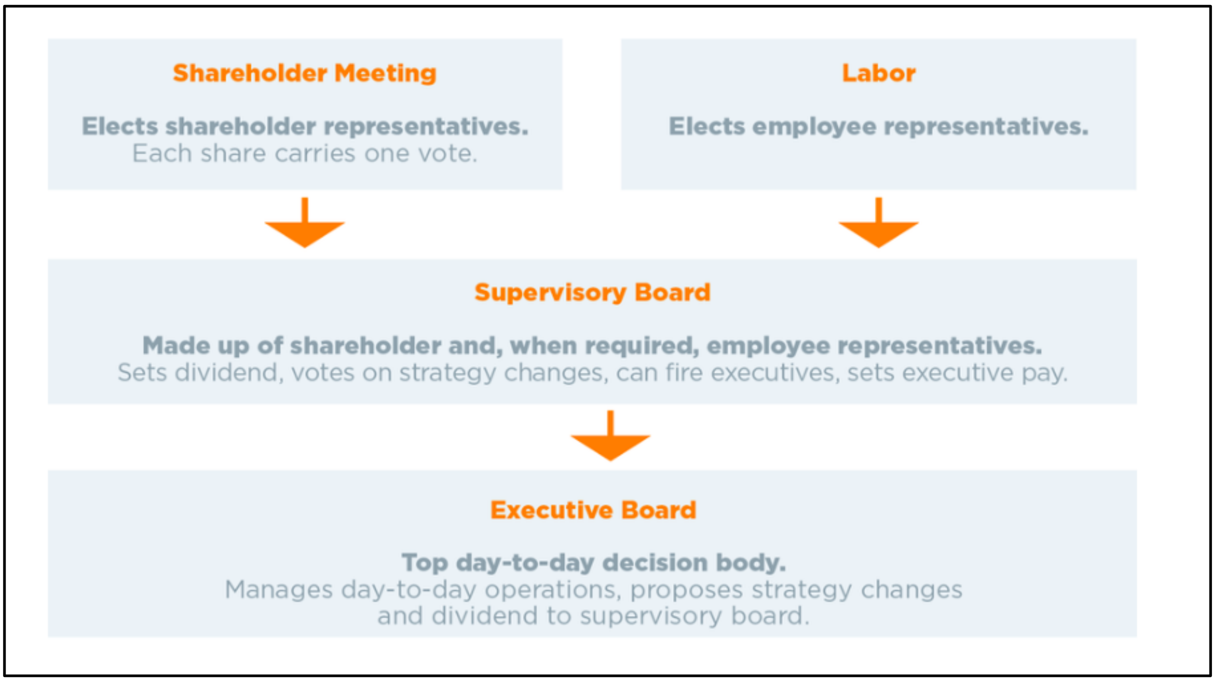
Countries with “insider-dominated” systems have publicly listed companies that are owned and controlled by a small number of major shareholders. These models are common in East Asian as well as some European countries, where the companies are mostly run and owned by families. Italy represents a good example of the insider CG system, where the corporate is family-owned with the extremely concentrated ownership structure. The relationship between shareholders and managers is very close in the insider CG system, making it easier to align the interests of managers and shareholders in the corporation. This close relationship, however, leads to little separation of ownership and control, which creates a major problem in companies with insider-dominated CG systems. According to Solomon (2013), a lack of separation between ownership and control could encourage managers to abuse their power against minority shareholders. In addition, in such companies, minority shareholders do not have access to the company’s operational information, and misuse of funds by managers happens frequently (Solomon, 2013). These issues were found to have weakened the CG system of Asian companies, compounding in the 1997-1998 Asian financial crisis (Claessens & Fan, 2002; Johnson et al., 2000; Mitton, 2002; Rajan & Zingales, 1998). For example, Mitton (2002) investigated the stock performance of East Asian countries, including Korea, Malaysia, Philippines and Thailand, to determine the impact of the CG system on their performance. The author found that companies which protected minority shareholder rights by offering high-quality disclosure and better transparency had better stock performance during the Asian financial crisis (1997-1998). To resolve the problems related to insider CG systems, Tricker (2015) suggested that the directors of insider-dominated companies need to follow the interest of the dominant shareholders while protecting the rights of the minority shareholders.

In contrast to the "insider-dominated" system, the "outsider-dominated" system refers to CG systems that are commonly observed in large multinational companies. In these systems, the actions of companies are controlled by managers, but the companies themselves are owned by shareholders, many of whom are dispersed globally. The Anglo-American system, predominant in the UK and USA, represents an outsider-dominated model in which large firms are mostly controlled by managers, but owned by outside shareholders (e.g. financial institutions or individual shareholders). This divorce of ownership and control may lead to agency problems (Berle & Means, 1932) stemming from the conflict of interest, whereby shareholders find it difficult to monitor and align the interests of managers with their own. Consequently, agency problems can lead to high agency costs, including monitoring costs, bonding expenditures and residual losses (Hill & Jones, 1992). Monitoring costs are the expenditures incurred by shareholders to monitor managers' actions, such as the cost of having a Board of Directors, publication of financial reports and independent audit. Bonding costs are incurred by managers and include budget controls, covenants and performance related pay, to align the interests of shareholders with their own. Finally, residual losses are any costs incurred from conflicts of interest that arise despite the use of monitoring and bonding. Agency costs can negatively affect corporate performance (Solomon, 2013). To reduce agency problems, directors of companies that operate outsider-dominated CG systems need to meet the conflicting expectations of shareholders, whilst also considering that shareholders can act collectively (Tricker, 2015).

Solomon (2013) proposed that outside shareholders can reduce agency problems by exercising their powers, such as voting rights, to influence management teams and to align interests. Hence, in countries with outside CG systems, the role of major shareholders, such as institutional investors, are considered an important mechanism to reduce the agency problem and enhance the quality of CG (Solomon, 2013). Moreover, outsider-dominated CG systems have been criticised for encouraging companies to only consider shareholder interests (Keasey et al., 2005). This encourages managers to seek risk to increase shareholder value, which might not be in the best interest of all stakeholder groups (e.g. suppliers, employees).

An alternative to Anglo-American CG system is the CG model of the Continental European countries such as Germany. According to Kreijger (2018), the CG system in Germany has developed in a different way to English-speaking countries. Figure 2.1. summarises the German CG system.

Figure 2.1 German's Corporate Governance System



Kreijger (2018) emphasised Board structure and the impact of workers in corporate decision-making as the main differences between the UK and German CG models. In contrast to the German CG system in which employees can influence the strategy through labour and supervisory board, Anglo-American systems minimise employee influence on corporate decision making. Moreover, in Anglo-American CG systems, the corporate's primary aim is to meet the interests of the main stakeholders (i.e. the shareholders). Whereas in Germany, the Board must, in theory, follow the interests of shareholders as well as employees, creditors, suppliers, and local governments. Considering the difference in CG systems among the countries, Solomon (2013) proposed that instead of applying one specific model to categorise CG systems, researchers should consider a broad model, helping them to discuss and analyse CG systems in different countries.

In summary, the UK CG system comes with its own weaknesses and critics. To address these weaknesses, various guidelines and policies have been introduced which are explained in the next section.

2.1.3 Corporate Governance Guidelines

In the UK, CG reform formally began in 1992, after the publication of the Cadbury Report. Following the Cadbury Report, a series of guidelines and codes were published, highlighting the importance of CG in the success of corporates and the economy as a whole. These guidelines are explained in more detail in the following section.

The Cadbury Report was predicated on the back of a number of the failures of well-known corporates (e.g. BCCI, PollyPeck, Maxwell Communications). It aimed to enhance CG by addressing the weaknesses of these failed companies and to prevent future failures. One of the best-known corporate failures of the time was Maxwell Communications. Robert Maxwell was the founder of Maxwell Communication Corporation and Mirror Group Newspapers, as well as a large number of private companies. Shortly after the death of Maxwell in 1990 it was revealed that he raided £727 million from the pension funds of his public companies to finance other activities. The group was placed into insolvency, with an estimated loss of £1 billion in shareholder value. Stiles & Taylor (1993) considered this to be the biggest fraud of the 20th Century. A number of CG issues were identified that enabled Maxwell to misuse his power. The first was the lack of separation of key Board Level roles, as Maxwell held positions of both CEO and Chairman at Maxwell Communication Corporation from 1981 to 1991 and within Macmillan Publishers from 1988 to 1991. The absence of a separation of the CEO and Chair roles is considered an indication of weak CG, as it enables managers to follow their own interests without being called to account. In addition, non-executive directors were criticised for not monitoring and controlling the

Chair effectively, as indicated by the lack of transparency around Maxwell's financial activities. The lack of sufficient audit functions was another CG mechanism that was criticised, particularly with regards to pension fund accounting. Moreover, the pension funds trustees, as the body responsible for the control of pension fund monies, were blamed for a lack of monitoring of the financial activities. The pension funds trustees should have been directly in control of the transfer of money from the funds to other parts of the company, so their action to allow such a transaction was questionable. Solomon (2013) also cited the unethical behaviour of Maxwell as implicit in this scandal (Solomon, 2013). In 1969, Maxwell agreed a takeover bid for Pergamon Press from Leasco, an American financial and data processing group. Leasco questioned Pergamon profits, prompting an investigation by the Department of Trade and Industry. The inspectors found that Pergamon's profits depended on transactions with Maxwell family private companies and concluded that Robert Maxwell was unfit to run a public company since he did not distinguish between his own funds and those of his shareholders. Notwithstanding this report, Maxwell took positions on a number of corporate Boards.

Businesses and policymakers did not learn from this scandal. There have been numerous CG scandals since, the most famous being Enron, one of the largest companies in America that collapsed in 2001, notoriously bringing down the accountants, Arthur Andersen, with them. Corporate scandals such as these encouraged policymakers and businesses to be more aware of weakness in their companies.

The changes in Anglo-American CG systems has been accompanied by reforms in ownership structures. During the 19th Century, a small amount of the shares of large public companies were in the hands of professional investors, but by the early years of the 20th Century, the number of institutional investors increased exponentially, with a concurrent decline in the number of individual shareholders. The increase in concentration in ownership created high expectations among policymakers, the general public and others who believed that institutional investors would act as responsible shareholders and play an active role in the governance of their investee companies (Roach, 2011). The evolution of CG guidelines is explored below in chronological order.

i) The Cadbury Report (1992)

After several financial scandals (e.g. Polly Peck and BCCI) underpinned by a lack of transparency in annual reports and misuse of powers by directors, confidence in corporate reporting declined. In response, the FRC, London Stock Exchange and the accountancy profession, established the Cadbury Committee in 1991. The foundation of this committee could be considered as reactive rather than proactive (Solomon, 2013). The remit of the Cadbury Committee was to review the financial aspect of CG in UK companies, specifically financial reporting and accountability. The outcome of the committee's deliberations was the Cadbury Report (1992). The report was the first CG guidelines that recognised not only the importance of shareholder rights but also discussed shareholder responsibilities, defining the role that should be played by responsible shareholders and especially by the very large institutional investors that account for a significant proportion of all shareholdings in UK companies. The Cadbury Code that emerged recommended that all registered companies should comply with this Code and prepare an annual report on their compliance for shareholders. The specific recommendations of the Cadbury report focussed on the need to: improve accountability by enhancing information disclosure to shareholders; appoint more independent directors, and; ensure that auditing companies are genuinely independent of the business that they are auditing (Keasey et al., 2005).

The immediate aftermath of the Cadbury Report was a change in directors' attitudes towards CG issues combined with initiatives to improve shareholder communication (Solomon, 2013). The Cadbury Report emphasised that, due to the number of votes that institutional investors have, they should actively use their power to influence CG because such institutional investors should not be seen as passive holders of shares who only consider the financial benefit of holdings when buying and selling shares. The Cadbury Report encouraged institutional investors to have regular one-to-one meetings with directors of their investee companies, to make positive use of their voting rights and to pay attention to the structure of the Board of Directors in investee corporates. Consequently, by the second half of the 1990s, the instances of institutional investors exercising their voting rights began to rise, indicating a positive impact of the report (Solomon, 2013). In addition to the above recommendations, the Cadbury Report asked companies to fully disclose the

Chair remuneration and their highest-paid director. A remuneration committee including wholly or mainly non-executive directors (NEDs) was also recommended to control executive directors' remuneration, which had been highlighted as an area subject to abuse.

While some companies immediately sought to implement the Cadbury recommendations, its findings were not without criticism. Solomon (2013) emphasised that although implementing the Cadbury Code is a positive development, it does not guarantee that the ambitions of the committee developing this Code would be met. That said, the Cadbury Committee stated that by following the recommendations of its report companies would strike the right balance between meeting the standards of CG and keeping to the spirit of the guidelines. On the other hand, Keasey et al. (2005) argued that the recommendations of the Cadbury Report were considered as a disruption to the management of companies. Lord Young (1995) recognised that improving accountability and transparency was essential for companies but concluded that the additional rules developed by Cadbury could result in a box-ticking exercise rather than genuine commitment to implement the spirit of the Cadbury Code. It is notable that the box-ticking approach is still an issue linked to the most recent CG guidelines (e.g. CG Code). The Cadbury Report assumed that accountability to shareholders was the primary objective of CG (Ezzamel & Watson, 1997). Solomon (2013), however, believed that too much accountability could discourage enterprise activity. On the other hand, although Cadbury emphasised the role of institutional investors in their investee corporates, it did not explain how institutional investors should perform their duties and, therefore, practical application of the Cadbury Code was limited (Arsalidou, 2012). Keasey et al. (2005) also identified that focusing on the financial aspects of the CG while ignoring non-financial accountability was another weakness of the Cadbury Code. They also noted that the Cadbury Code did not make any recommendations about the application of ethics and responsibility in the Boardroom, despite the fact that this issue was highlighted after the Zeebrugge ferry disaster (1987) and the King's Cross London Underground fire (1987).

ii) Greenbury Report (1995)

To address the weaknesses found in the recommendations of the Cadbury Report, specifically those concerning the director's remuneration, the Greenbury Committee was established by the Confederation of British Industry (CBI) in 1995. Director compensation was highlighted as a major CG issue at the time. Figure 2.2 demonstrates the exponential rise in CEO pay compared to American workers. This rise is not related to corporate performance. The ratio of CEO to worker compensation in 1995 was 123:1, considerably higher than the 1989 ratio of 59:1 (Mishel & Schieder, 2017).

Figure 2.2. Growth of CEO Pay in America

Figure 2.2 has been removed from this version of the thesis due to copyright restrictions

Source: Economic Policy Institute, 2011

The Greenbury Committee was asked by the government to identify good practice in determining the appropriate level of directors' remuneration to enhance the accountability and performance of UK companies. According to Solomon (2013), the aim of this committee was not to decrease directors' salary, instead to make a balance between their salary and performance. Keasey et al. (2005) believed that despite focusing on one aspect of the CG system (i.e. directors' remuneration), the findings of the Greenbury Report (1995) contributed greatly towards the development of UK CG systems overall. According to Keasey et al. (2005) the Greenbury Report was successful in raising the importance of NEDs in the governance system of their companies. While the Cadbury Report asked the remuneration committee to include NEDs, the Greenbury Report required only independent NEDs to form this committee to advise the Board on remuneration. The intention of this remuneration committee was to prevent directors from creating their own remuneration (Solomon, 2013). Like the Cadbury Code, the Greenbury Report authors proposed that all registered companies should comply with its recommendations and prepare an annual report on their compliance for shareholders.

Furthermore, the Greenbury Report was successful in increasing the quantity and quality of remuneration disclosure by companies. The Greenbury Report (1995) recommended companies to provide a full report on all the elements of their remuneration package including basic salary, benefits, annual bonuses, long-term incentive schemes such as share option as well as pension entitlements of their individual directors. Notably, this recommendation led to the criticism of this Report for requiring too much disclosure, leading to a decrease in effective communication within companies (Ernst & Young, 1996). In line with the criticism of the Cadbury Report, the Greenbury Report was also accused of increasing corporate bureaucracy without benefiting shareholders (Keasey et al., 2005).

iii) Hampel Report (1998)

The Hampel Committee was set up in 1995 to address the criticisms of both the Cadbury and Greenbury Reports, notably increased bureaucracy and unnecessary disclosure that distracted Boards from their main responsibility, which is to enhance the long-term value of their companies. This resulted in the Hampel Report (1998) which aimed to create a balance between accountability and corporate success. The Hampel Report supported the accountability of directors to shareholders but rejected the requirement for a wide responsibility towards other stakeholder groups (Tricker, 2015). Hampel emphasised that companies and shareholders needed to avoid the “box-ticking” approach, synonymous with the Cadbury and Greenbury Codes, when performing their responsibilities and suggested the avoidance of prescriptive guidelines by recommending a principle-based approach.

According to Solomon (2013) in the area of the role of institutional investors in CG, the Hampel Report had been less demanding compared to Cadbury. It also represented the interest of directors over shareholders which weakened the positive impact from the Cadbury Report. While the Hampel Report (1998, p.7) was enthusiastic about the level of accountability of UK public companies, it stated that:

“We strongly endorse this accountability and we recognise the contribution made by the Cadbury and Greenbury committees. But the emphasis on accountability has tended to obscure a Board’s first responsibility —to enhance the prosperity of the business over time”.

Solomon (2013) questioned the approach of the Hampel Report towards accountability and criticised it for placing less emphasis on this issue. Solomon proposed that while more evidence was emerging on the link between accountability and performance, the emphasis of the Hampel Report on the prosperity of organisations over accountability was outdated.

iv) Combined Code (1998)

The Hampel Committee produced the Combined Code in June 1998, embracing all the recommendations of the Cadbury, Greenbury and Hampel reports. The Combined Code advocated a “comply or explain” approach: recommendations are voluntary but instances of non-compliance must be explained in the annual reports of corporates. The Combined Code consisted of two sections, one for companies and one for institutional investors. An important contribution of the Combined Code was related to pension fund trustees, the largest group of investors, who were identified as needing to take their CG responsibilities more seriously. In this regard the Combined Code encouraged pension funds to follow a long-term approach and to avoid short-termism when it came to investment decisions.

v) Turnbull Report (1999)

The Combined Code recommended that directors review the effectiveness of their internal control and report this information to shareholders (Provisions D.2.1. and D.2.2.) The Turnbull report, published in September 1999, outlined these obligations of directors with regard to maintaining good internal controls such as having effective audits and checks to ensure the quality of financial reporting. This was intended to prevent fraud. The Turnbull Report maintained the comply or explain basis. The aim of Turnbull was to provide general overview guidelines needed to develop and maintain internal control systems without specifying the details of an ideal system. It also specified recommendations for improvements, including additional corporate risk disclosures. The Turnbull Report did not specify any certain risks but instead left it up to companies to evaluate individual risk environments. Solomon (2013) proposed that disclosing corporate risk would help to improve the information flow to shareholders, helping to reduce information asymmetry and consequently reducing agency problems. Hence, Solomon (2013) concluded that the Turnbull Report had an extensive impact on corporate risk disclosure since the signatories of this report subsequently provided detailed risk reports.

vi) Myners Report (2001)

The Myners Review was conducted in 2000 by HM Treasury to investigate institutional investors' behaviour, knowledge and incentives. The review found that pension fund managers were unenthusiastic about taking action and challenging underperformed companies. The Myners Report followed in 2001. This drew attention to the role and responsibilities of institutional investors in the UK and recognised the importance of monitoring by investors. It proposed that fund managers have the obligation of monitoring the Board, and that this would enhance the value of their portfolio. The Myners report argued that sometimes, shareholder intervention is the "right action to take" if fund managers truly judge that the interests of shareholders are above those of other stakeholders.

vii) Higgs Report (2003)

The Enron scandal in 2001 attracted international attention towards corporate failures and the importance of a high-quality CG to prevent such failures. Enron, which appeared to conform to CG guidelines, including separation of the chairman and CEO functions, the establishment of an independent audit committee and the appointment of an appropriate number of independent non-executive directors, proved that those guidelines were ineffective in practice. Therefore, the UK and other countries examined their CG systems to find potential weaknesses and prevent future failures. The Higgs report (2003) was the result of that action, specifically highlighting the role and effectiveness of NEDs. The report recommended changes to the Combined Code, including more NED representation on

Boards, applying appropriate remuneration for NEDs and creating a stronger relationship between NEDs and major shareholders.

viii) Code on the Responsibilities of Institutional Investors (2009)

In addition to the above CG guidelines, the ISC undertook a study in 1993, which found that only 24% of voting rights were exercised by investors in the top UK companies. The ISC was established in April 1973 after the recommendations of the Bank of England to examine and report a structure through which institutional investors could take actions to improve the efficiency of companies. Ultimately, ISC published "The Responsibilities of Institutional Shareholders and Agents" in 2002, which was an important initiative in the area of shareholder activism to improve CG standards in the UK. The ISC statement converted to a voluntary code in 2009, entitled "*Code on the Responsibilities of Institutional Investors*". This provided guidance on the development of a responsible ownership policy, monitoring of performance, voting and engagement, the escalation of intervention, and evaluation and reporting of activities.

As explained above, policymakers have only recognised the importance of shareholder action in improving the CG of corporates in the last ten years. Hence the process of encouraging shareholders to exercise their ownership rights, including voting rights, is relatively recent. Despite the action by policy makers, various studies have found that shareholders demonstrate passive ownership behaviour (Faccio & Lasfer, 2000; Robert & Monks, 2011; Sun et al., 2011). The financial crisis resulted in considerable criticism of shareholders who failed to prevent corporate failures by taking an active ownership role in investee corporates. After the financial crisis, the Stewardship Code was published in 2010 to enhance the quality of engagement between investors and companies. This is detailed in the next section.

2.2 UK Stewardship Code (2012)

According to Tomorrow's Company Report (2009, p.3): "s*tewardship is the active and responsible management of entrusted resources now and in the longer term, to hand them* *on in better condition*". According to this report, the aim of stewardship in business is to create long-term value for shareholders, involving thoughtful judgement between the immediate interest of beneficiaries and long-term consequences. Following the banking crisis in 2008, Tomorrow's Company identified the need for stronger investor stewardship, which was supported by Sir David Walker, a key player in developing the Stewardship Code. As a response to the financial crisis, the Financial Reporting Council (FRC) produced the UK Stewardship Code in 2010. The main objective of the Stewardship Code was to promote shareholder engagement and create a long-term investment culture on behalf of institutional investors (Arsalidou, 2012). According to the FRC website, the Stewardship Code provides the principles of effective stewardship statement by the investors, and its application would help to enhance the quality of engagement between investors and their investee corporates.

2.2.1 Principles of the Stewardship Code

The Stewardship Code consists of seven principles and is similar to the ISC Code (2009). Institutional investors should:

1. publicly disclose their policy for discharging their responsibilities;
2. have a strict policy on managing conflicts of interest in relation to stewardship that should be publicly disclosed;
3. monitor their investee companies;
4. have clear guidelines on when and how they will escalate their activities as a way to protect and enhance shareholder value;
5. be prepared to act together with other investors where necessary;
6. have a clear policy on voting and disclosure of voting activity;
7. report periodically on their stewardship and voting activities.

These are discussed in turn below:

i) Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Stewardship activities include "*monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration*" (FRC, 2012, p.6). Engagement is defined as *"purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meeting*s" (FRC, 2012, p.6). The FRC asked institutional investors to disclose their stewardship policy to reflect on their activities within the investment chain as well as the responsibilities that emerge from those activities. If stewardship activities are delegated to a third party, investors are asked to explain how the proper exercise of their stewardship responsibilities is assured.

ii) Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship, which should be publicly disclosed.

Conflict of interest is inevitable among institutional investors who manage assets on behalf of a wide range of clients. Hence the FRC asked its signatories to develop a policy for identifying and managing conflict of interest, helping them to better address this issue. This policy should be publicly disclosed and explains how institutional investors deal with any conflicts of interest.

iii) Institutional investors should monitor their investee companies.

Compared to other policies, the FRC provided more details for its signatories on how to monitor investee corporate. In addition, the FRC emphasised monitoring as "*an essential component of stewardship*" (FRC, 2012, p. 7). The Stewardship Code included six steps that institutional investors need to consider when monitoring:

1. Keep abreast of the company's performance.
2. Keep abreast of developments, both internal and external to the company, that drive the company's value and risks.
3. Satisfy themselves that the company's leadership is effective.

4. Satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other Board members.
5. Consider the quality of the company's reporting.
6. Attend the AGMs of companies in which they have a major holding, where appropriate and practicable.

In addition, the Stewardship Code asked institutional investors to closely monitor any departure from the UK CG Code and to enter into a dialogue with investee corporates to communicate their disapproval if they are not happy with any non-compliance. Furthermore, the FRC asked its signatories to try to identify the issues at an early stage to prevent any significant loss in their investment, and, to make members of their investee corporates aware of their concerns. This last recommendation suggested that the emphasis on monitoring by FRC is to aid corporate performance and to protect investor investment.

iv) Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

The FRC has encouraged all institutional investors, regardless of size, to intervene in investee corporates. According to the Stewardship Code the circumstances under which the investors should consider intervention include "*when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matter*s" (FRC 2012, p.8). Under the fourth principle, the Stewardship Code explains that if the companies did not respond to investors' concerns, they should escalate their activities. The examples of the activities that can be followed by the investors to escalate their engagement are provided below:

1. Holding additional meetings with management specifically to discuss concerns.
2. Expressing concerns through the company's advisers.
3. Meeting with the chairman or other Board members.
4. Intervening jointly with other institutions on particular issues.
5. Making a public statement in advance of General Meetings.

6. Submitting resolutions and speaking at General Meetings.
7. Requisitioning a General Meeting, in some cases proposing to change Board membership.

v) Institutional investors should be willing to act collectively with other investors where appropriate.

The Stewardship Code proposed that at times of "*significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value*", collaboration with other investors is appropriate and significant (FRC, 2012, p.8). Hence, investors should develop a principle to explain when they would consider collaborative engagement to achieve their objectives and to provide examples of the circumstances under which they are ready to work with other investors.

vi) Institutional investors should have a clear policy on voting and disclosure of voting activity.

The sixth principle asks the investors to vote on all the shares they hold. More importantly, the Stewardship Code asked investors to refrain from automatically supporting the Board. For example, if the investors could not reach an agreement with the investee corporates through a dialogue, they should register an abstention or vote against the resolution. Also, the Stewardship Code provides some guidelines for publicly reporting the voting activities, including disclosing the use of proxy services and the extent to which they follow the recommendations of those services.

vii) Institutional investors should report periodically on their stewardship and voting activities.

Finally, asset managers were asked to report their stewardship activities regularly to their clients and explain how they discharged their responsibilities. Asset managers should include both quantitative and qualitative data in their reports, which were recommended to be published annually, as a minimum. In addition, asset managers were encouraged to obtain an independent opinion on their engagement and voting process, which should be accessible for their clients, if requested.

Since December 2010, all UK-authorised asset managers are required under the Financial Conduct Authority (FCA) rules to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model (i.e. a ‘comply or explain’ basis). Stewardship reporting is intended to enhance readers’ understanding of the stewardship approach adopted by institutional investors. Although asset managers are the main audience of the Stewardship Code, the FRC emphasised that the responsibility of monitoring is not just for asset managers, as the asset owners can also monitor the company directly, or indirectly, through orders given to the fund managers. The background of the Stewardship Code is presented in more detail in the next section.

2.2.2 Background of the UK Stewardship Code

2.2.2.1 Financial Crisis (2008)

Before the financial crisis in 2008, for a decade lax monetary policies, cheap money and tremendous liquidity led to the formation of an asset bubble in western countries. Falling house prices in the US triggered the beginning of the financial crisis in 2007. Sun et al. (2011) described this as a mortgage crisis indicating that the house prices became lower than the value of the mortgage loans, leaving the owners in negative equity. Many of these loans were given to people with bad credit risk, making the existing situation worse. House prices reduced further because of foreclosures. According to Tricker (2015) this chaos resulted from financial engineering whereby financial institutions bundled up loan assets as ‘securities’, which consequently were sold to other financial institutions. This expanded the risk around, and lowered the confidence in the financial system that the credit would be available when required, and that the debt would be paid on time (Tricker, 2015). Banks subsequently limited their loan offerings, leading to insufficient funds in the debt market. Facing this situation, the central banks had to provide money for some institutions’ liabilities. The Northern Rock Bank was the first bank in the UK to fail as a result of the financial crisis, leading to a rescue operation by the UK government in 2008. Similarly, other financial institutions faced problems in the US, such as Bear Stearns, Fannie Mae and the American International Group (AIG). After the failure of financial institutions, respective governments tried to improve the lack of confidence by offering financial assistance. For example, in 2008, the US Federal Reserve and the US Treasury proposed to take on the bad debts of certain banks with underlying collateral security, with corresponding plans to take $700 billion in equity stakes. The financial crisis which originated in the housing market in the US spread quickly to other sectors and countries, due to globalisation of the industry, causing a series of financial and economic failures: the collapse of US and EU housing markets; collapse of global stock markets, and; the collapse of many large banks and financial institutions. For example, in the UK, three banks faced insolvency including Royal Bank of Scotland, HBOS and Lloyds TSB, which was subsequently nationalised. According to Sun et al. (2011) finding the reasons behind the financial crisis is not easy, due to the complexity of the industry and associated systems. Shortly after the financial crisis, in November 2008, the G20 summit on financial markets and the world economy took place in Washington DC, US. The leaders of the G20 concluded that the financial crisis of 2008 occurred as a result of:

> 1) Market participants demanded higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence.
> 2) Weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create vulnerabilities in the system.
> 3) Policymakers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.

Finally, the summit agreed that to stabilise the financial markets and support economic growth, a broader policy response was required. As aforementioned, the financial crisis led to failures of many financial institutions and public companies in the US and elsewhere in the world. This stimulated debate among academics as to the extent to which CG practices contributed to the financial crisis. Sun et al. (2011) identified three perspectives in this debate. The first school of thought purported that CG did not have a role in the financial crisis (e.g. Adamas, 2009; Cheffins, 2009) i.e. there is no correlation between the CG and the financial crisis. According to Cheffins (2009) the CG practices of publicly held companies were appropriate before and during the crisis. Cheffins used a sample of 37 firms which were removed from the S&P 500 index during 2008. Reviewing the CG mechanisms revealed that shareholder activism among the hedge funds was acceptable as they could make a change in a number of underperforming firms. In addition, Cheffin did not identify fraud or inappropriate remuneration among the companies that were delisted. Furthermore, Board performance was found tolerable due to the absence of public criticism among these companies.

The second school of thought identified by Sun et al. (2011) indicated that while the content of the current CG framework is not wrong, application of CG guidelines was insufficient during the financial crisis. This view is also reflected in the OECD report (2009), proposing that the principles of CG which were developed many years before the financial crisis, addressed all of the key CG concerns (i.e. executive remuneration, risk management, Board practices and exercise of shareholder rights) which contributed to the financial crisis. Despite this, the implementation of these CG policies was insufficient to prevent corporate collapse during the crisis. In line with this report, the FRC (2010) proposed that there were not any problems in the CG Codes developed before the financial crisis. Instead, the problem was the lack of compliance with those guidelines. It is notable that the OECD emphasis on voluntary based guidelines fell short of encouraging implementation.

The third perspective is that the financial crisis was due, in part, to the systematic failure of CG systems. Sun et al. (2011) proposed that although the CG weaknesses that were found in the OECD report are correct, the failure of CG was not only due to lack of implementation of the guidelines, but also a failure of institutional arrangements based on inconsistent assumptions such as priority of shareholders, profit maximisation, rational self-interested human behaviour and acceptance of agency problems. According to Sun et al. (2011, although the CG reforms have brought some positive changes for corporates such as independence of the Board and shareholder activism, it also encouraged companies to take excessive risk to create short-term profit. Sun et al. (2011) explained that the Anglo-

American CG model has external and internal governing forces. The external governing forces include regulatory governance, market governance and stakeholder governance. The internal governing forces include the AGM and the Board of Directors and management, as recommended by corporate law. Based on Sun et al. (2011), the internal governance forces failed systematically as shareholders followed passive ownership behaviour and failed to monitor their investee corporates or to highlight the Board's lack of independence or the abuse of power by management. In line with this, Monks and Minow (2011) who emphasised that the passive behaviour of shareholders (both institutional and individual) was the key problem with the Anglo-American CG system. The following section further investigates shareholder engagement during the financial crisis.

2.2.2.2 Shareholder Engagement During the Financial Crisis

Directors' Remuneration Report (DRR) regulation provided investors with clear information about executive pay (Conyon & Sadler, 2010). The new rules made it mandatory for all the public companies with a financial year ending on or after December 31, 2002, to seek approval of the DRR at their AGM. The DRR regulations were developed after the revision of the Companies Act of 1985 and subsequently were included in the Companies Act of 2006. According to the Companies Act (2006), section 172, it is the primary duty of directors to promote the success of the company for the benefit of their shareholders. It is also widely expected that shareholders would monitor the performance of their investee corporates and intervene when necessary to protect and enhance the value of their investments. To enable shareholders in performing this role, the Companies Act (2006) granted all the shareholders certain rights, such as voting rights. According to section 284, shareholders' rights depend on the size of their ownership. For example, when shareholders hold at least 5% of voting rights, they can request the directors of the company to call a general meeting (Companies Act, section 303, 2006).[1]

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[1] A summary of the rights given to shareholders by Companies Act (2006) is summarised below:
1. To be included in the company's Register as a member (section 113).
2. Right to inspect the Register of Members (shareholders) for free and be given a copy of them for a fee (section 116).
3. Right to inspect the Directors' Service Contracts for free and be given a copy of them for a fee (section 229).

Despite the above regulations, institutional investors (i.e. the major shareholders) did not systematically take action in their investee financial institutions against weak risk management systems and inappropriate remuneration policy which failed to reflect managerial performance. In line with this Manifest (2009) found that leading up to the financial crisis, only 9% of shareholders voted against the remuneration of banks between 2002 and 2007, which was the same as other sectors. Ineffective shareholder engagement was particularly evident in the example of ABN Amro, in 2007, which was taken over by a consortium of European banks led by Royal Bank of Scotland and Fortis. Despite all the concerns over the cost of the deal and the capital position of the acquiring banks, a significant number of shareholders (95%) voted in favour of the transaction. It is notable that shareholder participation in two general meetings organised by Fortis to get approval for the deal was very low (36%). Consequently, the acquisition of ABN, the biggest bank takeover on record, caused problems for the acquiring banks, resulting in their nationalisation in 2008 by UK and Belgium governments respectively. Based on this evidence, Robert and Monks (2009) concluded that prior to the financial crisis, institutional investors failed to perform their CG responsibilities in banks and other financial institutions. Policymakers recognised this as a weakness of the internal CG system and addressed this issue in various reports. For example, Sants (2009), Chief Executive of the FSA, proposed that investors, despite having rights to influence the governance of their investee corporates were unchallenging and merely relied on the information provided by companies. Likewise, Myners (2009) criticised shareholders for acting as absentee landlords and asked them to get more involved in the matters of their investee corporates. Following the financial crisis, governments and policymakers began to review the CG of the finance sector to find the reasons behind their failures and develop new regulations in response.

Another reason behind the low level of shareholder engagement is a lack of incentive to engage in active ownership. According to Monks (2010), UK and US shareholders mainly

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4. Right to vote at a AGM – the voting power depends on the proportion of shares you have (section 284).
5. Right to receive a notice of any AGM (section 310).
6. Right to have access to a record of resolutions and general meetings for free and be given a copy of them for a fee (section 358).
7. Right to receive a share certificate (section 769).

make their investment decisions using brokers or mechanistic formulas. Therefore, they are not interested in long-term investment, demotivating them from engaging in their investee corporates. Monks (2010) suggested that only 20% of outstanding shares are considered as long-term investments in which shareholders are willing to engage with investee corporates to monitor decision-making and the quality of CG systems. Monks (2010) argued that even among these investors conflict of interests might affect the level of their engagement.

According to Bainbridge (2012) since the financial crisis of 2008, there has been a rapid change in the CG legal system compared to any period in history. Policymakers and regulators believed that poor CG implementation was one of the main factors behind failures of corporate during the financial crisis (Bainbridge, 2012). Tricker (2015), who investigated CG issues that were emphasised due to the financial crisis, found the role of directors in failed financial institutions was a fundamental issue. Tricker questioned the efficiency of the role of the director, especially independent outside directors. He argued that they did not monitor managers nor understand the risks affecting their business. The role of auditors and credit rating agencies were also questioned, with respect to the verification of risk reporting (auditors) and through the awarding of high ratings to companies that faced significant risk (credit rating agencies). Further, he asked whether excessive bonuses and share options caused excessive risk-taking and short-termism within financial institutions. The following are important reports published to explore shareholders engagement during the financial crisis, including IMA, the Walker Review and the OECD report.

i) IMA

The Investment Management Association (IMA)[2] is the trade body representing the UK asset management industry. Its members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension schemes. IMA (2009) expected its members to engage in companies in which they are

[2] In 2014, the IMA merged with the Association of British Insurers (ABI) and was renamed to the Investment Association (IA). The IA now covers the entire range of investment issues for investment managers and clients. The aim of the IA is to help its members to comply with law and the best industry practice.

considered ‘major’ shareholders, by having active dialogue and exercising voting rights on behalf of clients. The aim of IMA was to measure fund managers’ engagement with investee companies two years before the 2008 financial crisis. The IMA’s report was based on the interviews which were conducted with the representatives from 32 firms, including corporate governance or environmental and social investment specialists, a portfolio manager and the Chief Investment Officer. The IMA report explored the compliance of IMA’s members towards the ISC statement, specifically monitoring and voting activities in their investee corporates. Table 2.2 and 2.3 show the response of IMA’s members towards the application of the ISC statement.

Table 2.2 Availability of policy statements

	30/06/08	30/06/06	30/06/05	30/06/04	30/06/03
	Number of firms				
Public - all on the web	28	25	24	20	9
Public - part on the web	–	1	3	1	5
Existing and/or prospective clients, and on request	4	7	8	12	14
Draft	–	–	–	1	5
Total	**32**	**33**	**35**	**34**	**33**

Table 2.3 Contents of policy statements

	30/06/08	30/06/06	30/06/05	30/06/04	30/06/03
	Number of firms				
Monitoring of investee companies	30	29	29	26	19
Policy for communicating with a company’s Board and senior management	30	29	29	26	18
Managing conflicts of interest	28	26	23	19	14
Strategy on intervention	30	28	28	26	17
When further action will be taken	29	27	27	23	16
Voting policy	32	33	34	28	22

These tables show that the number of firms publicly publishing their ISC statement increased significantly from 9 in 2003 to 28 in 2008. In addition, IMA stated that since 2003 the content of ISC statements of its members has been enhanced as more firms addressed all the matters raised in the ISC principles.

IMA’s findings also drew upon a questionnaire in which firms were asked for details of their engagement in the two years leading up to the end of June 2008. The report included fund managers’ engagement at seven companies, including Bradford and Bingley (B&B), a large mortgage and buy-to-let lender which ran into financing difficulties after the 2008 financial crisis. In May 2008, when B&B’s shares were around 150p, the company tried to raise funds through a rights issue of £300 million at 82p per share. Less than three weeks later, after the downgrade in B&B's credit rating, the underwriters, including Texas Pacific Group (TPG), withdrew their agreement to take up the company's shares. In September 2008, although key shareholders still supported the rights issue, the share price plummeted to 30p, causing the FSA to step in and secure the future of the company. B&B's UK and Isle of Man retail deposit business along with its branch network was transferred to Santander and the remainder of the business taken into public ownership. Among the participants of the IMA survey, 28 of them provided details of their interaction with B&B on financing issues. The survey found that among the 28 fund managers, 14 had in aggregate 28 meetings with the company, including 9 firms that had 17 meetings with the Chairman. A number of these meetings were around May and June 2008 when there were concerns about the financing of B&B. According to the IMA survey (2009, p. 16) "*One firm that met with the Senior Independent Director was concerned that B&B had given assurances that no additional financing would be required. In addition to the above, four firms met/spoke with Texas Pacific Group at the time of its offer, and one met with Resolution*".

In addition to monitoring, the survey provided some details of shareholder voting activities. Twenty-five firms provided details on exercising their voting rights in respect of UK companies in the years ended 30 June 2008 and 2007. The IMA found that firms voted in around 95 per cent of resolutions (2008 (96.1%); 2007(94.7%); 2006 (96.1%); 2005 (98.3%); 2004 (94.1%). Voting against the resolutions was 3.3% in 2008 and 3.8% in 2007, higher than previous years (2006 (1.8%); 2005 (1.8%); 2004 (3.0%). IMA concluded that this could be due to more controversial issues in 2007 and 2008 than in previous years, which shareholder engagement failed to resolve before the voting event. IMA argued that the low level of voting against management decisions did not help to resolve problems in companies during the financial crisis. For example, in 2008, Marks and Spencer decided to combine the chairman and chief executive roles, against the provisions of the Combined Code, yet only 4 out of 26 firms which answered the IMA questionnaire voted against this resolution. It is notable that the majority of IMA members tend to use more than two agencies, helping them with voting decisions. Furthermore, the survey reported positively with respect to the reporting of fund managers' engagement: "*All the firms report to clients, mainly quarterly, except that one firm reports to its corporate governance clients weekly and firms that* *prepare bespoke reports report more frequently if requested. All the firms provide some form of explanation, particularly in instances when they have voted against or consciously abstained*" (IMA, 2009, p.4). IMA encouraged a voluntary approach as an appropriate way of disclosing engagement information of fund managers to their clients. According to IMA (2009, p. 15) "*All the firms undertake the desk-based monitoring envisaged in the Statement of Principles and routinely meet with investee companies' executive management, and the dedicated specialists meet with non-executive directors*". The findings of this survey indicated that IMA's members engaged at an acceptable level with companies which were facing problems during the financial crisis, through holding meetings as well as exercising their voting rights.

ii) OECD

The Organisation for Economic Co-operation and Development (OECD) introduced itself as a "*unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population*" (OECD, 2009, P. 2). In June 2009, the OECD published a report to reflect on the Corporate Governance lessons learned from the financial crisis published by the Steering Group (February 2009). The OECD report found the Steering Group's conclusion convincing indicating that:

1. Remuneration of the financial sector was little related to company performance.
2. Risk management systems did not consider the firm as a whole and the risk inherent in compensation schemes.
3. Boards were, in a number of cases, unaware of their company's difficulties until too late.
4. Shareholders generally acted as traders with short interest in their investee corporates and undertook ineffective monitoring of the Boards.

The Steering Group considered these four weaknesses in the CG closely linked to corporate failures during the financial crisis. In line with findings of the Steering Group, the OECD report addressed these four areas of corporate governance and emphasised that they are closely related. The OECD expressed the link by asking the following questions: if remuneration has been excessive and/or not structured properly, why have the Boards allowed this state of affairs to occur? If risk management has failed to manage risk-oriented remuneration systems, why have the Boards apparently stood back or are we expecting simply too much of boards in large complex companies which are to a great extent themselves a product of board and shareholder decisions? Why have shareholders not been able to ensure accountability?

The OECD report allocated a section to investigate shareholders' engagement during the financial crisis. The report found that shareholders failed to ensure accountability of Boards by not exercising their ownership rights properly, given that the Board is appointed on behalf of the shareholders, so it is the responsibility of the shareholders to monitor the Boards' activity. It concluded that shareholders were to blame for the failures of the Board due to their passive ownership behaviour. The report explained that the reason behind passive ownership behaviour included the short-term focus of shareholders, high monitoring costs and conflicts of interest existing due to investors' business models.

It is notable that the OECD report evidenced some level of shareholder responsibilities towards investee corporates from the findings of the IMA survey (2009), including that institutional investors (i.e. their members) began to exit the banking sector in 2005 because of concerns about strategic direction. Manifest (2009) suggested that shareholders ignored their responsibility, as the level of voting against the resolutions in banks was not significant, being only 9% in 2002. In line with this, in the case of ABN Amro's takeover by the Royal Bank of Scotland and Fortis, only 5% of shareholders voted in against this controversial case, leading to nationalisation of these two banks. Shortly after the financial crisis in 2008, the level of voting against bank resolutions reached 10%, which whilst very low was sufficient enough to make a statement.

The OECD principles of CG were originally developed in 1999 to use as a basis for CG initiatives in both OECD and non-OECD countries. According to the OECD report "*The Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance*" (OECD, 2004, p.11). The OECD report agreed with all the weaknesses of CG which were addressed in the Steering Group report, including ineffective and inadequate shareholders engagement in their investee corporates. But the OECD proposed that there is no need for new guidelines and the existing OECD principles, which were reviewed in 2004, were appropriate to address the problems with the CG system. Instead, the members of the Steering Group should focus on effective implementation of the OECD principles.

iii) Walker Review

In February 2009, David Walker reviewed CG in UK banks in the light of the banking system failures due to the financial crisis. Specifically, Walker was asked by the government to address the following areas: "*the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively; the balance of skills, experience and independence required on the Boards of UK banking institutions; the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees; the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and whether the UK approach is consistent with international practice and how national and international best practice can be promulgated" (Walker, 2009, p.5).*

Examining the roles of institutional investors was one of the CG areas that this review focused on. This review was conducted based on the responses that Walker received from 180 stakeholders as well as discussions with interested parties including Chairmen, Chief Executives, executive and non-executive Board members of banks and other corporates, the accounting and legal professions, representatives of smaller shareholders and consumer interests, both within the UK and internationally. One section of the Walker review investigated institutional investors and their role during the financial crisis. The review found that voting against bank resolution was as low as 10 per cent, indicating limited engagement by institutional investors who could not prevent the crisis. Therefore, the review concluded that shortcomings of the Board and managers would have been addressed more effectively if the major investors were engaged proactively in their investee corporates.

After investigating the role of institutional investors, Walker (2009) suggested that the FRC's regulations should be extended to develop principles of best practice in stewardship by institutional investors and fund managers, and that these principles should be separated from the Combined Code and called the Stewardship Code. The FRC, as an independent authority would give greater weight, credibility and authority to the Stewardship Code. Walker (2009, p. 18) recommended that:

"FSA should require institutions that are authorised to manage assets for others to disclose clearly on their websites or in another accessible form the nature of their commitment to the Stewardship Code or their alternative business model".

In conclusion, Walker (2009) emphasised the need for better engagement between fund managers who should act on behalf of their clients, and the Boards of investee companies. The review proposed that while major shareholders had limited liability towards the failure of the banking system due to the financial crisis, it was the taxpayer who had effectively unlimited liability, hence, institutional shareholders were acknowledged as the true owners of companies to better perform their ownership responsibilities. The review did not ask all shareholders to follow active ownership behaviour, for example, hedge funds are exempt due to their business model based around short-term shareholding. On the other hand, pension funds are more likely to be interested in engagement with the companies in which they are considered as major shareholders to increase long-term absolute return. Therefore, Walker asked fund managers to disclose their business model so that the beneficial shareholder can make an informed choice about their investments. All the recommendations of this review are reflected in the Stewardship Code, published by the FRC in 2010. The Stewardship Code is explained in the following section.

2.2.2.3 Publication of UK Stewardship Code

Revealing the weaknesses of CG within financial institutions after the financial crisis led to action by regulators to prevent further problems. For example, in the US the SEC proposed a separation of the CEO and the Chairman, annual election of directors, creation of Board-level committees and voting on top executive remuneration by shareholders. In the UK the FRC acted to improve accountability to shareholders, improve Board performance and ensure that there is a well-balanced, diversified and challenging Board composition.

Various bodies, including academics and policymakers, acknowledged that during the 2008 financial crisis, institutional investors acted irresponsibly as absentee landlords who did not engage effectively in their investee corporates (Monks & Sykes, 2002; Myners Review, 2001). In January 2009, the IMA was questioned by the Treasury Select Committee. The IMA reported on a survey of shareholder engagement in 2005, some three years before the financial crisis, and stated that a number of active investors had concerns regarding risky business strategies pursued by some banks. These investors, however, lost their confidence in the banking sector, resulting in some divestment. For those investors who did not have a divestment option, directly engaging with management over the strategic concerns was pursued, but these attempts were held to be insufficient to prevent the crisis (IMA, 2005). According to the IMA's survey, 11 of the institutional investors examined had shares in Bradford & Bingley, which was subsequently partially nationalised and split into two parts (mortgage and investment) in 2008 due to the financial crisis. This survey highlighted that despite 55 meetings between the investors and bank management before the nationalisation, the restructuring and bailout could not be averted, indicating the ineffectiveness of engagement.

In contrast to this finding, as aforementioned, the Walker Review found that before the financial crisis, the voting level on bank resolutions rarely exceeded 10 per cent. Sir David Walker, who was appointed by the Prime Minister to review CG in UK banks and other financial entities, emphasised the role of institutional investors in the governance of issues such as selection, composition and performance of boards. This was to ensure that the Boards follow their agency role and are accountable to their principles. The Walker Review (2009) concluded that failures of the Board of directors might have been addressed effectively if major investors had acted as responsible owners and had been engaged in their investee corporates. Notably, the blame was not focussed on institutional investors alone. The CG guidelines mentioned above such as Combined Code (1998) and Myners Review (2001) were also blamed for their failure to familiarise investors about their ownership responsibilities, thus encouraging them to play an active role in their investee corporates (Tilba & McNulty, 2013; Walker, 2009).

Following the Walker Review, and to address the inefficiency of the existing guidelines, in the UK it was decided to put stricter regulations in place and to guide institutional investors to act as stewards in their investee corporates. In line with the Walker Review recommendations, in July 2010, FRC as the responsible body, published the Stewardship Code based on the ISC statements. According to the FRC website, the Stewardship Code aims to:

"*enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities''.*

A revised version of the Stewardship Code was published in September 2012. On 30 January 2019, the FRC published a consultation on the draft 2019 UK Stewardship Code. A revised version of the Stewardship Code was published in January 2020. The signatures of the Stewardship Code (2020) should still follow an "apply or explain" approach. This version of the Code has taken into account the change in the investment market, including growth in investment in assets other than listed equities such as fixed income bonds, real estates etc. The FRC asked the signatories to perform effective stewardship activities considering their own circumstances. Finally, the FRC stated that it will evaluate the stewardship reports against its assessment framework. The signatories that meet the FRC's expectations will be considered as signatories to the Code.[3]

[3] The Stewardship Code (2020) consists of 12 Principles for asset managers and asset owners, and six Principles for service providers. Followings is a summary of these principles:
1. Principles for Asset Owners and Asset Managers: **1.1** Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. **1.2** Signatories' governance, resources and incentives support stewardship. **1.3** Signatories manage conflicts of interest to put the best interests of clients and

Chapter 3

3.1 Shareholder Engagement

Shareholders, the Board of directors and the management have been widely recognised by academics and policymakers as the central players in CG (Tricker, 2015). In light of the financial crisis the link between weak CG systems and corporate failures has been widely debated (e.g. Bauer et al., 2004; Keasey et al., 2005; Solomon, 2013). Global corporate scandals such as WorldCom in the US, Marconi in the UK, Royal Ahold in Netherland and Parmalat in Italy all have been explained by their poor CG systems. Notably, one of the similarities between these scandals is the misuse of powers by CEOs and other senior managers who were able to influence the Board of directors to follow their own interests (Keasey et al., 2005). According to Cohen et al. (2002), to ensure that firms perform effectively and cope in times of change, such as during a crisis, member of Boards should play an active role in CG systems including the alignment of manager interest with shareholders, focus on monitoring, control and evaluating corporate performance, global risk management and management recruitment. In addition to the above responsibilities, Board members have other important roles in their companies including developing and implementing corporate strategy, disclosing information and financial reporting to external

beneficiaries first. **1.4** Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system. **1.5** Signatories review their policies, assure their processes and assess the effectiveness of their activities. **1.6** Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them. **1.7** Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities. **1.8** Signatories monitor and hold to account managers and/or service providers. **1.9** Signatories engage with issuers to maintain or enhance the value of assets **1.10** Signatories, where necessary, participate in collaborative engagement to influence issuers. **1.11** Signatories, where necessary, escalate stewardship activities to influence issuers. **1.12** Signatories actively exercise their rights and responsibilities.

2. Principles for Service Providers: **2.1** Signatories' purpose, strategy and culture enable them to promote effective stewardship. **2.2** Signatories' governance, workforce, resources and incentives enable them to promote effective stewardship. **2.3** Signatories identify and manage conflicts of interest and put the best interests of clients first. **2.4** Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system. **2.5** Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken. **2.6** Signatories review their policies and assure their processes.

stakeholders, whilst ensuring independence of the executives. Notably, in the mentioned corporate scandals executives had control over the Board, making it easy for them to carry out fraud and hide them from external reviews (Keasey et al., 2005).

To further investigate the importance of developing a strong CG system, Erkens et al. (2012) investigated the impact of CG on the financial performance of firms from 30 countries that were affected by the financial crisis. In contrast to the above arguments, their results showed that firms with independent Board members and concentrated ownership experienced worse stock returns during the crisis. They explained that firms with institutional ownership took more risk prior to the crisis, which leads to a larger shareholder loss during the crisis. Furthermore, firms with independent Board members raised more equity capital during the crisis, which in turn leads to a wealth transfer from existing shareholders to debt holders. Essen et al. (2013) found mixed results regarding the link between CG systems and financial performance of EU firms before and during the financial crisis. It was found that although some principles such as voting rights and creditor protection were beneficial for firm's performance, others such as Board independence and the separation of the key role were harmful to performance during the crisis.

In addition, Core et al. (2006) found that firms with weak shareholder rights exhibit significant underperformance. In line with this study, Gompers et al. (2003) suggested during the 1990s, firms with better CG had better performance, which resulted in higher firm value, profit, sales growth and lower capital expenditure compared to firms with weak CG. They analysed the relationship between the strength of shareholder rights and corporate performance during the 1990s, incorporating a comprehensive set of governance provisions into a proxy index for the strength of shareholder rights. Gompers et al. (2003) developed three hypotheses to find answers for different returns in companies with different shareholder right power, which are presented below:

1. *Weak shareholder rights caused agency cost*.

Based on this hypothesis, if the market underestimates the additional costs arising due to agency problems, such as capital expenditure (CE), then the stock return and operating performance of firms would be worse than expected. Also, corporate value at the beginning of the period would be too high. If shareholders find it costly or difficult to replace management, managers can act in their own interests, which may conflict with the interest of shareholders, such as taking part in ineffective investment. Consequently, in this situation, if the capital expenditure (CE) increases following the adoption of new governance provision (takeover defence), it would be associated with a negative firm value. They tested the relationship between CE and governance and found that firms with higher governance provisions have higher CE.

2. *Managers predicted poor performance, but investors don't.*

This hypothesis suggested that managers create governance provisions to protect their positions. It is accepted that insiders have access to more information and are able to predict returns. So, if insiders predict poor performance the expectation is that they create provisions to protect their jobs by reducing the power of shareholders to intervene. So, weak shareholder rights are a symptom of asymmetry of information between insiders and outsiders. Gompers et al. (2003) used net purchase to proxy for insider trading and G-index to proxy the power of shareholder rights. The G-index is a governance index in which one point was added for every provision that restricts shareholder rights and increases managerial power per firm. They failed to find evidence to back this hypothesis, indicating shareholder rights did not lead to poor performance for firms.

3. *Poor performance is not due to governance provisions but are correlated with other factors associated with abnormal returns.*

Gompers et al. (2003), found some observable factors that explain one-third of the performance differences of firms within their sample. To test this hypothesis, they ran separate regressions for each component of governance to find an omitted variable bias. They argued that if governance provisions cause poor performance certain governance provisions would have important roles. Five categories of governance provisions were applied, including tactics for delaying hostile bidders (Delay); voting rights (Voting); director/officer protection (Protection); other takeover defences (Other); and state laws

(State) (Gompers et al., 2003, p.111). They found industry classification can explain between one-sixth and one-third of abnormal returns, but for the remaining provisions this argument could not be supported. In summary, this study found that during the 1990s, firms with stronger shareholder rights had a higher return. They also found a correlation between shareholder rights and institutional ownership, training volume and past sales growth. They stated that despite finding a significant relationship, it is difficult to claim that this is a causal relationship as the obtained results could be due to unobservable firm characteristics. Caprio et al. (2007), Johnson et al. (2009) and Sierra et al. (2006) found a positive relationship between firm performance and CG mechanisms.

Researchers tend to use one of two approaches to measuring mechanisms of CG systems. One approach includes applying CG rating systems, such as Deminor for European companies and Standard and Poor for emerging markets. Deminor enables access to the CG practices of the Financial Times Stock Exchange (FTSE) and Eurotop 300 index companies, which covers 17 European countries. Deminor applies four main areas to measure CG practices, including the rights and duties of shareholders, absence of takeover defences, disclosure and Board structure, thereby permitting a relatively complete set of governance standards to be identified. Bauer et al. (2004) applied the Deminor rating system to measure CG as an independent variable to understand whether well-governed firms have better stock returns and higher corporate values compared to poorly governed firms. Deminor's categories have been used to identify the main determinants of CG. For example, Tricker (2015), Shleifer and Vishny (1997) and La Porta et al. (1999) considered shareholders, the Board of directors and the audit committees as the central players in different parts of the CG system. According to Mallin (20101), the benefit of rating systems is not only for researchers but also, to help companies and shareholders explore CG further. Despite the advantages of Deminor, it only provided data for two years, 2000 and 2001, which is a major shortcoming.

In addition to CG rating systems, researchers have considered a single or a mixture of the firm-level and country-level characteristics of companies to investigate CG systems. For example, Judge et al., (2010) incorporated firm-level characteristics of firms (e.g. firm size, ownership concentration and prior profitability) and found these to influence the likelihood of shareholder activism.

Despite using different approaches, researchers have mainly focused on the same main factors when exploring CG systems (i.e. Board of directors, shareholders and auditors). The CG codes explained in the second chapter (e.g. Cadbury Code, Greenbury Report, Combined Code) all emphasised these as the central issues for CG. For example, the Cadbury Code highlighted the critical role of the Board and suggested separation of the leading roles at the head of the company. On the other hand, the Myners Report (2001) recognised the significance of the role of institutional investors in actively engaging with companies. Since the main audience of the Stewardship Code are institutional investors (i.e. shareholders), this study focuses on shareholders as one of the main elements of CG systems. The next section presents an investigation around shareholders and their responsibilities.

3.1.1 Institutional Shareholders

Mallin (2010) defined shareholders as the individuals, institutions, firms or other entities that provide corporate capital. Hence, public corporations need to keep their shareholders happy to operate and exist in the market. Mallin pointed out that, in the UK, corporations determine their objectives around the interests of their shareholders, and this should help to create an environment in which a clear set of corporate goals can be determined. This proposition emphasised the importance of shareholders for their investee corporations. Institutional investors are one of the largest groups of shareholders. They are recognised as major shareholders in their investee corporates, particularly in the UK, providing liquidity to short term money markets as well as making a long-term investment in primary and secondary capital markets. Major institutional investors include pension funds, life assurance companies and major fund managers. According to the Walker Review (Walker, 2009), major institutional investors have the power to influence corporate performance by their decision to hold or sell shares.

As aforementioned, the proportion of shareholding held by institutional investors has risen exponentially. It is a reflection of this growth that the role of institutional investors in CG has become more critical and is emphasised by policymakers. Since the creation of the Cadbury Committee (1991), it has been argued here that there has been greater emphasis on the need for institutional investors to play an active role in the governance of UK companies (Keasey et al., 2005). The subsequent reports (i.e. Cadbury, Greenbury, Hampel and Higgs) all highlighted the importance of institutional investors in ensuring companies follow best practice in CG. In line with policymakers, academics have also been interested in institutional investors and the role they can play in the CG system of their investee corporates. The next section investigates shareholder engagement in their investee corporates and its impact on their investee corporates.

3.1.2 Responsibilities of Shareholders

UK institutional investors are now recognised as the second major group of shareholders in publicly listed companies. The importance of large shareholders in their investee corporates, however, was recognised as early as 1932 by Berle and Means. These authors identified the significance of separating ownership and control in large modern corporates, which enables executives to act in their own interests rather than those of shareholders. Berle and Means (1932) focussed on major shareholders who practised their ownership responsibilities to align the managers' interest with themselves. Since this publication the ownership structure, which was described by them as dispersed, has changed considerably becoming more concentrated. According to the Office for National Statistics (2017), at the end of 2016 insurance companies, pension funds, unit trusts, investment trusts, banks, other financial institutions and charities own over 30% of UK shares. On the other hand, overseas shareholders held around 54%, and individual shareholders held just 12% of UK shares. As the major owners, these institutional investors should have a duty of care to actively engage in their investee corporates to protect and enhance the value of their investments. The Walker Review argued that engagement by shareholders ensures that they are generating value from their shareholdings through "*dealing effectively with concerns about under-performance*" (Walker, 2009, p.72).

There are different ways in which institutional investors can engage in investee corporates. According to the Walker Review, the following activities can be undertaken:

1. Monitoring investee companies; by arranging a meeting with a company’s Chairman, senior independent director or senior management.
2. Developing a strategy for intervention where appropriate.
3. Developing voting policy.
4. Disclosing voting activities.

The Walker review stated that shareholders could enhance their engagement by communicating their views and concerns to the Board of directors. This approach does not imply acquiring private information by shareholders and risk becoming insider in the investee corporates. Indeed, the review recommended that if the fund managers gained access to insider information, such as a change in the Board of directors or a change in the company's strategy, the fund managers should ensure that such information does not leak to the relevant trading desk.

The appropriate role for institutional investors and the potential impact on investee corporates is a continuing debate in any economy (Gillan & Starks, 2003). Çelik and Isaksson (2014) are among the few studies that explore shareholder engagement. Their study suggested that shareholders could engage in their investee corporates and the market at two important stages. In the first stage, the investors are required to find the most prosperous corporate to invest their capital, and at the second stage, they should monitor their investee corporate to ensure it made the best use of their investments. Nevertheless, institutional investors, as the dominant shareholders, are at least expected to exercise their ownership rights and monitor their investee corporates to protect their investments and create wealth for their clients (Tricker, 2015). According to Shleifer and Vishny (1986), large shareholders, due to the size of their ownership, have enough incentive to monitor their investee corporates and consequently close the ownership-control gap within their investee corporates. Hendry et al. (2007) presented a list of factors that promote shareholder activism in the UK, which they called enabling factors and driving forces. Enabling factors included the size of shareholding, voting power and culture rather than compliance. Voting was found to be mostly exercised on behalf of pension funds and life assurance companies whose beneficiaries had long-term interest. Hendry et al. (2007) argued that in contrast to the US, the UK’s CG guidelines are based on the “comply or explain” approach, which

reduces the pressure from businesses and enables them to make their own governance rules. Driving forces that encourage activism in the UK include the government pressure on pension funds to act as responsible owners through holding their investee corporates accountable for their performance and governance.
Shareholders who actively engaged in investee corporates are known as activist shareholders, and their actions are referred to as "shareholder activism". Notably, shareholder activism is not a new phenomenon, especially in the US where corporates were challenged on social and moral issues by individual activists such as Wilma Porter Soss, Evelyn Y. Davis and Gilbert Brothers, known as the corporate gadflies (Hendry et al., 2007), and credited with creating the field of shareholder activism (Monks & Minow, 2011). For example, in 1932, Lewis Gilbert attended the annual meeting of New York City's Consolidated Gas Co., but he was unhappy about how the chairman refused to recognise the shareholder questions. He began to buy more stocks with his brother with the intention to attend AGMs to vote rather than to sell them for profit. In 1942, the Gilbert Brothers' remarkable activities resulted in the SEC adoption rule 14a-8, which gave shareholders the right to include their proposals in company proxy statements (Reid & Toffel, 2009). By 1943, shareholders began to submit their proposals to improve CG and the performance of their investee corporates. This trend continued for the next three decades to enhance corporate performance and share values (Goranova & Ryan, 2014). Shareholder proposals which focused on social responsibility issues began to appear in 1970 after a federal court permitted the proposal to forbid the sale of napalm by Dow Chemical. It is notable that social issues started to be a popular subject of proposals which was also reflected by the American Society of Corporate Secretaries, claiming that from 790 proposals they received in 1979, 179 were related to social issues. More recently, a report by Climate Action 100+ (2019)[4] illustrates some detailed evidence indicating growing concerns of active shareholders over the environmental issues in their investee corporates. For example, investor engagement led to a joint statement between Shell (an oil and gas company) and major institutional investors, setting a net carbon footprint ambition to reduce its emissions by 20% by 2035. This engagement was led by Robeco and the Church of England Pension

[4] Climate Action 100+ is an organisation, helping the investors to curb emission, improve governance and improve climate related financial disclosures in their investee corporates.

Board, supported by IIGCC (The Institutional Investors Group on Climate Change) and Eumedion. The signatories of Climate Action 100+ also reported successful engagement with Maersk, Volkswagen and the Duke Energy Corporation. Such engagement, combined with an increasing number of signatories of Climate Action 100+, indicates the growing importance of climate change for institutional investors.
Shareholder activism includes public and private activities to monitor and engage with investee corporates, more commonly nowadays to create value without trying to control companies (Ruggeri et al., 2019). Public activism includes submitting shareholder resolutions, votes at AGM or publishing letters, focus lists, and media campaigns (Brav et al., 2008; Dimitrov & Jain, 2011; Hillman et al., 2011). On the other hand, private activism includes private negotiations, behind the scene consultations, letters, phone calls and dialogues, which are not observable for researchers (Becht et al., 2009; Brandes et al., 2008). As aforementioned levels of shareholder activism have historically been low, as investors have been criticised as being passive owners which avoid exercising their ownership rights (Cadbury, 1992; Hampel, 1998; Solomon, 2013), even when investee corporates are underperforming (Myners, 2001). This passive behaviour was considered a major shortcoming of the UK CG system (Goergen et al., 2008). After the financial crisis, fund managers were criticised for not acting fast enough when there were concerns in their investee corporates, and their limited engagement did not help to control management effectively (Walker, 2009).

Shareholder activism has been a popular subject among academics who have investigated forms of activism, the determinants and barriers to activisms, as well as its outcome. In the following section, first different types of activism including voting, resolutions and dialogue that are employed by institutional investors to engage in their investee corporates are explained. Then, the determinants of investor engagement are discussed followed by the factors which prevent, or discourage, investors from engaging in investee corporates. Finally, the findings of the papers that investigate the outcome of shareholder engagement are explained.

3.1.2.1 Shareholder Voting

In the UK all major CG guidelines, such as Cadbury Report and the Combined Code considered voting rights as a critical CG mechanism for institutional investors to discharge their ownership duties by encouraging investee corporates to follow best practice. Goergen et al. (2008) posited that if investors do not exercise their voting rights managers would have substantial freedom to run corporations, potentially permitting managerial compensation for weak performance. Institutional investors can attend AGMs and vote directly or use proxy voting through external advisors. Proxy voting is popular among many pension and mutual funds particularly in response to shareholder campaigns led by hedge funds or private equity funds (Gilson & Gordon, 2013). Outsourcing voting decisions to an external advisor reduces voting costs (Choi et al., 2011). Despite its popularity, proxy voting among the institutional investors is criticised for being a form of reactive engagement (Choi et al., 2009; Strine, 2006). Choi et al. (2009) raised concern over the extent to which mutual funds assign their voting judgement to proxy advisors. Exploring the factors affecting recommendations made by four major proxy advisory firms (Institutional Shareholder Services (ISS), Proxy Governance (PG), Glass Lewis (GL) and Egan-Jones Proxy (EJ)) with respect to director elections at Standard & Poor (S&P) 1500 companies for 2005 and 2006, they found each proxy advisor emphasised different factors in their final recommendation. For example, for the ISS, audit was considered the most critical indicator of good CG, whereas for PG, executive compensation was the most important factor. When investors are not aware of the different approaches among the proxy advisors, they are very likely to follow their recommendation without determining their relevance for their institution. In this case, Choi et al. (2009) concluded that using proxy advisors would lead to an uninformed voting decision. They proposed a number of factors that challenge the effectiveness of these proxy advisors' recommendations: a lack of proper incentives; a lack of accountability; the ability to follow their own interests rather than investors, and; conflicts of interest. Strine (2006) also challenged the use of proxy advisors and accused institutional investors of following ISS advice without due consideration or analysis. There are limited papers that have explored the use of proxy advisors by UK shareholders. McCahery et al., (2016) included UK investors (16%) in their study to explore the role of institutional investors in CG. They found that 60% of institutional investors used proxy advisors to vote, with half using more than one proxy advisor. McCahery et al., (2016) reported that institutional investors were aware of the conflict of interest arising from using proxy advisors but maintained that the information provided by proxy advisors improved, rather than substituted, their voting decisions. This finding is in contrast with Choi et al. (2009) and Strine (2006). The findings of McCahery et al., (2016) may not be generalizable as participation in the study was voluntary, indicating a self-selection bias may be present. In 2019, the Financial Conduct Authority (FCA, 2020) published the regulation 'Shareholder Right Directives' (SRD II), which aims to "improve the stewardship of companies based in the UK, elsewhere in the European Economic Area (EEA) and Gibraltar by increasing shareholder engagement". SRD II recommended proxy advisors to disclose the following:

1. The code of conduct which they apply, while following a comply or explain approach;
2. Information on the preparation of research, advice and voting recommendations;
3. Conflicts of interests or business relationships that may influence the operation of proxy advisors.

This new regulation with detailed recommendations could be an answer to the criticisms raised above, helping to improve the quality of voting activities by proxy advisors.

Although voting rights have always been a fundamental part of UK CG structure, the level of voting by institutional investors was quite low until the 1990s (Solomon, 2013). This could be due to monitoring costs, lack of monitoring expertise or fear of being heralded as an insider (Crespi & Renneboog, 2010). The publication of the Cadbury Report in 1992 was the beginning of an increase in exercising voting rights by institutional investors, as prior to this voting was disorganised and infrequent due to lack of guidance. Stapledon (1996) focused on exercising voting rights by UK institutional investors through interviews with fund managers of 17 investment-management UK firms. He found that in the early 1990s there were three different attitudes towards exercising voting rights: 1. Institutional fund managers that always voted their shares, 2. Institutional fund managers that only voted on major issues, and 3. Institutional fund managers that started to vote on all matters post-Cadbury, with associated improvement of voting policies. NAPF (1995) encouraged its members to exercise their voting rights: Since most UK pension funds were members of

NAPF, and given that most institutional investors are pension funds, the NAPF report was a significant contributor to the change in the level of voting (NAPF, 2015). In addition to these guidelines, Institutional Voting Information Service (IVIS) provides CG research for shareholders by highlighting the issues, concerns and best practice for its subscribers to consider before voting. These reports adopt a colour code to help users evaluate the severity of issues: Red indicates a serious concern; Amber shows concern over a particular element of the report; Blue indicates no major issue, and; Green highlights a resolved issue. Despite the considerable number of guidelines that require institutional investors to improve engagement, in 1998, the Hampel Committee reported that the voting level was still as low as 40%. Rather than explaining this, recommendations were made to encourage institutional investors to vote all the shares that were under their control.

Shareholder activism has been intensified in the 21st century. Since 2001 shareholders have been allowed to vote on remuneration policies, which has helped improve accountability of corporates to their shareholders and institutional investors to their clients (Solomon, 2013). In 2002, the Directors' Remuneration Report Regulations required companies to produce a remuneration report that could be voted by shareholders at AGM. This has been referred to as the "say on pay" initiative (Conyon & Sadler, 2010). In 2003, the formation of Research, Recommendations and Electronic Voting, a joint venture between NAPF and Institutional Shareholder Service, also helped to increase shareholder activism. This move aimed to provide a basis for more active shareholding via exercising voting rights. In 2004 and 2005 Myners published two reviews following the concerns that the votes were being lost due to the inefficiency of the voting system. The first Myners Report (2004) found that the use of electronic voting systems should be developed first, to improve the voting of UK shares, however, voting systems such as CRESTCo, which was introduced in 2003, has not been adopted widely. In 2005, the Myners Report focused on how the recommendations of the previous year affected the shareholder community. It was found that a significant number of share issuers facilitated electronic voting. Secondly, the Myners Report (2005) emphasised the role of pension fund trustees to perform their responsibilities to their clients by ensuring the efficient voting of shares. Another contributor to the shareholder activism through exercising voting rights in the UK was the Shareholder Rights Directive (2009) which was designed to promote shareholder rights to vote and encourage them to ask questions at shareholder meetings. These independent initiatives, from a range of institutions, demonstrated a need for higher voting levels among investors, particularly institutional investors. This demand for increased voting levels was largely predicated on the basis that institutional investors have a duty of care to act proactively towards monitoring and ratifying management decisions on how corporates are run.

i) Shareholder Voting after the Financial Crisis

The financial crisis has highlighted the importance of institutional investor voting as a monitoring mechanism to improve CG. Following the financial crisis, the Walker Review suggested that institutional investors should actively look for opportunities of collective engagement to enhance their ownership influence, exercise their voting power and disclose their voting policies and records on their website. In line with this, the Stewardship Code (2010) included voting as a central issue and required investors to have a clear policy on voting and to disclose their voting activities regularly.

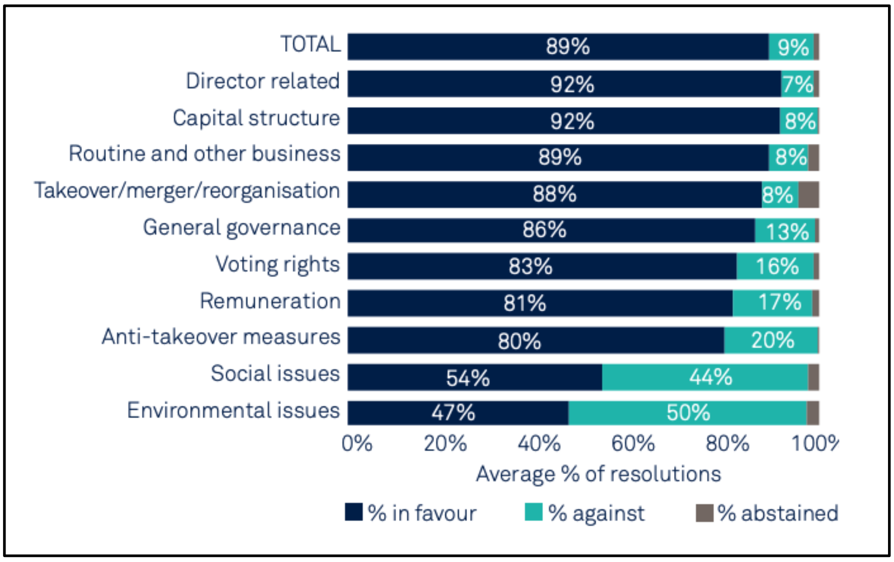
Since the publication of CG guidelines and the Stewardship Code, a considerable number of academic studies have investigated shareholder voting activities. According to Solomon and Solomon (1999) the attitude of institutional investors towards voting rights have transformed considerably, as they found that 72% of UK unit trust managers had written a voting policy for their investee corporates. Likewise, Conyon and Sadler (2010) investigated shareholders voting behaviour at a large sample of UK public firms between 2002 and 2007, and concluded that shareholders have started to use voting rights to influence the executive payments in investee corporates, although only 10% of shareholders voted against the remuneration policies proposed by investee corporates. Although the authors did not find this voting level significant, they acknowledged that 10% represented an increase in exercising voting rights. Mallin (2012) investigated the voting policies and activities of the two largest UK institutional investors (Hermes and Aviva). They found that voting level at top 250 firms had increased significantly from 35% in 1994 to 65% in 2010. Based on this sample, Mallin (2012) found that the most controversial resolutions were related to appointment or re-election of directors, Board compositions, remuneration packages, incentive schemes and strategic issues that may affect shareholder rights. FRC (2015), which investigated the effectiveness of the Stewardship Code, also announced a continued increase in voting activity of UK institutional investors. McCahery et al. (2016) reported that 53% of investors reported voting against management as an engagement measure, suggesting the use of voting rights as an effective CG mechanism. More recently FRC (2018) summarised voting where shareholders raised significant opposition to resolution at FTSE 350 AGMs from 2017 to 2018. It reported that in 2018 the number of resolutions increased by 20%, with a significant minority voting against the recommendation of the Board. This indicates a positive move towards exercising effective shareholder engagement. Furthermore, major fund managers were found to take actions to control executive payments. In 2018, the UK's fund management industry body wrote to FTSE 350 Boards warning of actions to vote against executive pay packages if the corporations failed to follow IA (investment association) new rules over remuneration (Jolly, 2018). IA rules aim to prevent companies from offering outsized pension contributions and instead to focus on linking payment to performance.

Although industry reports and guidance and academic studies found improvements in voting levels and the establishment of voting policies by institutional investors, the quality and impact of such policies on the CG of investee corporates is not clear yet. Furthermore, institutional investors do not always find it easy to exercise the voting right due to the barriers that they face. To address these issues, it is important that companies try to improve voter information, registration and voting services, by providing timely and detailed information. They can seek to eliminate barriers to voting by simplifying the voting process, providing more opportunities to vote and increasing the awareness and effectiveness of all existing voting channels, including online voting and proxy voting. The barriers towards effective engagement are discussed in section 3.1.4.

3.1.2.2 Shareholder Resolutions

Institutional investors can also engage through the formation of representative groups in order to submit resolutions to company management. Shareholder resolutions were initiated by John and Lewis Gilbert, Wilma Soss, and James Peck in the 1940s and 1950s, through attempts to promote social responsibility and corporate governance reform (Logsdon & Van Buren, 2008). Notably, these individuals did not have formal power and tried to use shareholding, networking and public attention to achieve success. During the 1970s, social activism was developed through the formation of activist groups such as the Interfaith Centre on Corporate Responsibility (ICCR), which used shareholder resolutions to make social change through changing business behaviour. Such groups could address a wide range of issues, such as environmental responsibility, human rights, diversity, tobacco, labour rights, the military, governance, corporate political action, and energy (Graves et al., 2001; Logsdon & Van Buren, 2008; Rehbein et al., 2004). Submitting shareholder resolutions is an extreme form of activism which has become increasingly popular in the UK. According to the Investment Association (IA) the highest level of voting among asset managers in 2018 was related to environmental and social issues (see Figure 3.1).

Figure 3.1 Voting by Topic for UK Companies



"Aiming for A" is an example of a UK environmental shareholder resolution requesting Oil companies to act to address the threat of climate change. It was organised by a group of investors including the UK Local Authority Pension Fund Forum, several UK and international pension funds, members of the UK Church Investors Group, and the US and Canadian faith investors. Shell, one of the targeted corporations, accepted the resolution and stated that it would provide additional reporting in 2015 as a response to the recommendations of the report. According to figure 3.1 only 7% of asset managers have voted against corporation resolutions regarding director related topics, however, this represents a 100% increase from the midpoint of the 2018 AGM season (Ker, 2018). Ker (2018) associates this increase in part to the new IA's public register which tracks shareholder dissents and includes FTSE All-Share companies that have either i) received votes of 20% or more against any resolution, or, ii) withdrew a resolution prior to their AGM.

3.1.2.3 Shareholder Dialogue

Having a purposeful dialogue between institutional investors and corporate management is a well-known type of private engagement which could be employed to exchange views and concerns on the governance of the investee corporate (Micheler, 2013b). The Stewardship Code (2010) stated that institutional investors should engage with investee corporates in a purposeful dialogue on matters such as strategy, performance and CG. Prior to the publication of the Stewardship Code, the importance of regular meetings between institutional investors and management of investee companies was raised by all important CG reports including Cadbury Report (1992), Myners Report (1995), Hampel Report (1998) and Higgs Report (2003). The Higgs Report (2003) noted that non-executive directors did not engage with their institutional investors, explaining that they rarely hear the view of major shareholders to discuss the company business with them. Furthermore, the ISC Code (2002) stressed the importance of active engagement between institutional investors and their investee companies. Based on the ISC Code, institutional investors could intervene in their investee corporates when necessary to discharge accountability to clients. Examples of intervention by investors include concerns over corporate strategy and performance, ineffective accountability controls from non-executive directors, inadequate internal control, inappropriate remuneration level, and failure to comply with the Combined Code.

Shareholder dialogue mostly happens behind the scene, and consequently raise challenges for researchers to observe or measure. Nevertheless, Goranova and Ryan (2014) believed that this type of engagement is more powerful than public engagement as directors are more reactive to private shareholder requests to prevent public embarrassment and potential reputational damage. Carleton et al. (1998a) investigated the private negotiation between TIAA, the largest US pension fund, and its targeted corporates, found the same result: that financial institutions were generally successful in reaching an agreement with the contacted corporates via private engagement. Based on the engagement correspondence between TIAA and its corporates, in 71% of the cases, the institution could reach an agreement before the TIAA's proxy resolutions. They found that insider-controlled firms were less likely to reach an agreement with TIAA before the proxy vote. It is notable that despite the emphasis on the importance of the private conversation, Carleton et al. (1998) could not confirm its effectiveness on the corporates' value in the long-term. Furthermore, McCahery et al. (2016) found that discussion with management was the most popular engagement tool among 63% of the institutional investors surveyed. They supported the view that institutional investors choose public engagement, such as shareholder proposals if their private negotiation with the corporates was unsuccessful. On the other hand, Anabtawi and Stout (2008) argued that this type of engagement could encourage the asymmetry of information between active investors and other shareholders because it is not subject to shareholder approval.

Shareholder activism has attracted academic attention since the activist shareholders have done much to challenge the corporate policies and practices. The existing empirical studies found that shareholder activism helped to reform the CG as well as promoting better performance for the firms (e.g. Brav et al., 2008; Hadani et al., 2011; Karpoff et al., 1996; Prevost & Rao, 2000; Ryan & Schneider, 2002; Smith, 1996; Strickland et al., 1996; Wahal, 1996). The next section presents a summary of empirical results over the outcome of shareholder engagement.

3.1.3 Outcome of Shareholder Engagement

According to Çelik and Isaksson (2014), being recognised as an institutional investor does not imply high-quality engagement. They explored the character and degree for ownership engagement within OECD countries and found four different degrees of engagement among institutional investors:

1. "No Engagement": investors who did not monitor their investee corporates, did not exercise their voting rights and did not engage in any dialogue with the management of investee companies. Çelik and Isaksson (2014) proposed that this is no longer common.

2. “Reactive Engagement”: investors who exercised voting rights based on predefined criteria related to proposals before the AGM. An example of this category is buying advice and voting services from external advisers such as proxy advisors for this category.
3. “Alpha Engagement”: activities to support short-term or long-term returns above the market benchmark. Hedge funds and private equity funds were given as examples. Hedge funds, holding relatively small investments, could influence their investee corporates by having the support of other investors (OECD, 2009). On the other hand, private equity firms, holding large controlling shares, could influence their investee corporates and improve their performance within a predefined period to sell their shares with profits.
4. “Inside Engagement”: investors who have controlling power over, or a significant influence via large shareholdings in, investee corporates.

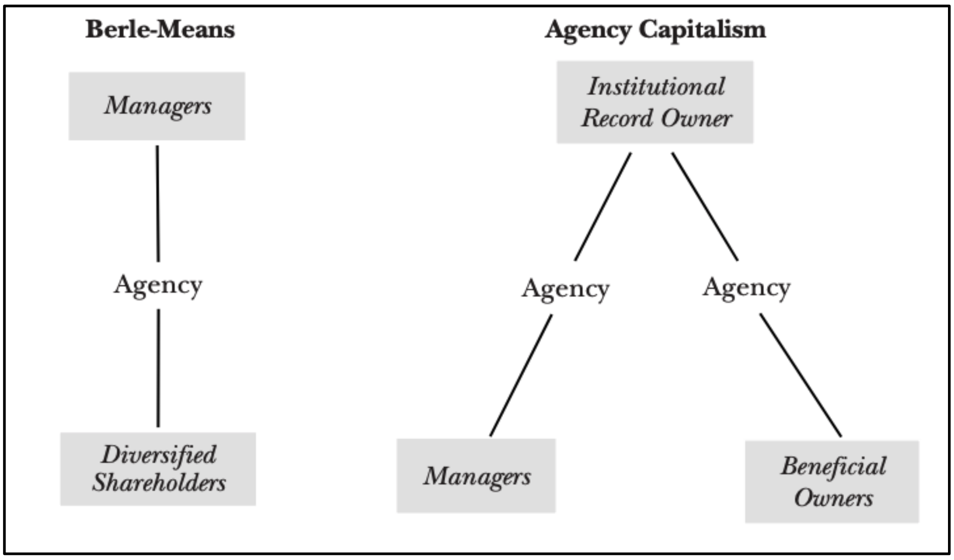
One of the potential negative impacts from institutional investors, found by Shleifer and Vishny (1997), was that large shareholders tend to represent their own interests rather than the interests of all shareholders per se. An example of this problem is the case of British Gas, where a controversial chief executive, Cedric Brown, awarded himself excessive executive remuneration which did not reflect his performance, receiving a 75% increase in salary from £270,000 to £475,000, and an annual pension of £316,000, reflecting two-thirds of his final salary. This pension increase was so large that it could not have been met by his contribution to the fund (Solomon, 2013). The term ‘fat cats’ was used to describe this incident where the directors’ remuneration package has little connection to their performance (Solomon, 2013). This incident attracted shareholder attention, and specifically, raised concern among the smaller shareholders. Although many smaller shareholders attended the AGM on 30 May 1995 to show their views and vote against the Board, the institutional investors’ votes supported the Board through proxy votes. This was seen as unfair by many of the shareholders who attended the AGM. This caused an outcry at the time as the view of the individual shareholder was overruled by proxy votes from institutional investors. In line with Shleifer and Vishny (1997), Solomon (2013) stated that in some countries, large shareholders use their control rights to redistribute wealth from other shareholders causing high costs to all shareholders. Such cases are more relevant to countries where large shareholdings are related to funding families, rather than in the UK, where large shareholdings are held by institutional investors who follow ethical codes of practices and go through substantial financial market regulations. As the awareness of the role of institutional investors in their investee corporates has been heightened and understanding their characters and responsibilities has become more important.

3.1.3.1 Agency Problems of Engagement

Agency theory is covered in detail in section 3.3. This section explores the agency problems associated with engagement. The agency problem is the result of separation of shareholders (principal) as the true owners of the business and managers (agent) who are directly involved in running the business. This agent-principal relationship can cause potential problems including the agent not acting in the best interest of the principal, the agent misusing his power or the agent taking inappropriate decisions as he has a different attitude to risk. The monitoring role of large shareholders is believed to limit these agency problems (see Admati et al., 1994; Huddart, 1993; Maug, 1998; Noe, 1997, 2002; Shleifer & Vishny, 1986). Shleifer and Vishny (1986) and Gilson and Gordon (2013), who investigated the free-rider problem, suggested that due to the size of their ownership, large shareholders have sufficient incentive to monitor their investee corporates. Institutional investors have sufficient power and influence to ensure that managers align their interests with shareholders, thereby reducing agency costs. Crespi-Cladera and Renneboog (2003) and Goergen et al. (2008), however, did not find any evidence to support the impact of institutional investors in reducing agency problems. Goergen et al. (2008) rejected the hypothesis that due to the monitoring of institutional shareholders, directors' trades would transfer less information to the market, resulting in a weaker reaction to the stock price, as they found that institutional investors did not monitor the management of investee corporates effectively and could not reduce information asymmetry between management and the market. Gilson and Gordon (2013) also found that large institutional investors, such as mutual funds, are no longer able to reduce agency problems through monitoring their investee corporates as the business model of institutional investors have created new agency problems arising from the separation of the intermediary institutions (e.g. pension funds and mutual funds) and their clients (i.e. beneficial owners). According to Gilson and

Gordon (2013), the ownership model of US public companies (agency capitalism) has changed considerably from the model discussed by Berle and Means, i.e. "*an ownership structure in which agents hold shares for beneficial owners*" which resulted in a *"double set of agency relationships: between shareholders and managers and between beneficial owners and record-holders*" (Berle & Means, 1932, p. 865). The following figure illustrates the changes from the ownership model proposed by Berle-Means to the current ownership model (i.e. agency capitalism).

Figure 3.2 Transformation of the Ownership Model



Gilson and Gordon (2013) argued that institutional investors with a complex business model are not motivated enough, nor have the right capacity to monitor investee corporates closely and concluded that limited incentives, combined with limited capacity, prevent investors from governance intervention. Instead, investors prefer to sell underperforming shares, thereby preventing institutional investors the ability to reduce agency problems through engagement. Although the main focus of Gilson and Gordon (2013) was on the US market, they believed that other countries, including the UK, could benefit from their findings in developing their CG system. In this regard, Gilson and Gordon demonstrated that regulations in some countries, including the UK, which has ignored agency capitalism, make it less likely for institutional investors to comply.

3.1.3.2 Asymmetry of Information

Asymmetry of information is a common agency theory problem. This occurs when insiders (managers and Board members) have privileged access to corporate information compared to shareholders (Goergen et al., 2008). Fidrmuc et al. (2006) proposed that insider share purchase conveys positive information about the business to the market, whereas an insider share sale conveys negative information. Fidrmuc et al. (2006) proposed that monitoring activities of major investors could reduce the asymmetry of information between management and shareholders, making directors' trading less important in signalling information to outsiders. This formed the hypotheses that "t*he announcement effect of directors' purchases and sales is weakened by the presence of an outside blockholder who monitors the firm*" (Fidrmuc et al., 2006, p.2940). Notably, this article made a distinction between shareholders who are more likely to monitor managers (e.g. corporations, individuals and families unrelated to directors) and those who are less likely to monitor managers (e.g. institutional investors). These authors found that market reaction is higher for firms with significant shareholding by institutional investors. They argued that institutional investors do not reduce information asymmetry, and associated market reaction, towards insider trading through monitoring activities because they avoid engaging in their investee corporates. This is due to fears of being accused of insider trading, which attracts a custodial sentence as the UK law prevents institutional investors from trading on private insider information.

In line with Fidrmuc et al. (2006), Goergen et al. (2008) concluded that institutional investors could not mitigate information asymmetry due to ineffective monitoring. They rejected their hypothesis, indicating that the monitoring activities of institutional shareholders were insufficient to transfer information about the firm's future to shareholders. Faccio and Lasfer (2000) and Franks et al. (2001) also found that UK institutional shareholders did not monitor their investee corporations effectively and did not reduce problems of asymmetric information. On the other hand, Çelik and Isaksson (2014), who examined how institutional investors executed their CG roles, posited that institutional investors could provide valuable information about corporates and their prospect, through an empirical overview of the relative size of different categories of institutional investors. In contrast, Çelik and Isaksson

(2014) highlighted the importance of choosing investee corporations wisely via prior analysis and subsequent monitoring to ensure the protection of their investment. According to Çelik and Isaksson (2014) investors could have a beneficial role by bringing new and unique information about their investee corporates to the economy which is gained through monitoring. This would make better use of the resources that are already allocated. It is notable that this study did not mention whether shareholders would be happy to share negative information about their investee corporates and risk the value of their shareholdings falling.

3.1.3.3 Shareholder Engagement in Corporate Governance

All major CG guidelines such as Cadbury Report (1992), Greenbury Report (1995) and Hampel Report (1998) stressed the role of institutional investors as an important CG mechanism in ensuring that corporates follow best practice. Bebchuk (2006) argued that shareholders should be given power to make an impact on CG of their investee corporates in order to benefit shareholders by reducing the agency cost, enhancing shareholder value and improving corporate performance. Lipton and Savitt (2007) criticised the Bebchuk proposal, arguing that he failed to propose a quantifiable benefit from transferring the power from managers to shareholders. They believed that Bebchuk (2006) did not address the potential negative impact from implementing his proposal, including the cost of disruption of corporate management as a result of a contested election, as well as a short-termism approach that could be followed by investors such as hedge funds. Arsalidou (2012) found that a low level of shareholder engagement in governance matters gives freedom to directors to manage the companies by using experts and without too much shareholder interference. At the same time, the low level of shareholder engagement can adversely affect the accountability of directors towards shareholders, which leads to agency problems of self-interest.

3.1.3.4 Shareholder Activism and the Performance of Investee Corporates

Many studies have attempted to address whether shareholder activism could result in higher financial performance in investee corporates (Agrawal & Knoeber, 1996; Boyson &

Mooradian, 2011; Erkens et al., 2012; Faccio & Lasfer, 2000; Mehran, 1995; Shleifer & Vishny, 1997; Strickland et al., 1996). However, the evidence is inconclusive and conflicting. While some studies found a positive impact from institutional investor engagement on financial performance, others could not find any significant link between the engagement of investors and financial performance of their investee corporates. For example, Strickland et al. (1996) reported positive abnormal returns for investee corporate as a result of the United Shareholders Association's activism between 1990 and 1993. Agrawal and Knoeber (1996) by contrast, found weak evidence to support the relationship between institutional investors engagement and better corporate financial performance. Moreover, Karpoff et al. (1996) found that shareholder activism, in the form of shareholder proposals, did not improve company value nor corporate policy.

Conversely, Faccio and Lasfer (2000) did not find evidence to support the positive impact of pension fund activism on company value or profitability. Employing a correlation matrix to determine if there was a positive relationship between firm value and ownership structure, they found a negative association and concluded that the existence of pension funds does not add value to investee corporates. They suggested that their results could be due to the fact that pension funds fail to monitor investee corporate because of monitoring costs. Faccio and Lasfer (2000) added that pension funds might refuse to intervene to avoid any public attention on their investee corporate's problems. Erkens et al. (2012) explored the impact of Board independence and institutional ownership on bank stock returns in 30 countries from January 2007 to September 2008 and found a negative relationship between the banks' stock return and having larger institutional ownership in banks during the crisis. Moreover, Erkens et al. (2012) document a positive relationship between institutional ownership and bank risk-taking at the onset of the crisis.

3.1.3.5 Return to Activist Investors

In contrast to the academic studies that investigated the outcome of shareholder activism in their investee corporates, there is small evidence on the impact of activism for the activist investors. Brav et al. (2008) are among the few studies that explored the returns to hedge fund activism. They applied a large dataset from 2001 to 2006, detailing activism by 236 hedge funds in the US. This study found that these hedge funds increasingly followed an activism approach, which they found different from other institutional investors. Hedge funds' activism brought positive abnormal returns for both shareholders in investee corporates as well as the activist hedge funds. To measure the performance of activist hedge funds, they used a capital asset pricing model (CAPM), and found that since 2003, activist funds have outperformed equity-oriented hedge funds. Their finding indicates that the way hedge funds choose investee corporates was an important factor, enhancing the financial performance of these activist funds and that hedge funds focus on value companies which are profitable but have low market value relative to book value. The majority of papers that have explored institutional investors' performance (e.g. Byström, 2011; Cuthbertson et al., 2008; Cuthbertson et al., 2016; Thomas & Tonks, 2001) do not specifically explore the impact of shareholder activism on performance.

In summary, reviewing the academic literature on institutional investor activism revealed that the main focus has been to understand the characteristics of shareholder activism such as types of activism, the motivations behind activism and the impact of activism on investee corporates. As illustrated, academics have not reached a conclusive result around the outcome of shareholder activism. Hence, the real impact of shareholder engagement remains unknown. While some studies found a positive impact from shareholder activism and required higher accountability to shareholders by managers (Bebchuk, 2005, 2007; Dimitrov & Jain, 2011), others criticised the view of corporations as a portfolio of assets to benefit the shareholders (Welker & Wood, 2011). Most of the above studies have used US data, with little exploration of UK institutional investor engagement. Solomon (2013) called for further research around the link between shareholder activism and financial performance, as without sufficient evidence it seems that it is just the assumption of supporters of shareholder activism, such as Hample Report, that institutional investor engagement in investee corporates creates higher returns, rather than a proven assertion. Notably, there is limited academic literature that has explored the outcome of activism for activist institutional investors from the perspective of the institutional investor.

The aim of the next section is to gain a better understanding of shareholder responsibilities by exploring some of the barriers which are common among investors. These barriers demotivate institutional investors to actively engage in investee corporates and therefore may help to explain the inconsistent results discussed above.

3.1.4 Barriers of Shareholder Engagement

Institutional investors do not always find it easy to exercise voting rights due to barriers that they face (Mallin, 2010). IMA (2009) found a lack of resources, the size of holding, concerns over acting in concert and being labelled insiders, differing opinions among portfolio managers and shareholders, and lack of client demand as the barriers to shareholder engagement. Some of these factors that were found in existing studies are explained in more detail below.

3.1.4.1 Size of Holdings

Micheler (2013) posited that asset owners are unlikely to engage in investee corporates or receive attention from investee corporates if they have a small investment. Micheler added that even if sufficient investment is held to approach their investee corporate, the corporation may have a weak governance structure that prevents effective shareholder engagement. For example, the person who is responsible for communicating with shareholders may not be informative about addressing investors' complaints. According to FRC (2011) the issue with the size of the investment can be overcome by collective engagement. Collective engagement requires individual investors to find other investors with the same view as well as comparing it to the opinion of other market participants, which is an intensive exercise and needs high resources. Factors that make coalitions difficult include conflict of interest, the rivalry between investors as well as different locations of investors, which makes the connection between investors a challenge (Micheler, 2013).

3.1.4.2 Risks of Insider Trading

Micheler (2013) argued that collective engagement might be difficult due to regulatory reasons such as the rules on acting in concert and being made insiders. Faccio & Lasfer (2000), Goergen & Renneboog (2001) and Stapledon (1996) all identified a link between low level of Investors' intervention and fear of becoming an insider from involvement in their investee corporate.

3.1.4.3 Intermediation of Shareholders

Increasing intermediation of shareholdings is another reason leading to a low level of engagement. Rodrigues (2011) refers to this phenomenon as a separation of ownership from ownership as asset owners, such as pension trustees, employ asset managers to make investment decisions on their behalf. It is notable that within the asset management system, there is a significant degree of separation of function (Micheler, 2013). For example, there are individuals who are involved in analysis, those who make investment decisions and those who take stewardship responsibilities. The separation of function does not lead to problems on its own, rather the individuals who are appointed for these functions raise the complications. Asset managers and investment analysts, for example, usually know more about markets without trying to understand individual investee corporates. Besides, they do not use the information available to them from those individuals who are responsible for performing stewardship responsibilities but rely heavily on quantitative data to perform their duties. Hence, asset managers with little understanding of the business they invested in would be less able to engage in investee corporates. This issue was addressed by Reisberg (2015) who stated that the separation of functions along the intermediary chain had weakened the ultimate investors' accountability towards their investee corporates.

Furthermore, asset owners usually hold shares in companies through a chain of intermediaries known as custodians. Custodians arrange engagement between investee corporates and the asset owners, such as pension funds, complicated and impossible (Micheler, 2013). Furthermore, some of these intermediaries, despite having the rights to monitor and control investee corporates on behalf of the asset owners, are not motivated to be accountable towards their investments. In line with this, Gilson and Gordon (2013) proposed that the business model of key intermediary investment institution has made them less motivated and less capable to actively engage in their investee corporates, e.g. mutual funds whose main focus is to increase assets under their management by returning a high performance of their portfolio. Instead of monitoring the business they want to invest in, these investors monitor share performance and pay high returns to attract and retain clients. Therefore, mutual funds have less incentive and capacity to monitor their investee corporates. The ownership behaviour is described as “rationally reticent”, indicating that they are willing to respond to governance proposals but not to create them (Gilson & Gordon, 2013, p.867).

3.1.4.4 Client Demand

Sometimes asset owners do not demand stewardship from their asset managers. According to Kay (2012) a lack of demand could be due to uncertain financial benefits from shareholder engagement. Although institutional investors do not need to engage in the day to day management of investee corporates, they could make an effective contribution to major investment decision making (Micheler, 2013). Furthermore, the financial crisis raised awareness of the importance of effective stewardship activities by institutional investors (Walker, 2009). Micheler (2013) found that during the financial crisis, corporates with poor governance structures failed to identify and manage risk effectively, causing widespread damage to the economy. This, he suggested, was compounded by the short-term focus of institutional investors.

3.1.4.5 Type of Investor

An index-tracking fund is a passive investor who invests in the corporates in a fixed proportion relative to their size and portion on the stock exchange i.e. they cannot choose the investee corporate in their portfolio as these are determined by the stock market listing (Fidrmuc et al., 2006). Therefore, the expectation is that passive institutional investors would be less interested in CG and the activities of investee corporates. Solomon (2013) argued that passive investors could not easily change investee corporates through the threat of divestment, as divestment is not an option. Therefore, there is a greater incentive to influence corporate management through exercising voting rights and through active dialogue. In line with Solomon, Monks (2001) also found that shareholder activism could be important for passive, index-tracking fund managers since they cannot divest their shares limiting actions to improving their investee corporates through direct activism.

3.1.4.6 Liability Structure

The choice of liability has been considered as an essential part of the business model for institutions (Çelik and Isaksson, 2014). Some institutions, such as life-insurance corporates, are experts in long-term obligations, whereas others, like mutual funds, provide undefined or short-term obligations. Çelik and Isaksson (2014) argued that long-term obligations are measurable with accuracy, enabling institutions to match their portfolio liquidity accordingly. In contrast, mutual funds, where investors could exit without any notice, required a fully liquid portfolio. They posited that the liquidity requirement could be a barrier to ownership engagement where shareholder engagement could restrict trading shares legally.

3.1.4.7 Portfolio Strategy

Çelik and Isaksson (2014) considered the number of investee corporates within the institution's portfolio as another factor that determines the quality of engagement. The degree of portfolio concentration varies among institutions: CalPERS, for example, holds shares in more than 10,000 corporates, whereas others may have very few holdings. This factor affects monitoring costs, which could limit the engagement of institutions who have a large diversified portfolio. Such institutions chose to reduce costs by buying monitoring services from consultancies which apply a predefined formula in their advice. Although a diverse portfolio could reduce the quality of engagement due to monitoring costs, a concentrated portfolio may not result in high-quality engagement (Çelik and Isaksson, 2014) as an institutional investor with a concentrated portfolio may still perform limited engagement e.g. some sovereign wealth funds.

3.1.4.8 Free rider issues

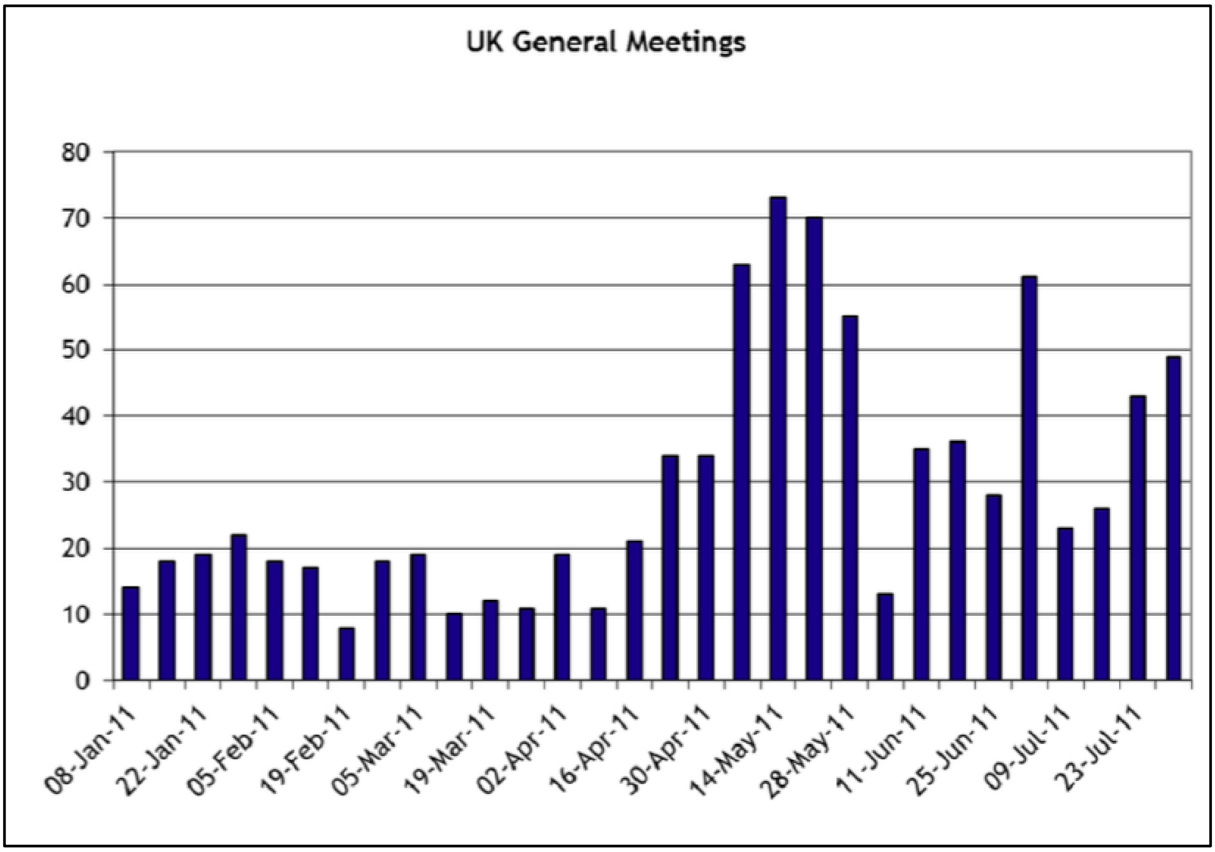
A number of studies suggested that free-riding problems demotivate shareholders from active engagement as activists shareholders bear the costs whilst others enjoy the benefits (Becht et al., 2009; Goranova & Ryan, 2014; McCahery et al., 2016; Shleifer & Vishny, 1986) McCahery et al. (2016) identified the free-rider problem as one of the main barriers institutional investors face limiting their engagement.

3.1.4.9 Cross-border Voting

In the UK, foreign investors are considered as major shareholders. Therefore, the ownership role of these shareholders cannot be ignored. Mallin (2010) recognised the following as the barriers that are involved in cross-border voting:

- Timing of the AGM; for example, in Japan the vast majority of AGMs are clustered around a few days in June, and so institutional investors have to deal with a lot of meeting notices in a short space of time. In the UK many AGMs are held from 7th to 28th of May, making it difficult for investors with large portfolios or international investors to thoroughly investigate and challenge the proposed resolutions at the meetings (FRC, 2011). The following graph was published by FRC, illustrating the timing of AGM (Source: Manifest - the proxy voting Agency).

Figure 3.3 Timing of Annual General meeting



- Translation. Mallin (2010) found that translation can act as a barrier to effective engagement among foreign shareholders.
- Availability and reliability of resolution information.
- Depositing or share blocking, which is required in some countries.
- Voting methods, for example, some countries do not allow electronic voting and investors must be physically present at the meetings to vote.
- Voting control mechanisms such as multiple voting rights.

To enhance shareholder engagement, both domestic and foreign, it is important for policymakers and corporates to address these barriers. According to the EU proposal in 2007, the only way to deal with intermediation issues is to develop regulations aimed at asset managers and ask them to publicly disclose strategy, monitoring, engagement and dialogue with investee corporates. Although academics and policymakers were successful in recognising the barriers of active engagement, the real impact of shareholder engagement remains unknown. Introduction of the Stewardship Code (2010) and its popularity among institutional investors have given new motivation to investigate the stewardship responsibilities of the institutional investors in investee corporates. The following section presents the existing academic evidence around the effectiveness of this guideline.

3.2 The Stewardship Code

Although institutional investors, as owners, are entitled to elect appropriate managers, they are not directly involved in day-to-day decision making of investee corporates. This restriction should not prevent investors from actively engaging with investee corporates, given that they are recognised as key players within CG (Monks & Minow, 2011). Published in 2010 by the FRC, the Stewardship Code sought to enhance the quality of engagement between investors and investee companies. According to the FRC, applying the Stewardship Code would benefit investors, companies and the economy as a whole. Since the publication, this guideline has been successful in attracting a significant number of signatories and inspiring other countries (e.g. Japan, South Korea and Malaysia) to publish their own stewardship guidelines. Ten years after the publication of the Stewardship Code, it is important to determine whether it has achieved its proposed aims (i.e. to enhance the quality of engagement, to benefit investors and to benefit companies). Since the publication in 2010, FRC as the responsible regulator has reviewed the application of the Stewardship Code annually. Reviewing all the available resources, the current study found very few academics which explored the Stewardship Code. A summary of the reviews of the Stewardship Code, and then a review of the limited academic literature in this area, is presented in the following sections.

3.2.1 The FRC Review

The first review of the Stewardship Code was carried out in 2011 through assessing stewardship statements and conversations with companies, investors and other interested parties, including a 'One Year On' event for signatories. The FRC was excited by the number of signatories and stated that "*the sign-up to the Stewardship Code by over 230 asset managers, asset owners and service providers in its eighteen months of life was beyond our expectations*" (FRC, 2011, p.1). On the other hand, signing up to the Stewardship Code by a large number of signatories does not imply that they followed the principles of Stewardship Code thoroughly. In line with this, the FRC emphasised that the main aim of the Stewardship Code was to help investors improve the quality of their engagement and to become a signatory is only the first step. It is notable that this review was carried out eighteen months after the publication of the Stewardship Code. Hence, the FRC could not claim that it has been successful in achieving this aim. The FRC found that the Stewardship Code was not clear on the stewardship role of asset owners. Also, some investors suggested providing a clear definition of stewardship would help to encourage better engagement in the Stewardship Code by asset owners as well as foreign investors with large shares in the UK equity market. Another issue raised in this review was the quality of stewardship reports. The FRC found while some signatories provided detailed stewardship statements, others offered general and brief reports on their stewardship statements. Therefore, the FRC encouraged signatories to review their reports annually and enhance the quality of their statements.

From 2012 to 2014, the FRC published three reviews. In each the FRC positively reacted to the number of signatories, which was increasing, but at a slower rate compared to the first twelve months. In line with the first review, the primary concern of the FRC was the quality of stewardship statements. The FRC (2012) emphasised that it was crucial for signatories to publish high-quality statements since they help companies to understand the stewardship approach taken by their major shareholders and enable potential clients in identifying managers whose approach is in line with their own. Further reviews were published by the FRC from 2011 to 2017 outlining the following characteristics of a high-quality stewardship statement:

1. A transparent report on the issues that are raised in the Stewardship Code, such as showing a willingness by signatories to act collectively with other investors, the use of proxy voting agencies and other service providers. Regarding collective engagement, the FRC expected signatories to "*explain whether they act collectively and, where they do not, explain their alternative approach*" (FRC, 2016, P.25). In addition, FRC review in 2014 stated that "*It is the responsibility of signatories to make clear the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by proxy advisers*" (p.21).
2. To clearly describe how signatories have applied the seven principles of the Stewardship Code while disclosing necessary information for each principle. For example, if an investor decides not to follow a principle, the FRC expect to see *"a proper explanation for non-compliance with a Principle of the Code provides information as to why the signatory does not comply, details their alternative approach and explains how it continues to meet the spirit of the Code*" (FRC, 2016, P.26).
3. Clear disclosure on how conflicts of interest are managed. According to the FRC (2016, P.25), institutional investors should "*describe which conflicts are relevant to them given their client base, holding structure and investment style, amongst other things, and how they would address these conflicts if they were to arise*."
4. Explain which of the funds are covered by their stewardship approach of the institutional investor.

5. Annual update of the stewardship statement.

. Despite a revision of the Stewardship Code in 2012, 20% of the signatories had not revised their statements, suggesting that they were following a “box-ticking” approach whereby signatories just signed up to the Stewardship Code to claim compliance without committing to adopt and report against its principles. In the 2015 review, the FRC reminded signatories of the main objectives of the Stewardship Code including: to help build a critical mass of investors that are willing and able to engage with investee companies; to increase the quantity and quality of engagement, and; to increase accountability down the investment chain to clients and beneficiaries.
The FRC believed that the Stewardship Code was going in the right direction, and they received encouraging news on the occurrence of more engagement between investors and companies, including an increase in voting activity of UK institutional investors. The quality of stewardship statements, however, was criticised again, stating that too many signatories do not comply with the Stewardship Code completely. Due to the low quality of stewardship reports, the FRC was cautious about claiming an improvement in the quality of engagement. The quality of stewardship statements varies. Low quality statements exist where the signatures fail to provide a thorough disclosure against each principle of the Stewardship Code. This was raised as a concern in the FRC reviews from 2011 to 2014 and in response, in 2016, it was announced that all the signatories’ statements were going to be assessed and tiered from Tier 1 (high-quality stewardship statements) to Tier 3 (low-quality stewardship statements). This tiering system aimed to “*improve the quality of reporting against the Code, encouraging more transparency in the market and maintain the credibility of the Code*” (FRC, 2015). According to the FRC website:

- Tier 1 signatories represent those “*provide good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary”*.
- Tier 2 signatories include investors who *“meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the Code”*.

- Tier 3 included signatories whose stewardship reporting *"required significant improvement"*.

The FRC stated that Tier 3 signatories who could not improve the quality of their reports would be removed from the signatory list in mid-2017. After this deadline, around 20 of the signatories of the Stewardship Code stopped implementing this guideline. And, the rest moved either to Tier 2 or Tier 1 stewardship statements. The Tier 3 category has now been removed.

The following figures show examples of the difference between the stewardship statements of Tier 1 (Brewin Dolphin) and Tier 2 (Baring Asset Management) asset managers, explaining how they followed the second principle of the Stewardship Code (i.e. managing the conflicts of interest in relation to stewardship).

Figure 3.4 Brewin Dolphin Stewardship Statement (Tier 1)

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The above figure illustrates that Brewin Dolphin fully explained how they manage conflicts of interest, by providing examples of conflict of interest situations that they previously faced, as well as details of their policy. On the other hand, Figure 3.5 shows that Baring has provided a general explanation of how they manage conflicts of interest when managing their clients' funds.

Figure 3.5 Baring Asset Management Stewardship Statement (Tier 2)

Figure 3.5 has been removed from this version of the thesis due to copyright restrictions

Based on the FRC (2018) signatories should avoid a box-ticking approach when applying the Stewardship Code. More importantly, this report addressed the change in the UK investment market where listed equities are no longer the main investment for many investors. The FRC is aware of the growing recognition of the importance of responsible investment, specifically around the environmental, social and governance (ESG) issues which cannot only improve financial performance but grant a more sustainable financial system. To address these points, the FRC issued a revised Stewardship Code for consultation on 30 January 2019, which was subsequently published in January 2020. In contrast to the 2012 version, the 2020 Stewardship Code uses different guidance for asset owners, asset managers, proxy advisors and investment consultants while emphasising the stewardship responsibilities of all key actors. Furthermore, it aims to recognise that stewardship is not only the engagement between asset managers and companies to improve corporate performance, but it also involves the responsible management of assets which would improve long-term financial returns for asset managers, asset owners, and ultimate beneficiaries. Whilst the 2020 Stewardship Code is discussed here it is important to note that this was published after the completion of this PhD research, consequently this research focuses on the 2012 Code.

In conclusion, the main focus of the FRC reviews was on the quality of stewardship statements. This resulted in developing the tiering system where the investors categorised into Tier 1, 2 and 3, based on the quality of their stewardship statements. In all of the FRC reviews, more engagement between signatories of the Stewardship Code and companies was highlighted. Despite this, considering low-quality stewardship statements, the FRC could not translate the increase in the number of engagements into a better quality engagement. The first finding after reviewing the FRC reports was that the Stewardship Code has been successful in attracting a significant number of signatories to sign up to this guideline. The second finding was that the FRC raised concern over the quality of stewardship statements in all of its reviews, making it hard to believe that application of the Stewardship Code could enhance the quality of engagement between investors and companies.

The FRC's review to explore the success of the Stewardship Code is a useful source of information, however it should be noted that the FRC, as a responsible body which developed this guideline could be biased in its review. Furthermore, the process of the FRC's selection of individuals who were surveyed about the Stewardship Code is not clearly explained in the reviews. This would make it difficult to validate the reviews' findings. Therefore, it is essential to look at some independent resources before concluding the success or failure of the Stewardship Code. The next section summarises the existing academic studies which investigated this.

3.2.2 Academic Perspectives on the Stewardship Code

Arsalidou (2012) noted that since the publication of the Stewardship Code in 2010, many investors have welcomed this development and more than 282 asset managers, asset owners and service providers have signed up to the Stewardship Code. The supporters of the Stewardship Code believe that it will bring the so-called “ownerless” corporation to the top of the agenda, promoting active owner participation. Only a small number of key studies were found which investigated the Stewardship Code. The following table summarises the most relevant papers which are published in CG, Law and Accounting journals.

Table 3.1 Summary of Key Academic Reviews of the Stewardship Code in chronological order

Author(s)	Aim	Findings
Cheffins (2010)	Determine the impact of the Stewardship Code on passive behaviour of shareholders.	Doubted any significant transformation in the engagement behaviour of institutional investors through the application of the Code.
Roach (2011)	Explore the origin and scope of the Stewardship Code as well as discussing its content.	Despite recognition of the Stewardship Code as an important guideline, the author doubted a significant impact from its application on shareholder engagement.
Arsalidou (2012)	Exploring whether the publication of the Code helps to develop a systematic and continuous relationship between institutional shareholders and managers.	Doubted the success of the Stewardship Code to achieve its proposed aims, specifically to enhance the quality of engagement between investors and companies.
Tilba and McNulty (2013)	Investigate how the practice of pension fund management informs the ownership behaviour of pension funds regarding investee corporations.	Raised concern over the success of the Stewardship Code to achieve its proposed aims.
Micheler (2013)	Examines the idea that the creation of an online review facility where all market participants are able to review and rate all companies listed in a particular market would encourage better engagement from the shareholders.	Institutional investors cannot fully commit to the Stewardship Code, affecting the success of the Stewardship Code in enhancing the engagement between shareholders and their investee corporates.
Sergakis (2013)	This paper aims to analyse the benefits of the Stewardship Code and to address remaining problematic issues. The author proposes that the findings of this study will help the UK regulatory framework achieve optimal impact on the market.	Doubted an effective practice of stewardship responsibilities by institutional investors due to the structure of the investment chain. It is not practical for all market participants to exercise stewardship due to the considerable distance between investee corporates and investors.
Reisberg (2015)	Explore the success or failure of the Stewardship Code by reconsidering arguments about the conceptual problems with this Code (i.e. how it is drafted and upon what it focuses).	Stewardship Code has achieved very little of its proposed objectives since the publication. The author doubted the effectiveness of the Code to enhance the quality of engagement, changing the attitude of companies towards their investors as well as helping the investors to provide a high-quality stewardship statement.

Lu et al. (2018)	Examined whether compliance by institutional investors with UK Stewardship Code is related to the earnings quality of their investee companies.	The authors did not find any direct effect between Code compliance and earnings quality. Based on their findings, this study proposed that the Stewardship Code in its current form is unlikely to have a significant impact on institutional investors' CG.

Very shortly after the publication of the Code in 2010, Cheffins (2010) tried to find the answer for the following question: *"Will the launch of the Stewardship Code disrupt the traditional pattern of passivity and foster substantial shareholder involvement in UK corporate governance?".* Cheffins (2010) argued that any significant transformation in the engagement behaviour of institutional investors through the application of the Stewardship Code is unlikely. The author described the factors that discourage institutional shareholders from engaging in activism including a lack of expertise by shareholders, preference of asset managers to act as traders rather than owners to retain the value for their clients and the free-rider problem where passive shareholders receive the same returns as active shareholders. Cheffins stated that the publication of the Stewardship Code suggested by the Walker Review could reduce the power of these factors and encourage activism among institutional investors. On the other hand, he explained that the share ownership of UK publicly funded companies is a major obstacle to achieve this goal. Cheffins (2010) argued that over the past 20 years, there had been a change in ownership from UK-based fund managers, pension funds and insurance companies to foreign shareholders. This is problematic for the Stewardship Code as foreign shareholders are not its primary intended audience. In addition to the above conclusion, the author emphasised that previous studies failed to find a significant relationship between shareholder activism and improvement in the long-term operating performance of their investee corporates.

Moreover, during the financial crisis, institutional investors were part of the problem by being "relaxed" when the banks used leverage to generate high returns for them, placing short term gains ahead of long-term sustainability and stability. Therefore, policymakers should not assume that shareholder activism is necessarily a good thing, suggesting arguments against a change from a voluntary approach to mandatory regulation to increase shareholder activism. It is notable that Cheffin's study was conducted very shortly after the publication of the Stewardship Code in 2010. Therefore, the author could not explore the application of this guideline through reviewing stewardship reports. Instead, to generate the conclusion, he reviewedCG developments in the UK by referring to the published reports (e.g. Cadbury Report, Hampel Report and Combined Code). Then, Cheffin examined the potential impact of the Stewardship Code by reviewing the existing resources including reports by relevant associations such as NAPF (2009), IMA (2009), ISC (2009) and FRC (2010).

In line with Cheffins (2010), Arsalidou (2012) also doubted the success of the Stewardship Code to achieve its proposed aims, specifically to enhance the quality of engagement between investors and companies. The first issue mentioned is that the Stewardship Code included short-term institutional investors as part of the solution to improve engagement, whereas they were part of the problem during the financial crisis. Then, it is argued that in a perfect world, institutional investors would engage effectively with management, but in reality, managers and shareholders in large companies exist separately. In addition, Arsalidou doubted whether institutional investors are interested in having a conversation with management. Investors believe that the Board are the true stewards of the company and shareholders do not have the knowledge or interest to direct investee companies' matters. Also, opportunity costs discourage investors from gathering information for monitoring management, and it is not clear whether the benefit of monitoring is greater than its associated costs. More importantly, he proposed that stewardship is not a priority for the investors, and pressure to sign up for the Stewardship Code may result in a "box-ticking" exercise rather than encouraging more efficient stewards. The box-ticking approach was also raised as a concern by FRC (2014), as aforementioned, as it received reports that accused proxy advisors of following "box-ticking" without any effective corporate engagement.

Furthermore, Arsalidou (2012) argued that firms do not use the comply or explain model effectively to adjust their governance to changing circumstances and instead focus simply on the choice of whether or not to comply. Finally, Arsalidou (2012) argued that the domestic focus of the Stewardship Code is a major limitation given the increase in the number of foreign investors. It is notable that the FRC recognised that this issue would create a challenge for enhancing the engagement of investors through the application of the Stewardship Code. Lack of expertise, cost of engagement and domestic focus of the Stewardship Code were also raised by Cheffins (2010) as reasons that could lead to the failure of the Stewardship Code to fulfil its aims. One of the important discussions by

Arsalidou (2012) was the proposition that the UK CG Code reduces the importance of the Stewardship Code as it provides more practical approaches for the investors' engagement. For example, to enhance the accountability of directors, UK CG Code recommends that all directors of FTSE 350 companies should face annual re-election. Arsalidou (2012) explained the annual re-election makes the directors vulnerable to shareholder dissatisfaction and forces companies to listen to shareholders. This method is considered as a practical and useful alternative to the stewardship duties presented by the Stewardship Code. In addition, the latest version of the CG Code (2018) emphasised the establishment of effective engagement between the Board of Directors and shareholders. To support this principle, the CG Code stated that if the Board receives a significant level (20% or more) of votes against its resolution, the company should explain how it will consult shareholders to address their concerns, as well as providing a summary of this event in its annual report. Finally, Arsalidou (2012) argued that there are more logical alternatives to company democracy and investor engagement than the generalist duties of the Stewardship Code. The recognition of two-tier share ownership with greater voting rights given to longstanding institutional investors, the improvement of shareholder remedies and the annual re-election of all directors of FTSE 350 companies as recommended by the UK CG Code 2010, are some possible alternatives. In agreement with Cheffins (2010), Arsalidou also provided a discussion around the effectiveness of the Stewardship Code using the existing evidence. This article was published in 2012, enabling the author to bring more insight into the debate by reviewing the stewardship statements and including the opinions of the signatories of the Stewardship Code.

In line with these studies, Tilba and McNulty (2013) also raised concern over the success of the Stewardship Code to achieve its proposed aims, albeit that the main focus of this study was not exploring the Stewardship Code per se but to investigate how the practice of pension fund management informs the ownership behaviour of pension funds regarding investee corporations. After conducting interviews with pension fund trustees, executives, investment officers and financial intermediaries, together with documentary analysis and observations of four fund investment meetings, Tilba and McNulty found a significant gap between the expectations of the Stewardship Code and the actual exercise of stewardship responsibilities by pension funds. They found that pension funds do not act as effective stewards in their investee corporates due to lack of expertise, skills and resources. This finding is in line with Arsalidou (2012) and Cheffins (2010) who included lack of expertise as a barrier towards the success of the Stewardship Code. Moreover, Tilba and McNulty (2013) proposed that pension funds operate at a distance to their corporates, motivating them to build a stronger, closer relationship with their asset managers instead of the corporates. This finding indicated that in contrast to the expectation of the FRC, the majority of pension funds would not be able, or motivated, to comply with the guidelines of the Stewardship Code. Tilba and McNulty (2013) suggested that to increase engagement of pension funds in investee corporates and comply with the guidelines, policymakers should consider the relationship between pension funds and other agents as well as complexity within the investment chain.

Micheler (2013) proposed findings in line with these studies, but also raised the issue of the lack of a monitoring body to evaluate investor commitment to responsible engagement. Micheler (2013) also found the ‘comply or explain’ approach ineffective to illustrate the full commitment of the signatories, suggesting setting up an internet-based review and rating system to facilitate shareholder engagement instead.

More recently, Reisberg (2015) proposed that the Stewardship Code has achieved very little of its proposed objectives since publication. It was criticised for being an ineffective CG tool due to its lack of enforceability, triviality, its non-progressive nature, and unresponsiveness. Reisberg also questioned the effectiveness of the Stewardship Code to enhance the quality of engagement, changing the attitude of companies towards their investors as well as helping investors to provide high-quality stewardship statements. The author argued that despite the positive reports of the FRC’s reviews, the Stewardship Code has not been successful in enhancing the quality of engagement between investors and companies and consequently challenged the quality of the stewardship activities by the signatories on two counts. Firstly, that compliance of institutional investors could be based on a fear of the alternative representing a “*regulation-based approach which is seen as carrying with it the loss of rights*” (p.7), and secondly, that criticism had been deflected because signing up to the Stewardship Code was seen as a trendy activity. Consequently, the evidence that this guideline has been successful in attracting a significant number of signatories (300 as of October 2013), did not demonstrate commitment of signatories to the principles of the Code per se. Furthermore, Reisberge proposed that the Stewardship Code has not changed the attitude of companies towards their investors. According to DBIS report (2010) some investors felt that their investee corporates did not take engagement seriously. In line with this, FRC (2011) found mixed results with some companies following a more active approach to engage with their major shareholders, others were found less responsive towards shareholder votes. Reisberg (2015) concluded that the Stewardship Code did not have a positive impact on the quality of disclosures made by institutional investors. FRC (2013) had, however, admitted that many statements provided little insight into stewardship practices. Reisberg (2015) blamed the limitation of the comply or explain approach. This does not allow investors to reflect on their true engagement activities, as some signatories follow a box-ticking approach, which negatively affects the quality of stewardship statements. Reisberg (2015) proposed that although, in theory, it is sensible for investors to engage in investee corporates to enhance performance, in reality, investors are more likely to sell their under-performance shares instead of exercising stewardship responsibilities. According to Reisberge (2015), the Stewardship Code has not been successful in encouraging investors to actively engage in their investee corporates. The following reasons were given to explain the failure of the Stewardship Code:

- After the financial crisis, the FRC rushed to publish the Stewardship Code and included the principles without testing them first, to be seen to be doing something.
- A lack of a clear definition of stewardship confused the signatories about what is expected from them. This issue should have been addressed in the 2012 revisions but the FRC has missed this chance to develop thoughtful principles that could change shareholder behaviour in the long run.
- Shareholders do not have enough incentive to act as stewards in investee corporates. According to Reisberg (2015), the engagement costs and difficulties of determining the value and outcome of engagement initially demotivates shareholders to engage. To further explain this factor, he argued that within the diverse and modern UK share ownership structure, agents hold shares for the benefit of owners who are not considered in the Stewardship Code.
- In line with the previous articles, Reisberg highlighted that the Stewardship Code overlooked non-UK investors, despite being regarded as a dominant UK shareholder group. He emphasised that the need for foreign investors to buy into a Stewardship Code is critical, and, indeed, the FRC has acknowledged this.

In summary, all the academics that exclusively investigated the Stewardship Code doubted its success in achieving the proposed aims, including enhancing the quality of engagement between investors and companies. The most cited reasons included a lack of shareholder incentive to engage in investee corporates due to engagement cost, the free-rider problem and the unknown outcome of the engagement. These studies collectively argued that publication of the Stewardship Code could not resolve these issues. Moreover, existing studies criticised the Stewardship Code for not considering the shift in the ownership pattern from domestic to foreign investors. Therefore, the existing studies concluded that transforming the passive behaviour of shareholders by applying the Stewardship Code is not very likely.

It is notable that all of the above studies applied existing arguments and evidence to find the significant obstacles leading to failure of the Stewardship Code in achieving its proposed aims. Therefore, these findings are not driven based on the stewardship activities or the opinions of the signatories of the Stewardship Code. One reason behind this approach could be the age of the Stewardship Code, being a relatively young guideline. Hence the previous studies did not have access to adequate evidence, such as the stewardship statements, to form sound conclusions. Given it is now 10 years after the publication of the Stewardship Code it is crucial to determine its success to enhance the quality of engagement between investors and companies. Although the FRC sounded positive in its reviews and believed that the Stewardship Code is going in the right direction, academics have doubted its effectiveness. Therefore, this PhD study aims to close the existing research gap by investigating the stewardship activities of the signatories through a review of stewardship statements and seeking the opinion of signatories in the determination of the impact of applying the Stewardship Code for asset managers as the main signatories of this guideline.

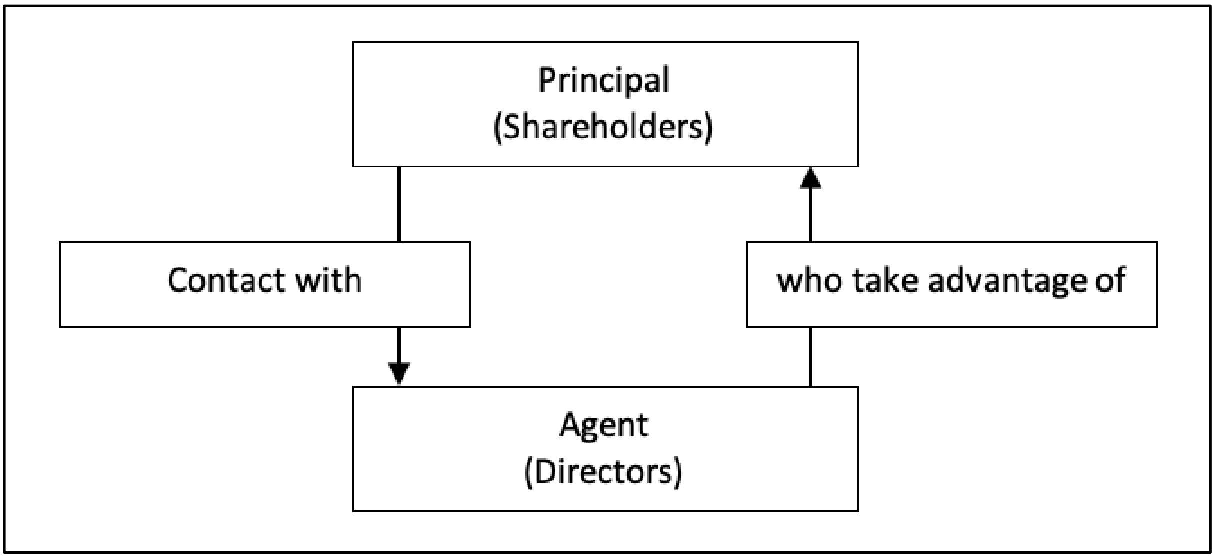
3.3 Theoretical Review

The range of definitions existing to describe CG illustrates the scale and scope of published papers, which has grown considerably over the years since the 1990s. Academic journals are applying CG related topics across a range of fields including economics, accounting, law and management. Despite this growth, existing papers have failed to propose a widely accepted theory that would help to explain the mechanism of CG and how they work. The following sections outline the main theories used to explain the role of shareholders within CG. These are agency theory, transaction cost economics, stakeholder theory (including enlightened stakeholder theory) and stewardship theory.

3.3.1 Agency theory

In the UK and USA, shareholders provide capital to allow a business to develop and, therefore, collectively own its assets while transferring the duty of running the company to managers and other employees within the business. Therefore, the market structure leads to a separation between ownership and control. Solomon (2013) argued that this can lead managers to make decisions that may not be in the best interests of shareholders, as the agent-principal relationship provides an opportunity for the managers to misuse their power and take inappropriate risks. The figure 3.6 illustrates this relationship.

Figure 3.6 Agent-Principal Relationship



Mallin (2010) recognised that agent-principal relationships can also be negatively affected by information asymmetry. Although shareholders own companies, directors have access to more information since they are involved in the day-to-day running of the business, leaving the principal at a disadvantage. This delegation of duties from shareholders (principals) to

managers (agents) can result in agency problems (Mallin, 2010) raising the question of "How can shareholders ensure that managers will act only in their interests?" Since the mid-19th century and after growing in the number and diversity of shareholders, the agency problem has increased in complexity. Agency theory has been applied to explain how CG mechanisms can help overcome agency problems (Eisenhardt, 1989). This theory assumes that a manager's interest is to maximise their own benefit while ignoring the shareholder interests. The main reason behind this self-interest behaviour is that managers are not the owner of the business, which could demotivate them to deliver their responsibilities efficiently (Carney et al., 2011). An example of such behaviour can be found in the Lehman Brothers scandal. Lehman was a 158 years old firm which filed for bankruptcy in 2008 after losing most of its clients, dramatic losses in its stock and lack of liquid assets. A major reason behind the collapse of Lehmans related to the agency problem as executives followed their own interests rather than shareholders (Kim, 2016). Among the factors that led to this failure was that executives did not own a considerable number of shares and they were offered inappropriate executive pay arrangements, encouraging them to make high-risk decisions that would primarily benefit themselves (Kim, 2016). Bebchuk et al. (2010) investigated executive compensation at Bear Stearns and Lehman Brothers and estimated that the top five executive teams at Lehman earned a total amount of $1 billion during the 2000-2008, which was significantly higher during this period and excessive compared to shareholder returns. This finding indicates that managers should not be assumed to act according to shareholder interests, and their decision making may only benefit themselves rather than the owners of companies. Hence, it is important to monitor managers as well as implementing a relevant payment system to prevent such a crisis in the future.
Proponents of agency theory view shareholders as an important CG mechanism to reduce agency problems by closely monitoring manager actions (Shleifer and Vishny, 1997; Zeckhauser and Pound, 1990). This increases accountability, helping managers to align their interests with shareholders (Burkart et al., 1997; Mallin, 2010). Shareholders incur monitoring costs (i.e. time and money) which include the cost of monitoring, costs of evaluating managerial performance (Panda & Leepsa, 2017), the cost of appointing and maintaining Boards, the cost of recruiting executives and the cost of training them. Monitoring costs are initially incurred by shareholders, but later on, managers should pay since they are compensated to cover these expenses (Fama & Jensen, 1983). Therefore,

costs act as a barrier to monitoring. Institutional investors, however, as the major shareholders are expected to have the incentive to monitor investee corporates to protect and enhance the value of their investments (Shleifer & Vishny, 1986).

Solomon (2013) recognised direct monitoring methods which can be practised by shareholders. The first direct monitoring method is exercising voting rights at AGMs. According to Solomon (2013), voting rights are valuable financial assets for shareholders, helping them to influence investee corporates, such as voting on the composition of the Board of Directors. Shareholders can also directly monitor managers through the takeover mechanism. Solomon explained that the threat of takeover when the shareholders are not happy with a management structure is a powerful tool to control managers since they do not want to lose their jobs. Another monitoring method is through one-to-one meetings between the investors' representative and a manager. Solomon (2013) proposed that such meetings have become more popular among shareholders, helping them to influence investee corporates significantly. Alternatively, shareholders can encourage the alignment of interest through bonding, for example by imposing incentive schemes via remuneration contracts and debt covenants. Finally, Solomon (2013) added that if monitoring mechanisms do not effectively control managers to increase their accountability, the government needs to intervene by producing regulation or formal guidance. The example of such intervention can be found in several voluntary codes of practice and policy documents in the UK (e.g. Cadbury Code and Greenbury Code).

Agency theory has been widely applied by CG researchers, specifically, those that investigate shareholder activism (Faccio & Lasfer, 2000; Gillan & Starks, 2003; Judge et al., 2010). Gillan and Starks (2003), for example, explored the role of institutional investors in financial markets and the CG of investee corporates by reviewing academic papers. They proposed that institutional investors play a central role in encouraging change in many CG systems, such as encouraging Board independence. The authors illustrated the difficulty in measuring the effectiveness of shareholder activism as most engagement occurs behind the scene. They concluded that empirical evidence of the influence of shareholder activism is diverse. Although studies have found some change in real activities of investee corporates, they found it difficult to confirm a causal relationship between shareholder activism and these changes (Gillan & Starks, 2003).

Judge et al. (2010) applied agency theory to further explore motivations behind shareholders activism, categorised into financial motivation and social motivation. Socially motivated reasons for engagement included shareholder concerns over the natural environment and employee welfare. Financial motivation involves shareholders concern for management decision making, dividend payments or remuneration policies. Judge et al. (2010) used agency theory to explain financial motivation of shareholder activism across six economies (Australia, Germany, Japan, South Korea, UK, USA). They predicted that prior profitability of investee corporates would be negatively related to financially driven shareholder activism. In other words, when the investee corporates are profitable, shareholders are less financially motivated to engage in investee corporates. They proposed that firms with more concentrated ownership are less likely to be associated with financially driven activism as concentrated ownership would motivate and enable close monitoring of managers due to the ability of institutional investors to bear activism costs compared to individual investors. In line with their predictions, their findings indicated that agency theory fitted sufficiently to explain the financial motivation behind shareholder activism.
Hendry et al. (2007) conducted a series of in-depth interviews with UK asset managers to explore institutional investor engagement. Although they did not directly apply agency, they found evidence suggesting that shareholder monitoring will help to align the interests of owners with managers. One of their participants stated that:

"When executives know that they have a few large shareholders who are constantly monitoring their moves, they will be very careful" (Hendry et al., 2007, p.232).

Agency theory remains a relevant theory to explain the mechanisms of CG. Rashid (2015), for example, examined the influence of Board independence on firm agency cost among listed firms in Bangladesh. This study included agency costs as the dependent variable and Board independence, Board size, frequency of Board meetings and, CEO duality, as the independent variable. The results indicated that the Board appointed by institutional investors to monitor managers can play an important role to control management actions, reduce agency costs and add shareholder value. After revisiting agency theory, Rashid (2015) concluded that agency theory is still valid to explain the role of outside independent directors as a helpful mechanism to monitor managers.

In line with Rashid, Yegon et al. (2014) found a positive influence from CG mechanisms on reducing agency costs of service firms listed in the Nairobi Securities Exchange during the period 2008-2012. Agency costs were considered the dependent variable, measured by the asset utilisation ratio (i.e. total revenue divided by total assets), with various explanatory governance variables, such as director ownership, external ownership, and institutional ownership, as independent variables. According to Yegon et al. (2014), higher institutional ownership reduced agency costs, and that institutional investors have helped investee corporates to make optimal and productive investment decisions.
On the other hand, Tilba and McNulty (2013) found little evidence to support agency theory. These authors explored the ownership behaviour of pension funds using in-depth semi-structured interviews with pension fund trustees, executives, investment offices and financial intermediaries, and observations of four fund investment meetings and document analysis, making their findings valid and reliable. They proposed that pension funds do not consider themselves as principals to actively engage in investee corporates. In fact, the vast majority of their participants acted at a distance from investee corporates and followed "exit" ownership behaviours, whereby investors divest if dissatisfied with management performance. Only a small number of well-resourced pension fund managers were actively engaged in investee corporates. Tilba and McNulty (2013) suggested a complex relationship within the investment chain of pension funds as one of the reasons behind the adoption of "exit behaviour" as pension funds often rely on external experts to manage their investments, making them more likely to emphasise share performance over sound CG. Consequently, within the investment chain, the primary role of trustees is to decide on investment strategy, which is transferred to external experts, including investment consultants and fund managers. Nevertheless, the trustees remain accountable for poor investment strategies. Although external experts are a very powerful part of the investment chain, they hold little responsibility for the outcomes of the actions they followed on behalf of the trustees. The authors proposed that in practice, the main interests of trustees are to enhance the performance of their investment portfolio in general, regardless of the performance of individual shares. Consequently, multiple actors within the investment chain reduce the explanatory power of agency theory with regards to the ownership behaviour of investors in investee corporates. The findings of Tilba and McNulty (2013) are in line with

Davis (2008, 2009) and Jackson (2008), who argued that institutional investors do not act as responsible owners.

Based on the above studies, agency theory has allowed the researchers to explore different CG mechanisms, including shareholder engagement. The popularity of agency theory is in part because it focuses on the relationship between shareholders and Boards, which removes the necessity for researchers to access the Boardroom directly, enabling research based on secondary publicly available data such as directors' reports and company accounts. Tricker (2015) concluded that, because of the simplicity of this theory and the availability of reliable data, it creates a powerful approach to understand CG mechanisms. Consequently, many authors (e.g. Clarke & Branson, 2012; Daily et al., 2003; Eisenhardt, 1989; Shleifer & Vishny, 1997; Tricker, 2015) highlighted its limitations, which are presented as follows:

- To study CG in detail, it is naive to only focus on the relationship between agents and principals (e.g. Tilba & McNulty, 2013).
- Shareholders act to increase their return, with a limited role within the firm. The director's role is limited to monitor managers.
- In practice, the shareholder/director agency model is too simplistic to reflect reality. Institutional investors such as pension funds and hedge funds can act as traders rather than long-term investors perceived by agency theory. Monks and Sykes (2002) argued that although institutional investors are major shareholders, for many years they have preferred to act as absentee landlords who are not interested in engaging in investee corporates. They argued that this passive behaviour had caused loss of millions of pounds for ultimate beneficiaries of pension schemes.
- Agency theory assumes that people are self-interested and unable to look after the interests of others. This is based on a questionable conjectural morality that people cannot be trusted and act in the interest of others. Hence, this theory considers managers as opportunistic and ignores their human capabilities.
- Agency theory focuses only on a few stakeholders and treats shareholders as the centre of attention. Despite this, in reality, legal rules of CG rarely allow control by shareholders over corporate policies. Therefore, shareholders have to appoint the Board of Directors to monitor managers. This delegation of duties from the owners

to directors to control decision-making of managers provides very little opportunity for shareholders to engage in investee corporates.

Since the application of the agency theory by Berle and Means (1932) this theory has been popular among researchers. At the same time, it has been criticised for using an excessively narrow vision to explain CG (e.g. Eisenhardt, 1989; Hirsch & Friedman, 1986; Nyberg et al., 2010; Perrow, 1986). For example, in the UK, foreign investors became the major shareholders in UK listed companies, making the distance between owners and managers more considerable, negatively affecting the quantity and quality of shareholder engagement and its impact on reducing agency problems. Therefore, it is not clear how institutional investors are able, and willing, to follow an active ownership attitude to reduce the agency problems in investee corporates. CG mechanisms are indeed much more complex compared to the 19th century when agency theory was first applied, reducing the predictive power of agency theory. Nevertheless, agency theory is still considered as a valid theory helping to simplify the governance system of companies. Specifically, this theory is helpful to explore institutional investors and their role within investee corporates. In addition, the application of agency theory has helped to develop alternative theories to address its shortcomings. These theories are explained in the following sections.

3.3.2 Transaction Cost Economics Theory

Transaction cost economics (TCE) theory is defined as "*an interdisciplinary alliance of law, economics and organisation*" (Williamson, 1996). Originally TCE theory aimed to explore the scale and scope of firms, more specifically to determine why economic activities are coordinated through firms rather than through market contracts (Coase, 1937; Shelanski & Klein, 1995). This theory was initiated by Coase (1937), who proposed if a firm internalised its transactions, it could save costs. The first reason behind this argument is that internalisation removes risks and uncertainties about future prices and the quality of products. The second reason is that it helps to remove information asymmetries and reduces business risk and so there are economic benefits for companies to undertake transactions themselves (Solomon, 2013). On the other hand, as companies grow, more transactions are committed to the point of expansion at which it would be cheaper to undertake the transactions externally (Coase, 1937). Based on this argument, companies may become less efficient as they expand. According to Tricker (2015), TCE theory focuses on the enforcement costs such as internal and external audit controls, having independent outside directors on Boards, the separation of the roles of Chairman and CEO and the addition of risk analysis procedures. These costs should occur to the point that the increase in costs equals the reduction of the potential loss from non-compliance.

TCE theory considers managers behaviour to be characterised as "bounded rationality" (Solomon, 2013). This is the first assumption of this theory, indicating that human behaviour is limitedly rational due to the cognitive limitation of mind, lack of available time to make decisions and challenging problems to solve. Proponents of this theory also consider managers to be opportunistic by nature, at least some of the time. In line with this Mallin (2010) proposed that managers' behaviour is bounded rationality since they have a tendency to follow personal interests rather than profit maximisation. Opportunism is the second assumption, which has been defined as the tendency of agents to take advantage of all the available opportunities to reach their own interests (Crozier, 1964). Based on these two assumptions, managers organise transactions in their own interest; hence, their actions need to be controlled.

It was after the publication by Williamson (1975) that other empirical studies began to apply TCE in different disciplines including economics, sociology, organisation theory, law, corporate finance and marketing (e.g. Clegg et al., 1996; Granovetter, 1985; Moe 1991; Palay, 1984; Rindfleisch & Heide, 1997). Rindfleisch and Heide (1997), through a thorough review of published academic studies, argued that transaction cost analysis is not very well integrated as studies mainly considered a governance problem as the independent variable and the governance mechanisms as the dependent variable in analysis. Monitoring is one such mechanism analysed through TCE theory (e.g. Anderson & Weitz, 1992; Parkhe, 1993; Stump & Heide, 1996), for example partner selection and incentives used by buyers to safeguard their assets (Stump & Heide, 1996).

Despite its popularity TCE theory has been widely criticised over its assumptions of bounded rationality and opportunism (Argyres & Liebeskind, 1999; Argyres & Mayer, 2007; Dore, 1983; Dow, 1987; Granovetter, 1985; Perrow, 1986; Simon, 1991). For example, Dow (1987) argued that it is inconsistent to bring bounded rationality as an essential assumption in the analysis of contracts and governance structures, and then assume that substantively rational choices can be made with respect to the contracts and governance structures. Also, the relevance of opportunism was criticised by Foss and Klein (2010) who stated that there are few chances that opportunistic action can be observed, thereby reducing the reliability of TCE to explain CG in practice. Moreover, Ghoshal and Moran (1996), who reviewed TCE theory by mainly focusing on Williamson's TCE publications (1975, 1987, 1991), argued that bounded rationality and opportunism are not only wrong, but dangerous assumptions for corporate managers to follow. According to TCE theory, organisations exist because of their ability to reduce the opportunistic behaviour of humans through hierarchical controls that are not available in the market. By contrast, Ghoshal and Moran (1996) proposed that such controls are not a guarantee to resolve such issues, and instead, they could encourage opportunism within organisations. The authors explained that imposing hierarchical controls in organisations can adversely affect both the controller (i.e. manager) and the controllee (i.e. employee). Previous studies showed that use of such controls could lead to managerial distrust of employees and increase the imposition of further organisational controls (Galinsky et al., 2003; Kipnis, 1972). Kipnis (1972) found that managers who were given the power to control their employees valued the performance of the employees less and linked the employee's efforts to their own control rather than the motivation of the employees. On the other hand, employees who were being controlled might feel that they are not being trusted to behave appropriately without the controls of managers. This could make the employees demotivated and less committed to performing their duties effectively (Arnaud & Chandon, 2013; Baker et al., 1988; Enzle & Anderson, 1993). Based on these arguments, controlling opportunistic behaviour is very difficult within the organisation even through hierarchical controls. This conclusion challenges the TCE theory proposition that organisations exist due to their ability in controlling human opportunistic behaviour. Ghoshal and Moran instead declared that the organisation exists in the market because *"they are able to achieve efficiency and facilitate adaptation in different ways, following different institutional logics*" (p.32). They argued that TCE theory is bad for practice since it has not recognised the purpose of organisations correctly and called for building a different theory that acknowledges the reality of organisations.

In conclusion, TCE is closely related to agency theory, as both are based on economic rationalism. Both theories present a rationale for controlling managers by the shareholder but mainly used different terminology. While TCE assumes people are opportunistic, agency theory focuses on the consequence of this opportunistic behaviour (agency cost). Likewise, TCE focuses on transactions to analyse CG issues, whereas agency theory places the emphasis on agents. Furthermore, TCE assumes that humans are self-interested and unable to care for the interest of others; an assumption has already been questioned and considered as one of the weaknesses of agency theory. This overlap makes it difficult to find a considerable difference for CG studies and restricts its ability to resolve the weaknesses of agency theory.

3.3.3 Stakeholder Theory

In contrast to Agency theory, Stakeholder theory takes into account the interests of wider stakeholder groups affected by company decisions (Freeman, 1984). Solomon (2013) stated that corporate stakeholders could be defined in different ways depending on the user's perspective. She included shareholders, employees, suppliers, customers, creditors, communities near the company's operations and the general public. Freeman (1984) is credited with developing stakeholder theory as a strategic theory of the firm. This theory assumes that managers and directors are interested in the firms' long-term success (Mallin, 2004). In fact, over time, managers see the company as an extension of themselves, encouraging them to follow optimal decisions to run a sustainably successful business (Clarke, 2004). Proponents of stakeholder theory suggest that companies which manage a broad group of stakeholders effectively and efficiently will gain benefits that are not available to other organisations (Freeman, 1984). According to Solomon (2013), accountability to all stakeholders is the only way to ensure the satisfaction of shareholder interests and long-term success of the company.

The argument for being accountable to a wide range of stakeholders is based on the concept of legitimacy, meaning that responsible behaviour is the price demanded by society for the privilege of incorporation which will grant shareholders limited liability for companies' debts (Tricker, 2015). In the UK, the first time that an accounting body (i.e. the UK Accounting Standards Steering Committee) recognised the importance of accountability to all stakeholders was in the Corporate Report (ASSC, 1975). This report required companies to voluntarily publish additional statements for stakeholders.

During the 1980s, stakeholder theory faded away due to the growth of the free market but has been revived because of growing environmental and social concerns worldwide since the 20th century. Stakeholder theory promotes the concept of corporate social responsibility (CSR), indicating that companies should take into account their social responsibilities and how their activities affect the whole community (Bird et al., 2007). According to the European Commission (2001), CSR is a "*concept whereby companies decide voluntarily to contribute to a better society and a cleaner environment*" (European Commission, 2001, p. 4). Nowadays, CSR and sustainability reports are taken more seriously by existing and potential clients in the financial sector (Tricker, 2015), leading to a growth in the number of socially responsible investors (SRI). The growth in awareness of climate change and global warming, has been accompanied by a movement of the SRI sector towards businesses that positively impact the environment by creating harmless energy sources or reducing emission (Medleva, 2019). According to the US Sustainable and Responsible Investment Forum (US SIF), a foundation for responsible investors, total investments in managed funds that apply SRI strategies grew to more than $22.8 trillion in 2017, compared to $1 trillion in 1995. In the UK, during 2017 investors bought £1 billion pounds in active ethical funds, a 500% increase in a single year (FT, 2018). Ethical funds usually avoid companies that harm the society, such as not dealing in tobacco, gambling or armaments. The shift in public opinion towards the stakeholder approach is also evident in the current versions of CG Guidelines:

"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" (FRC, 2018, p.1)

Donaldson and Preston (1995) examined the underlying arguments behind stakeholder theory following three different approaches, including the descriptive, instrumental justification and normative validity. First, the author proposed that the stakeholder theory is descriptive as it tries to describe and explain different approaches. For instance, stakeholder theory has been used by academics to describe different CG mechanisms, management styles and how Board members think about the interests of corporate constituencies (Harjoto et al., 2015; Reynolds et al., 2006; Wang & Dewhirst, 1992). Second, stakeholder theory has been applied by many CSR studies to identify the relationship between stakeholder management and the achievements of traditional corporate objectives such as profitability (e.g. Kotter & Heskett, 1992; Li et al., 2018; Theodoulidis et al., 2017; Preston & Sapienza, 1990). These studies concluded that following stakeholder thinking would help companies to achieve better results compared to other corporates. For example, Kotter and Heskett (1992) stated that highly successful companies such as Hewlett Packard, Wal-Mart, and Dayton Hudson all shared a stakeholder perspective. Third, under the normative approach, the theory was applied by academics to interpret the function of corporations such as identifying the moral behind operation and management of corporations (e.g. Deegan, 2002; Durden, 2008; Moir, 2001; Nowak, 2015). For example, Durden (2008) followed a normative approach to investigate the measurement and monitoring of CSR within the management control system (MCS) of a case study. He defined the MCS as "*processes by which managers influence other members of the organisation to implement the organisation's strategies*" (Durden, 2008, p.689). The MCS did not measure or monitor social responsibility but applying stakeholder theory helped to explore the link between stakeholders, social responsibility and the MCS.

Stakeholder theory has gone beyond acknowledging stakeholders to the belief that following a stakeholder philosophy by managers will lead to better corporate performance. By contrast, Donaldson and Preston (1995) proposed that although such a declaration is widely believed, it is not enough to be used to justify this theory, which should have business ethics at its core.

One of the challenges of applying stakeholder theory is for Boards to balance the interests of diverse stakeholder groups. While there is a potential conflict of interests within different stakeholders, meeting their needs simultaneously is not always achievable (Tricker, 2015). In line with this argument, Sternberg argued that it is not possible to maximise the interest of all stakeholders at once and that it is not clear who should establish the interest of each shareholder group: management or the stakeholders themselves. Sternberg (2000), a critic of stakeholder theory, proposed that to overcome the potential conflicts of interest between different stakeholders, Boards should have sole responsibility to their shareholders. In addition, compared to shareholders, most of the stakeholders, such as creditors and suppliers, are restricted to engage and influence the governance of corporates. Hence, they have limited power to protect their investments and make sure that their interests are being followed by managers. For example, Carney et al. (2011) found visible engagement restrictions on suppliers of venture capital, which exposed the suppliers of capital to considerable risk since they have to rely on managers' decision making to receive their return. This might affect the practicality of stakeholder theory, where there is an emphasis on the interests of all stakeholder groups without paying attention to their power and influence on corporates.

Power and influence were specifically addressed by Mitchell et al., (1997). They recognised the main weakness of this theory (i.e. the degree to which managers should give priority to different groups of stakeholders) by proposing a theory of stakeholder salience. They proposed three attributes that are fundamental in the recognition of a stakeholder: *power*, *legitimacy* and *urgency*. Firstly, the stakeholder's *power* to influence the firm's behaviour. It should be noted that power alone does not warrant high levels of salience in the stakeholder-manager relationship as it may be latent and therefore can be ignored. Secondly, the *legitimacy* of the stakeholder's relationship with the firm i.e. the right to have their interests considered. The final attribute of the salience theory is *urgency*, meaning the degree to which stakeholders' claims call for immediate attention. The authors proposed that the greater the number of attributes, the greater salience and the more resources and attention management should grant to attending to stakeholders' needs. Figure 3.5 depicts how management should balance stakeholder needs according to the degree of salience.

Figure 3.5 Stakeholder Groups

Figure 3.5 has been removed from this version of the thesis due to copyright restrictions

Source: Mitchell et al. (1997)

Definitive stakeholders exhibit all three attributes and are considered as having the highest level of salience. Hence, Definitive stakeholders are considered an important CG mechanism, as they have power to be listened to, an urgent issue to address and the legitimacy to have their claims answered. In contrast, Dormant, Demanding and Discretionary stakeholders represent those with only one attribute, making them less important to management. Meanwhile, managers should be aware that these stakeholders can become more salience by achieving other attributes. In conclusion, Mitchell et al. (1997) proposed that stakeholder theory should incorporate these three attributes to make a dynamic and comprehensive model, helping to maximise firm value.

In summary, stakeholder theory has played an important role in the studies in the management field. In contrast to agency theory, which mainly focuses on the shareholders, this theory has addressed a wide group of stakeholders, promoting accountability of managers and helping them to build a more sustainable business. On the other hand, this theory failed to provide a clear guideline for management. Even the definition of stakeholders is not very clear, so the managers do not exactly know who should be included as a stakeholder in their company. For example, radical deep green ecologists suggest that the environment, animal species and future generations should be included as stakeholders (Solomon, 2013). In addition, the extent to which the managers should be accountable to the stakeholders is not very clear. These weaknesses could encourage managers to adopt opportunistic behaviour (being accountable to everyone means being accountable to no one?), hence increasing agency problems. These weaknesses of stakeholder theory lead to the conclusion that Stakeholder theory does not provide the best explanation of CG, nor does it help to resolve the main CGI problem (i.e. agency problem), but it does provide a lens for both long-term performance and the impact of CG on a wider range of corporate actors. Following stakeholder theory would make managers aware of all the stakeholders' interests, even if it does not provide clear guidance on how to meet those interests. To address the shortcomings of the Stakeholder Theory, the Enlightened Stakeholder theory was proposed, which is explained in the next section.

3.3.4 Enlightened Stakeholder Theory

Stakeholder theorists purport that managers should take into account the interests of all stakeholders in a firm. Solomon (2013) believes that it is more likely that businesses which create value for stakeholders will also create financial value for shareholders, so ignoring the interests of stakeholders can lower financial performance and even result in corporate failure. Furthermore, Solomon concluded that empirical evidence demonstrates that by taking account of stakeholder interests as well as shareholder interests, companies can achieve long-term profit maximisation and consequently shareholder wealth maximisation. Jensen (2001), however, argued that stakeholder theorists did not determine how managers should prioritise between the different interests of these stakeholder groups. According to

Jensen (2001), the stakeholder theory requires managers to serve “many masters” whose interests could conflict with each other. The stated issue could make managers unaccountable for their actions as they become accountable to everyone and therefore to no one. Jensen proposes that following stakeholder theory is unlikely to help the managers to maximise the value of corporates since this approach does not provide a specific objective function for them. Without a specific objective function, managers’ performance cannot be evaluated, allowing them to use corporate resources to pursue their own interests. Consequently, Jensen (2001) believed that the application of stakeholder theory could increase agency costs in the economic system.

It is notable that the findings of Mitchell et al. (1997) were not addressed by Jensen (2001) when he criticised stakeholder theory. Instead, Jensen tried to resolve the weaknesses of stakeholder theory by developing a new Enlightened Stakeholder theory. Jensen (2001) employed the structure of stakeholder theory but considers the maximisation of the firm’s long-term value when prioritising between interests of stakeholders. Therefore, the Enlightened Stakeholder theory was able to overcome the problem of conflict of interest that relates to the Stakeholder theory by introducing a specific objective function for managers. Jensen (2001) argued that providing an objective function for managers would also make them more accountable since their performance can be evaluated against this. Introduction of the Enlightened Stakeholders theory has been very appealing for academics, but it has not been subjected to much empirical evaluation. Sanda et al. (2005) proposed two reasons for the lack of application of this theory. The first reason is the growth of externalities and monopolies. These reasons were addressed by Jensen (2001): if externalities and monopoly exist, increasing the firm value does not result in maximising social welfare. He further explained that externalities exist when the decision-maker does not bear the full cost or benefit as a result of his/her decision (e.g. water and air pollution). The second reason is the difficulty in measuring long-term corporate value, which was proposed by the theory as the main objective of firms.

Bird et al. (2007) applied the Enlightened Stakeholder theory to study the relationship between the companies’ CSR activities, both positive and negative, and their equity performance. First, the authors proposed that investment in some CSR activities could help to raise the value of companies in the long-term, which is in line with the proposed objective of the Enlightened Stakeholder Theory. They provided three examples of such activities, helping to increase the value for companies. For example, investing in activities that result in a good corporate reputation would increase profitability and market value in the long-term. Improving the quality of the product or making a donation towards medical research are good examples of such activities. After running a regression analysis between the dependent variable (equity performance) and the independent variables (CSR activities), they found that companies who consider a wider group of stakeholder interests will benefit compared to those that failed to meet regulatory expectations and social norms. The Enlightened Stakeholder theory has also been applied in the management discipline (e.g. Agle et al., 2008; Benson & Davidson, 2010; Laplume et al., 2008). For example, Benson and Davidson (2010) explored the relationship between firm value, stakeholder management and compensation. They found a positive relationship between the management of stakeholder relations and firm value, indicating that managers were directed to follow the social welfare of their stakeholders. In line with the Enlightened Stakeholder theory, they found that firms' ultimate goal is to maximise their value. In addition, they found that managers have been compensated based on this goal, which motivates goal congruence (i.e. value maximisation).

Businesses are beginning to realise they cannot operate in isolation and need to consider a broader group of stakeholders as well as considering shareholders. According to Solomon (2013), compared to other CG theories, stakeholder theory, or enlightened stakeholder theory, is attracting more attention among academics, the business community and policymakers. In fact, directors have been encouraged to include wider groups of stakeholders by statutory requirements such as UK companies Act (2006) as well as CG guidelines such as UK CG Code (FRC, 2018):

"*The Board should understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making*" (FRC, 2018, p.5).

Like other theories, Enlightened Stakeholder theory has some criticisms. The critics of this theory believe that it continues to make shareholders the centre of attention for companies and their managers. Satisfying the interests of stakeholders achieve by sacrificing the value maximisation for shareholders. Therefore, although managers should act in the best interests of all stakeholders, the ultimate result mainly benefits shareholders (Andreadakis, 2012). On the other hand, managers are presented as the main mechanism to maximise the value of companies, however, a lack of cognitive resources available to humans as well as bounded rationality of some managers raises the question over the practicality of this theory (Bolton & Faure-Grimaud, 2010). Furthermore, as with Stakeholder theory, the Enlightened Stakeholder theory has failed to clearly direct managers on how to fulfil all stakeholder interest to maximise firm value. Lack of clear guidelines would make it difficult to evaluate the managers and can make managers unaccountable for their action (Andreadakis, 2012).

In conclusion the Enlightened stakeholder theory has been successful in addressing one of the weaknesses of the stakeholder theory, by providing a single objective for managers (maximising the long-term value of the firm). On the other hand, it has been criticised for the same shortcomings concerning the stakeholder theory. One of the most significant criticisms is the failure to make managers accountable for their actions, leading to agency problems. Hence this theory cannot be considered as a comprehensive framework for CG in assessing the Stewardship Code.

3.3.5 Stewardship Theory

Stewardship Theory developed in psychology and sociology to examine the situations where the agent acts as the steward or principal and therefore their interests are aligned with the principals (Davis et al., 1997). The agent follows rational behaviour and puts the higher value towards the objective of the organisation. Davis et al. (1997) proposed that following such behaviour, the agent will consequently benefit the principal, including an increase in profit resulting in higher share price and dividends. A key assumption made is the existence of a strong relationship between the success of the organisation and the principal’s satisfaction. This will motivate managers to act as stewards to maximise firm performance and consequently satisfy shareholder interests. In addition, stewardship theory advocates argue that if the interest of a manager is in line with the principal, he/she should be empowered to enhance the performance of the manager. For such managers, their autonomy should be deliberately extended to maximise their benefits, since they can be trusted. Donaldson and Davis (1991) stated that CEOs as stewards can act more effectively if the corporate structure gives them more power and authority. Also, Mallin (2010) suggested that, by having the role of CEO and Chairman in one person, shareholders could reduce the risk of losing the return on their investments, as this will empower managers to make the best decision. Furthermore, Stewardship Theory suggests that monitoring and controlling of such managers should be stopped since these mechanisms can negatively affect the manager motivation (Argyris, 2017).

In contrast to agency theory, where managers are believed not to always act in the best interest of shareholders, Stewardship Theory considers managers as less opportunistic and more as a trustee of shareholders (Clarke & Branson, 2012; Mallin, 2010). Notably, this consideration doesn't imply that the Stewardship Theory views directors as completely unselfish, instead there are many situations where managers act rationally. This argument indicates that managers believe that following shareholder interests leads to serving their own interests (Daily et al., 2003; Lane et al., 1998). The reputation of the directors is therefore closely linked to the financial performance of their firms and so managers try to improve the financial performance indicators such as shareholders return to protect their reputations (Daily et al., 2003). According to Fama (1980) by being effective stewards of the firm directors can also effectively manage their careers. These arguments form the assumption of Stewardship Theory, which is the presence of a strong relationship between the success of the organisation and the principal's satisfaction (Davis et al., 1997).
In addition, proponents of Stewardship Theory recognise the importance of identifying the interests of customers, employees, suppliers and other legitimate stakeholders. It is notable that the first responsibility of managers is to their shareholders (Clarke & Branson, 2012). Hence, this theory has highlighted that the Board responsibility is to maximise shareholder value sustainability in the long-term (Tricker, 2015).

Since its introduction, Stewardship Theory has been widely applied in legal and organisational studies. According to Davis et al. (1997), academics that applied Stewardship

Theory have focused on a structure that empowers managers rather than a structure to monitor and control managers. These authors proposed that in such a structure, managers could act more effectively and choose the best strategy without the fear of cancelling their decision by outside directors (e.g. Donaldson & Davis, 1991, 1994; Fox & Hamilton, 1994). Empirical research has aimed to validate Stewardship Theory as an important predictor of CG, but conclusions are diverse. Supporters have illustrated an association between empowering managers and higher firm performance, reducing the need to control or monitor executives (e.g. Donaldson & Davis, 1991; Finkelstein & D'aveni, 1994; Coles et al., 2001; Lin, 2005; Tian & Lau, 2001;). Others have failed to find convincing support (e.g. Chaganti et al., 1985; Kula, 2005; Molz, 1988). For example, Donaldson and Davis (1991) conducted an empirical examination of Agency Theory and Stewardship Theory to determine which theory better explained the CEO role and rewards. They compared shareholders' returns in the corporates with a dual CEO-Chair with those where the Chair is independent of the CEO. After analysing the data, they collected from 321 US firms, they found a positive relationship between CEO duality and shareholder wealth. The findings did not support Agency Theory, indicating that controlling opportunistic managers through having an independent chair from the CEO will not help to align the interests of managers and shareholders. On the other hand, in line with Stewardship Theory, they found that combining the roles of CEO and Chair led to empowerment and higher shareholder returns. Lin (2005) confirmed this result and proposed that having a different CEO and Chair of the Board could raise some issues in companies such as conflict of expectations, increasing competition and lack of trust leading to weaker performance. In contrast Kula (2005) evidenced that separating the role of the CEO and the Chair is positively related to firm performance. This finding is in contrast with Stewardship Theory, indicating that managers do not act as stewards in the companies and they need to be controlled and monitored using CG mechanisms.

Stewardship theory reflects the classical ideas of CG that directors can act as a responsible agent with independence and integrity. Clarke and Branson (2012) provide criticism over Stewardship Theory. First, they argue that its shortcomings lie at the root of regulatory failings: i.e. it is unable to predict the relationship between the Board and corporate performance and thus cannot dictate whether the Board would necessarily pursue the corporation's best interests. Second, they argue that it is no longer fit for purpose for modern corporations in which shareholders are separated from managers and managers are not directly accountable to shareholders. Third, they challenged its application in other countries, such as continental Europe and Latin America, where there is limited protection for shareholders against empowered managers pursuing self-interests.

Previous studies applying this theory failed to reach conclusive results. Considering the criticisms of this theory it is irrational to accept that this theory has been able to address all CG issues and provide adequate solutions to resolve them. The Stewardship Code, however, has been able to address one of the main weaknesses of the previous CG theories by describing managers as stewards who can follow a rational behaviour and act to enhance firm performance.

3.3.6 Discussion

A range of theoretical bases have been applied to explain CG practice incorporating different perspectives including finance, economics, accounting and law. These are all problematic to some degree which means that academics still seek defining paradigms (Tricker, 2015). Solomon (2013) argued that whilst CG theories analyse the same problems, the findings are expressed using the languages of different disciplines. Agency theory, an early theory of CG, addresses the Agency problem of divergent interests of agents and principals. It has been widely applied empirically. Despite its popularity, agency theory was considerably criticised for assuming that all managers are self-interested and need to be monitored to align their interests with shareholders. In line with Agency theory, TCE theory considers managers as opportunistic individuals with bounded rationality behavior. Based on these assumptions, TCE theory suggests organisations could help to control managers' behaviour through hierarchical systems. However, TCE theory is widely criticised over its assumptions (e.g. Foss & Klein, 2010; Ghoshal & Moran, 1996). To address the weaknesses of Agency and TCE theories, Stewardship Theory was proposed by CG academics. This theory assumed that managers could be trusted to act as stewards in increasing corporate value. The assumption of Stewardship Theory concerning manager behaviour complements the Stakeholder Theory assumption that the role of management is to recognise and balance stakeholder interests. Enlightened stakeholder theory was developed to help managers prioritise stakeholder interests. These theories are summarised in Table 3.2.

Table 3.2 Summary of Corporate Governance Theories

Theories	Discipline	Assumptions	Criticisms	Summary
Agency Theory	Finance and Economics	1. Conflict of interest between shareholders (principals) and managers (agents). 2. Existence of agency problems.	1. Focus on quantitative metrics. 2. simplistic shareholder/director relationship. 3. philosophical assumption that people are self-interested.	Principals give managing responsibilities to another party (agents). CG mechanisms (Board of directors and shareholders as monitoring devices) have an important role to minimize agency problems. Corporate objective is the maximization of shareholder wealth.
Transaction Cost Economics Theory	Economics and organizational disciplines	1. Defines managers' behaviour as "Bounded rationality". 2. Opportunism; managers might organise transactions in their own interest.	Both assumptions of this theory regarding the behaviour of managers (bounded rationality and opportunistic) have been criticised for not being relevant.	Views firms as governance structures. Assumes managers are opportunistic individuals whose behaviour could adversely affect the firm. Appropriate CG mechanisms should be applied to monitor shareholders.
Stakeholder Theory	social-oriented discipline	Fiduciary duty and social responsibility; firms should take responsibilities for their actions.	This theory has been criticized for not providing a single objective for firms. It is not clear how the firm should prioritise between the interests of different stakeholder groups.	Managers need to consider the interests of all stakeholders (including shareholders). Corporate objective is the maximization of stakeholder value.
Enlightened Stakeholder Theory	social-oriented discipline	Fiduciary duty and social responsibility; firms should take responsibilities for their actions.	1. Shareholders have central attention for managers. 2. Managers are the main mechanism to maximize firm value. 3. failed to clearly direct managers on how to fulfil all the stakeholders' interest to maximise the value of their firms.	Advances stakeholder theory by reducing conflict of interest when prioritizing between divergent stakeholder interests. Corporate objective is the maximization of long-run value of the firm.
Stewardship Theory	psychology and sociology disciplines	A strong relationship between the success of the organization and the principal's satisfaction.	1. Unable to predict the relationship between Board and corporate performance and whether the Board would pursue the corporation's best interests. 2. Not fit for purpose for modern corporations in which shareholders are separated from managers and managers are not directly accountable to shareholders.	This theory indicates that managers can be trusted to act as stewards on behalf of the shareholders.

One of the noticeable differences between these theories is their recommendation about the main objective of corporates, which varied from the maximisation of shareholder wealth (Agency theory) to the maximisation of stakeholder value (Stakeholder theory) or the maximization of long-run value of the firm (Stewardship Theory). It is therefore unsurprising that Mallin (2010) stressed the need within the theoretical framing of CG to consider whether the primary objective of a company should be an enhancement of shareholder value or delivering the interests of other stakeholders such as employees, customers, local communities and suppliers.

In conclusion, CG theories have helped in the development of CG structures and emphasising its importance in companies (Mallin, 2010). Their implementation is, however, subject to legal, cultural, and ownership differences and, therefore, some theories may be more appropriate to particular contexts or cultures at different points in time, notwithstanding the aforementioned criticisms.

3.3.7 Theory for This Research

This study proposes that to explore CG structures by using empirical data, existing CG theories cannot be ignored and remain relevant to varying degrees. The main focus of this study is to explore the Stewardship Code and its impact on financial performance and the ownership behaviour of investors. Given that the Stewardship Code has been introduced to enhance the engagement between investors and their investee corporates Agency Theory appears to be of most relevance as it is predominantly concerned with addressing the agency problem (Faccio & Lasfer, 2000; Gillan & Starks, 2003; Judge et al., 2010; Yegon et al., 2014). This recognises that shareholder monitoring and engagement are key CG mechanisms, helping to align the interests of shareholders and managers, which is in accordance with the aims of the Stewardship Code.

Recent and high-profile company collapses have resulted in criticism of the bases for CG thinking and agency theory has been a particular focus of attention. The key criticism is that the theory is overly simplistic and unable to explore the full range of shareholder responsibilities within investee corporates. Tilba and McNulty (2013), for example, found that the relationship between investors and companies is far more complex than a simple agent-principal when studying investor behaviour in UK pension funds. Other researchers criticised this theory for assuming that shareholders are able or have a tendency towards active engagement in their investee corporates (Hellman, 2005; Webb et al., 2003). It is acknowledged that Agency theory has been criticised for being overly simplistic and unable to explore the full range of shareholder responsibilities within investee corporates, however, in line with Rashid (2015), Agency Theory is valid, promoting outside independent directors as a good mechanism to monitor managers.

While Agency Theory addresses the central issue of CG (i.e. agency problem), TCE theory seeks to find the reason behind the internationalisation of firm activities. Hence, given the focus of this study is to explore the impact of institutional investor engagement (i.e. market factors), TCE is not particularly relevant as a lens for analysis.

Stewardship Theory can also be considered relevant as it attempts to resolve the shortcomings of Agency and TCE theories when explaining CG systems through the analysis of the relationship between shareholders and managers. Based on Stewardship Theory, managers should be empowered to improve their performance which leads to creating higher value for principals (Mallin, 2010).

Stakeholder theory has received growing academic attention due to its suitability in the modern environment whereby companies are under public pressure to act ethically for the wider benefit of all stakeholders. It assumes that managers are accountable to a wide group of stakeholders, which will bring benefit to the shareholders in the long term (Solomon, 2013). Hence, Stakeholder theory is another relevant framework for this study to consider, despite its criticisms, including its failure to provide a clear guideline for managers to prioritise the interests of stakeholders (Tricker, 2015). This helps to compensate for the criticism that Agency Theory might be out of date for the shareholders of this study who are investing in a period where stakeholders' interest is at the forefront of managerial decision-making.

Consequently, this study concludes that it is better to consider Agency Theory, Stewardship Theory and Stakeholder theory to provide explanations of the role of shareholders and their ownership behaviour in engaging with investee corporates. This is in line with Rashid (2015), who encourages researchers to not dismiss a theory due to its criticism (e.g. Agency theory). Rashid (2015) proposes that by dropping a theory, researchers would miss the opportunity from contributing to knowledge on the alignment of shareholder interests.

Chapter 4

4. Methodology

The Stewardship Code, despite its importance for corporate governance (CG), has received limited academic attention. The main aim of this study is closing the existing gap by exploring the application of the Stewardship Code to determine its outcome for the institutional investors both financially and non-financially. The objective of the methodology chapter is to develop and present an appropriate research approach to explore the proposed subject. Following are the main research questions, directing this study towards choosing the best method:

1. *To what extent has applying the Stewardship Code provided financial benefits to its signatories?*
2. *To what extent has applying the Stewardship Code provided non-financial benefits to its signatories?*
3. *To what extent has the Stewardship Code been successful in enhancing the quality of engagement between investors and their investee corporates?*
4. *To what extent has the Stewardship Code been successful in achieving the aims that are proposed by FRC?*

Answering these questions will determine the real impact of applying the Stewardship Code on the quality of engagement between investors and their investee corporates as well as their financial performance. Mixed methods is a suitable approach to answer the above research questions. This methodology combines the potential strengths of both qualitative and quantitative methods, permitting researchers to uncover relationships and correlations that exist between important factors concurrently. By applying mixed methods, a better understanding of the motivations and pressures that drive ownership behaviour of institutional investors can be gained (Creswell, 2014). This is particularly apt in a research area, such as the effectiveness of the Stewardship Code, where the previous academic focus has been scant and therefore, in-depth knowledge is unknown. Following a mixed methods approach helps to combine the quantitative and qualitative findings to determine the impact of the Stewardship Code on financial performance as well as the behaviour of institutional investors towards their stewardship responsibilities. This study has followed a sequential explanatory research design. The explanatory research design begins with the quantitative method (i.e. regression analysis) to explore the relationship between the application of the Stewardship Code and the financial performance of institutional investors (i.e. signatories of the Stewardship Code). Then, a qualitative method (i.e. interviews) is applied to expand on the initial quantitative findings and to determine whether the Stewardship Code has been successful in enhancing the quality of engagement between investors and investee corporates. Following this research design permits the establishment of the relationship between the two variables (i.e. application of the Stewardship Code and financial performance of its signatories) as well as finding a reason behind this relationship (Saunders et al., 2019). Consequently, combining quantitative and qualitative findings is a useful strategy to understand the proposed research questions thoroughly. This chapter aims to justify and detail the quantitative and qualitative methods. To provide context, it starts with the philosophical worldview relevant to this study.

4.1 Philosophical Worldview

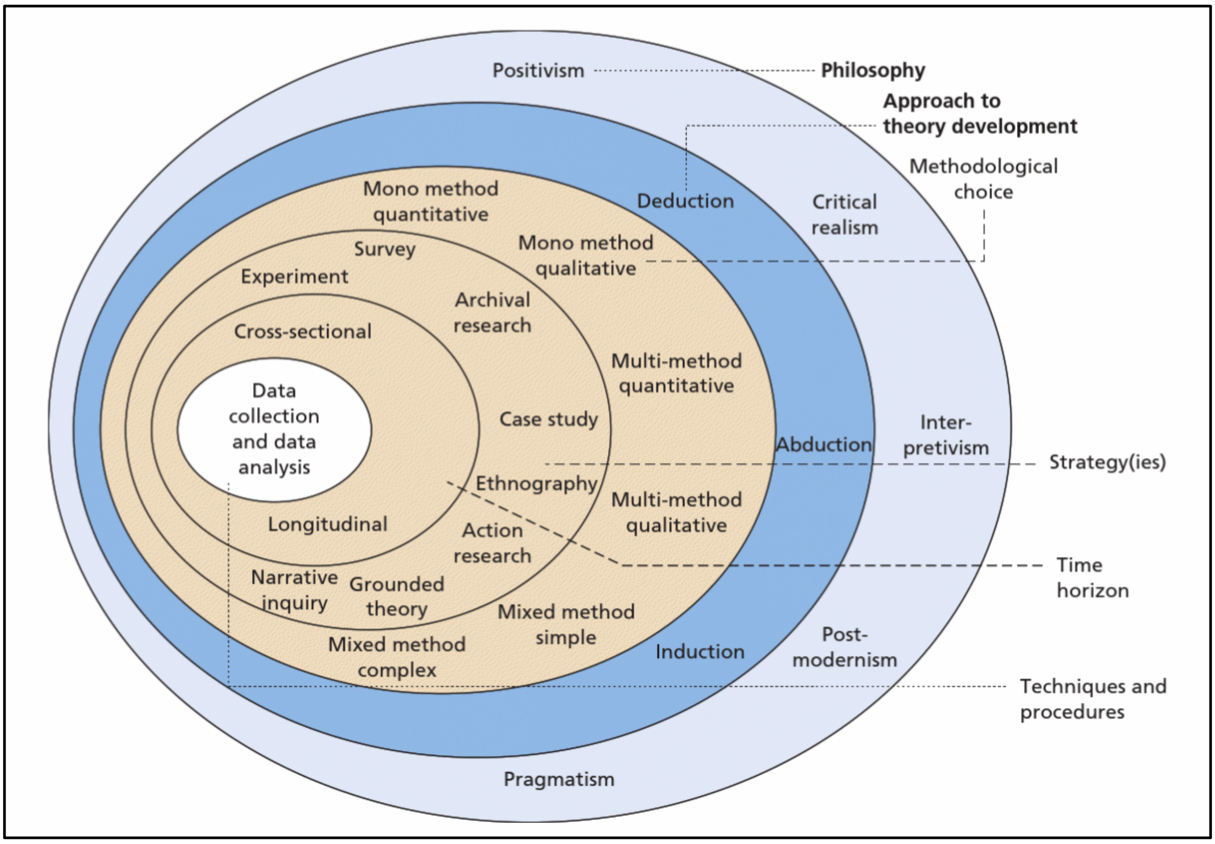
According to Burrell and Morgan (1979) researchers will make a number of assumptions relating to ontological (how we find facts) and epistemological positions (how we interpret facts). The overriding *ontological worldview* adopted is one of realism, recognising that facts can be observed at the market level (through statistical analysis) and at the individual or corporate level (through interviews). In line with other papers this study assumes the *epistemological position* derived from the theories of CG outlined in the previous chapter, notably that:

i) shareholder engagement is an important CG mechanism, helping to reduce agency problems, asymmetry of informations and enhancing CG systems of investee corporates (Faccio & Lasfer, 2000; Bebchuk, 2005; Judge et al., 2010; Arsalidou, 2012; Gilson & Gordon, 2013; Çelik & Isaksson, 2014; Yegon et al., 2014).

ii) shareholders can have a positive impact on investee corporates as well as themselves through performing effective engagement activities. Therefore, applying the Stewardship Code could benefit shareholders by enhancing the quality of their engagement. This is an important ontological position that forms the basis for developing the current research questions.

This study assumed that both quantitative and qualitative data are considered as valid knowledge which will be explained in more detail in section 4.2. In line with Saunders et al. (2015), the choice of data collection method should be the last step of the methodology. To justify the data collection method, it is essential that the researcher peel away the outer layers first. According to Figure 4.1 the first 'layer' is the research philosophy.

Figure 4.1 Research Onion



Research philosophy is a system of beliefs and assumptions about the collection, interpretation and analysis of the collected data (Saunders et al., 2019). Different factors can affect the researcher's philosophy, such as the discipline orientation, the researcher's mentor inclinations or past research experience. The researcher's worldview dominates the choice between quantitative, qualitative or mixed methods approaches. The philosophical approaches that are followed to answer these questions, including positivism, interpretivism, pragmatism, and realism, are explained below.

4.1.1 Positivism

The first research question tries to determine the financial benefit of applying the Code for its signatories. Therefore, we asked:

Question 1. "To what extent has applying the Stewardship Code provided financial benefits to its signatories?"

To answer this question, the positivist approach should be followed. In line with the positivist philosophy, the researcher assumed that financial impact from the application of the Stewardship Code is a phenomenon which is measurable by using the existing data that indicates the financial performance of signatories of this guideline. Therefore, the answer to this question already exists, which could be understood by applying empirical and analytical methods (Saunders et al., 2015). The nature of data that is going to apply for this question is quantitative, leading to statistical analysis to generate research findings (Gill et al., 2010; Saunders et al., 2015). Following this method would create data that are not influenced by human bias or interpretation; hence, they are independent of the researcher.

4.1.2 Interpretivism

Interpretivism developed as a critique of positivism philosophy to study human beings and the meanings that are created by them. Interpretivism believes that positivism cannot be applied to study human beings the same way as physical phenomena since they are not directly observable and measurable. To analyse the non-financial impact of the application of the Stewardship Code, question two and three are developed as follows:

Question 2. "To what extent has applying the Stewardship Code provided non-financial benefits to its signatories?"

And,

Question 3. "To what extent has the Stewardship Code been successful in enhancing the quality of engagement between investors and their investee corporates?"

To investigate these questions, the researcher cannot apply any quantitative data that are readily available. This investigation requires in-depth understanding of the beliefs and actions of the signatories. Therefore, the signatories of the Stewardship Code need to be interviewed to provide answers. Accordingly, an interpretivism philosophy should be followed, assisting to study human beings and the meanings that are created by them. The interpretivism argues that human beings, in contrast to physical phenomena, are not directly observable and measurable. Therefore, they aim to develop new interpretations of social worlds by collecting data that are meaningful for the participants (Saunders et al., 2015). Consequently, the focus is on the micro-level, or even mesa-level of analysis at the company, Board of Directors or individual management level. The interview data will include beliefs and opinions and therefore are qualitative in nature. Following the interpretivism philosophy allows us to explore the Stewardship Code by incorporating the signatories' point of view while considering the complexity of shareholders. After conducting interviews, the researcher has to make meaning from the signatories' responses expressed about the application of the Stewardship Code. Answering the above research questions while following an interpretivist approach, helps to create new understanding about following a guideline (i.e. Stewardship Code) by shareholders and how it has affected their engagement. Although this philosophy is helpful to explore complex phenomena, one of its criticisms is that the researcher's values, as well as interpretation of the data, play an essential role in the research process. This would make it difficult for the researcher to understand the subject from the participants' point of view.

4.1.3 Pragmatism versus Realism

The final question of this study helps to determine the success of the Code in reaching its proposed aims. The fourth question presents as follows:

Question 4. "To what extent has the Stewardship Code been successful in achieving the aims that are proposed by FRC?"

Combining the results found by exploring the last three research questions helps to gain a stronger understanding of this research question (Creswell & Creswell, 2018). Two philosophies generally applied by researchers who applied a mixture of data and methodologies to conduct their study, including realism and pragmatism (Saunders et al., 2015).

First, realism believes that reality exists externally, independent from the description of the researcher. Hence the researcher directs his/her attention to better understand this reality. There are two types of realism, including empirical realism and critical realism. Empirical realism states that the researcher can understand reality by using appropriate methods (Bryman, 2012). This philosophy has been criticised for being naive, as it assumes that reality can be fully understood and explained by the researchers. In line with this, Bhaskar (1982, p.2) proposed that empirical realism "*fails to recognise that there are enduring structures and generative mechanisms underlying and producing observable phenomena and events"*. Hence, the understanding achieved by exploring the reality is 'superficial' (Bryman, 2012, p.29). To address the shortcomings of empirical realism, critical realism was formed in the late twentieth by Roy Bhaskar, whereby the researcher is only able to understand reality by focusing on the structures of reality that form the observable event. Like empirical realism, critical realism considers reality as external and independent. But, not directly accessible through observation and having the knowledge of it (Bryman, 2012). Critical realism took two steps to understand reality. The first step is the experience of sensations and events. And, the second step is reasoning backwards, based on the researcher's experiences, to reach the reality that might have caused them (Reed, 2005). In conclusion, critical realists "*focus on explaining observable organisational events by looking for the underlying causes and mechanisms through which deep social structures shape everyday organisational life*" (Saunders et al., 2012, p.140).

Second, a pragmatic worldview assumes that collecting the various types of data provides a thorough understanding of the research problem rather than focusing on one type of data (qualitative or quantitative). This philosophy originated in the late 19th century in the work of Charles Pierce, William James and John Dewey. Pragmatism aims to reconcile both

subjectivism and objectivism, values and facts, accurate knowledge and different contextualised experiences (Saunders et al., 2015). Based on this philosophy, research begins with a question and aims to contribute practical solutions informing future practice. Pragmatists acknowledge that there are different ways to interpret the world and conduct research. Therefore, no single point of view can ever give the entire picture, and there may be multiple realities (Saunders et al., 2015). Supporters of this worldview use methods that provide credible, reliable and relevant data collection, which help to advance the research (Kelemen & Rumens, 2008). A considerable number of mixed methods researchers and theorists made strong associations with mixed methodology and pragmatism (Bazeley, 2003; Maxcy, 2003; Tashakkori & Teddlie, 2003).
To answer the last question, the findings of the previous research questions (i.e. Question 1, 2 & 3) are going to be used to determine the reality behind them. This approach is in line with realism, where the quantitative analysis of the data which is readily available is followed by a qualitative method to explore the opinions of the institutional investors on the application of the Stewardship Code. Following this approach assists in the understanding of the impact of the application of the Stewardship Code on its signatories.

4.2 Mixed Methods Approach

Mixed methods refer to the research designs that combine both quantitative and qualitative approaches and their related data in a study. Campbell and Fiske's (1959) study of psychological traits inspired other studies to collect various types of data such as observation, interviews and surveys in their studies (e.g. Sieber, 1973). It was by the early 1990s that the idea of combining different types of research designs emerged, and mixed methods became an efficient convergence of quantitative and qualitative approaches. The central assumption of mixed methods is that the combination of both quantitative and qualitative data provides a better understanding of the research question, compared to each approach alone (Creswell & Clark, 2007): .The quantitative method is used to focus on the macro aspect while the qualitative method is used to focus on the micro aspects of the research. The next section explains the rationale for choosing this research methodology.

4.2.1 Rationale for adopting a mixed method

In line with the realism philosophy, a different type of data will be collected, providing a thorough understanding of the research problem rather than focusing on one type of data. Consequently, there is no alternative method to mixed methods if we want to contribute to the real understanding of how the application of Stewardship Code affects the performance and ownership behaviour of the institutional investors. Following are the rationale behind choosing the mixed methods as the research approach of this study:

i) Thorough Understanding of the Research Question

The primary goal of this study is to determine the impact of the application of the Stewardship Code for its signatories, both financially and non-financially. According to Creswell (2014), quantitative research is suitable to identify and understand the best predictors of the outcomes. On the other hand, qualitative research is useful to explore and understand a new subject. The researcher believes that either the quantitative or qualitative method on their own are not enough to understand the research problem and the power of both methods bring the best understanding (Creswell, 2014). Collecting and analysing the available numeric data helps to identify the relationship between the application of the Stewardship Code and financial performance of the institutional investors. On the other hand, collecting and analysing the institutional investors' view on the application of the Stewardship Code helps to uncover the impact of this guideline on their non-financial performance as well as their ownership behaviour. In addition, qualitative data will help to explain the quantitative findings. Consequently, with limited academic knowledge around the application of the Stewardship Code, both quantitative and qualitative methods can and should be used for this exploratory research. So, gathering knowledge from different perspectives (macro and micro) can help to map the landscape and understand what is happening.

ii) Access to Data

Assessing the impact of the Stewardship Code on the performance of institutional investors (both financial and non-financial) is not possible without analysing both quantitative and qualitative data. This study has access to the financial performance of the institutional investors which are publicly available in the investors' factsheets. Also, the stewardship statements provide data related to the degree and quality of the institutional investors' engagements, including monitoring and voting activities in their investee corporates. Relying on quantitative data helps to determine whether the Stewardship Code is linked to the enhanced financial performance of funds, but it cannot tell us the reason behind the statistical findings. Besides, this study does not have access to the data related to private engagement between institutional investors and their investee corporates. Whereas, the importance of private engagement has been raised in various literature (e.g. Carleton et al., 1998; Goranova & Ryan, 2014; McCahery et al., 2016). For example, Goranova and Ryan (2014) believed that private engagement would be more powerful than the public engagement. They argued that, since directors are more reactive to shareholder requests behind the scene to prevent public embarrassment and cost to their reputations, investors are more likely to persuade their desired changes. This emphasises the importance of analysing private engagement in addition to monitoring and voting activities of the signatories. Therefore, using qualitative data is as important as using quantitative data in this study. Interviews with institutional investors could help this study to investigate the quantitative findings further, get valuable information about shareholder private engagement as well as the impact of the Stewardship Code on the non-financial performance of investors.

iii) New Subject

The proposed research subject is relatively new and there is a lack of academic evidence. It is therefore important to explore a range of available data, including quantitative and qualitative. This will prevent the chance of missing or wrongly measuring important variables. Mixed methods provides an opportunity to discover unpredicted variables and include them again if necessary.

iv) Triangulation

Applying both quantitative and qualitative methods enables this study to combine data to establish whether the findings from one method verify the findings from another method (Saunders et al., 2019). Financial performance is a variable that could be affected by various factors such as the trading environment, organisation-specific characteristics and strategy-based variables (Capon et al., 1990). Hence, the application of qualitative methods allows this study to confirm the reality of the initial quantitative findings, which are based on a positivist assumption (Saunders et al., 2019). In addition, triangulation will add depth and richness to the qualitative findings which are based on interpretivism assumptions (Denzin and Lincoln, 2011).

In conclusion, quantitative methods seek to determine the potential relationship between the Stewardship Code and financial performance of institutional investors, whereas, qualitative methods will seek to thoroughly understand the quantitative results as well as revealing non-financial impact from the application of the Stewardship Code. The mixed methods approach has been valued for bringing the strengths of both quantitative and qualitative methods together, whilst overcoming the weaknesses of both approaches (Creswell & Creswell, 2018). Despite the benefits of the mixed methods, there are some challenges associated with this methodology including the requirement for extensive data collection. This is time-consuming to analyse and requires skills and familiarity of both approaches. Considering the above rationales, whilst being aware of its challenges, this methodology is the appropriate approach to reach the research objectives.

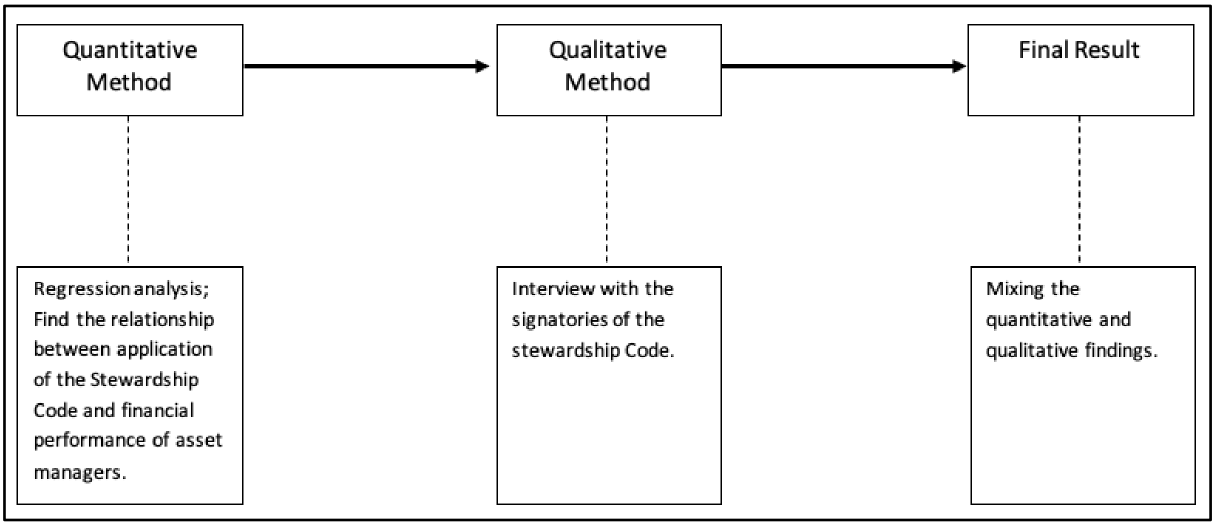
4.2.2 Research Design

The most important determinant of the research design for the mixed methodology is the research problem or research question (Saunders et al., 2019). The way researchers combine quantitative and qualitative methods and the extent of this combination leads to various mixed methods designs including concurrent, sequential explanatory, sequential exploratory and sequential multi-phase research designs (Saunders et al., 2019).

The concurrent design includes a single phase of quantitative and qualitative data collection and analysis, whereas the sequential design allows the researcher to follow the use of one method with another to expand the initial findings (Tashakkori & Teddlie, 1998). The sequential research design will be a more appropriate strategy if the study has a time constraint. Besides, Creswell (2014) proposed that since sequential design involves collecting and analysing quantitative and qualitative databases separately, it could be spread over time. In other words, the investigation can be divided into two manageable tasks rather than multiple data collection and analysis procedures. One of the challenges related to this research design is identifying the appropriate quantitative/qualitative results for further investigation in the follow-up stage.

This mixed methods study will address the impact of the Stewardship Code on the performance of institutional investors by applying an explanatory sequential design. Figure 4.2 illustrates how this study combines quantitative and qualitative methods through the proposed research design (Tashakkori & Teddlie, 1998).

Figure 4.2 Combining Quantitative & Qualitative Methods



The explanatory sequential research design involves collecting quantitative data first and then explaining the quantitative results with in-depth qualitative data. The sample of this study includes asset managers who have applied the Stewardship Code. During the first stage, quantitative data will be collected from the Stewardship statements and the factsheets of the institutional investors, which are publicly available. This stage aims to assess whether there is any relationship between application of the Stewardship Code and financial performance of the investors by following a deductive approach. Based on deduction, this study starts with a testable proposition, informed by existing theory, about the relationship between applying the Stewardship Code and financial performance of its signatories. Following this approach allows this study to determine whether there is any significant relationship between the variables and to explain this relationship using measurable data (Saunders et al., 2019). After completing the first stage, the qualitative method will be conducted as a follow-up method. It is notable that the quantitative findings will be used to develop the interview questions, allowing the study to explore the statistical results. In other words, the quantitative findings will influence the qualitative part of this study. In the exploratory follow-up an inductive approach will be followed, which includes interviewing a sample of signatories of the Code to further explore the initial quantitative results through gathering perspective of the signatories on the application of the Stewardship Code and how it affects their financial and non-financial performance. The next section describes the two methods stages of this study.

4.2.3 Quantitative Method

The quantitative method has been popular among researchers since the late 19th Century, whereas qualitative approaches became more popular during the latter half of the 20th Century along with the development of mixed methods (Creswell, 2014). The quantitative researchers see the world in terms of variables, and they explain phenomena based on the statistical relationship between different variables (Maxwell, 2013). According to Creswell (2014), researchers who use quantitative methods create assumptions about testing theories deductively through specifying narrow hypotheses and the data collection to either support or reject the hypotheses. As a rule, quantitative research seeks to create findings that are generalizable and replicable (Creswell, 2014). Quantitative methods can help unpick problems in which the researcher tries to understand the scale of an impact or the outcome of an intervention, prove or disprove a hypothesis (Burns & Burns, 2008), or determine the links between known variables (Creswell, 2014).

The main research question that this study seeks to answer is "*what is the relationship between the Stewardship Code and the financial performance of institutional investors?*"

The important aim of the first quantitative stage is to answer this question by using the regression analysis. This study used correlational statistics to measure the degree of relationship between the variables (Creswell, 2014). Other aims of this stage are to determine the quantitative results that require further investigation and develop the interview questions for the second stage of the study. The following sections explain the steps that are taken within the quantitative method to find an answer for the proposed question.

i) Choosing the Sample

There are two main types of quantitative sampling: probability sampling and convenience sampling (Maxwell, 2013). In probability sampling, each member of the population has the same chance of being included in the sample. In situations where the researcher intends to learn about a group which is difficult to gain access to or a type of people which are relatively rare, a practical sampling approach is needed, such as convenience sampling (Weiss, 1994). Due to the lack of available data, this study follows convenience sampling.

This study started sampling for the first phase of the methodology in August 2017. By this time, the Stewardship Code had 252 signatories, including asset managers (164), asset owners (77) and service providers (11). The Stewardship Code is directed in the first instance to institutional investors, i.e. asset owners and asset managers with equity holdings in UK listed companies. It is notable that asset owners' commitment to the Stewardship Code may include engaging directly with companies or indirectly through the mandates given to asset managers. They should clearly communicate their policies on stewardship to their managers and hold them to account for their stewardship activities. Although the FRC has encouraged asset owners to follow the guidelines of the Stewardship Code, asset managers are the primary audience of the Stewardship Code. The Stewardship Code (2012) has emphasised the important role of asset managers and posited that asset managers with day-to-day responsibility for managing investments are well positioned to influence companies' long-term performance through stewardship. Hence the first criteria considered for sampling was to only include asset managers in this research.

The second criteria considered for sampling was the portfolio of asset managers. Among the listed signatories, asset managers have formed the vast majority group, including 164 institutions who are applying the Stewardship Code. Asset managers offer a range of funds to their clients, investing in different countries, including the UK. Funds are an attractive type of investment, where asset managers pool and invest their clients' money in different kinds of assets such as equities, properties and bonds (Ganti, 2019). This type of investment creates a diversified portfolio, helping to reduce the investment risk compared to investing directly in individual companies' shares. This study only includes those asset managers with UK equity funds in their portfolio, who have applied the Stewardship Code. Institutional investors who manage UK equity funds are more likely to implement the guidelines of the Stewardship Code. This criterion reduced the sample size from 164 to 92 asset managers who held UK equity funds in their portfolios.

The third criteria considered to select the sample was having access to data necessary to answer the proposed research questions. Only those asset managers with data available in the public domain, including stewardship statements and financial performance added to the sample. Having access to the stewardship statements is important as it would provide a potential source of data for this study. Since December 2010, all UK-authorised asset managers are required under the FCA's Conduct of Business Rules to produce a statement of commitment to the Stewardship Code or explain why it is not appropriate to their business model. Asset managers should regularly report to their clients or beneficiaries as to how they have discharged their responsibilities. Consequently, only those asset managers who publicly published their stewardship statements on the FRC website included in the sample of this study. Moreover, this study requires access to the financial performance of UK equity funds to answer the first research question. In total, 50 asset managers were identified that meet the sample requirements, and these are listed in the table 4.1.

Table 4.1 Sample

Sample	Asset Managers	UK Equity funds
Tier 1	39	185
Tier 2	11	24
Total	50	209

According to Tashakkori and Teddlie (1998), to enhance the probability of the external validity of the study, it is important to have a sample that is representative of the population. The sample of this study represents the population of asset managers who are applying the Stewardship Code. This sample is the best representative of the institutional investors, who are implementing this guideline.

ii) Quantitative Variables

To accomplish the first stage, a regression analysis of the UK asset managers' financial performance, as the dependent variable, and their application of the Stewardship Code, as the independent variable, is performed. Table 4.2 summarises all the variables that are used in the statistical analysis. These variables will be explained in more detail in this section.

Table 4.2 Variables

Variable	Type	Definition	Sources	Data Collection Source
Annual Financial Performance	Dependent Variable	Rolling 12 months total return on a bid to bid basis	UK Stewardship Code (2012)	Morningstar website & Funds' factsheets
Monitoring 1) Compliance with CG Code 2) AGM 3) Material Risks 4) Monitor the Stewardship	Independent Variable	Institutional investors should: 1) Monitor Compliance with the CG Code by their investee corporates. 2) Attend the annual general meetings (AGMs) of investee corporates. 3) Consider material risks related to the investee corporates. 4) Monitor their stewardship activities.	UK Stewardship Code (2012) Shleifer and Vishny, (1986) Wang (2014)	Stewardship Statements
Voting 1) Disclose Voting 2) Voting Against	Independent Variable	Institutional investors should: 1) Publicly disclose their voting records. 2) Consider voting against management proposals.	UK Stewardship Code (2012) Goranova and Ryan, (2014) Mallin (2010) James and Gifford, (2010) McCahery et al. (2016)	Stewardship Statements
Total Stewardship Rate	Independent Variable	Sum of monitoring and voting rates	UK Stewardship Code (2012)	Stewardship Statements
Size *Age*	Controlling Variable	Size: Total assets of the fund Age: Launch date of the fund	Thomas and Tonks, (2001) Dahlquist et al. (2000) Chen et al. (2004) Pollet and Wilson (2008) Yan (2008) Ferreira et al. (2012)	Funds' factsheets
Tier	Dummy Variable	Quality of stewardship statements (Value of 1 if Tier 1, 0 otherwise)	UK Stewardship Code (2012)	FRC website

- Dependent Variable

The dependent variable is a variable that is measured or observed to detect changes due to the variation of the independent variable. This variable is treated as the effect in the causal model that depends on the influence of some other factor (Frenz et al., 2011). According to the FRC, effective stewardship through following the principles of Stewardship Code, benefits companies, investors and the economy as a whole. The common objective of UK asset managers is to maximise and protect the interest of their owners. Moreover, the Stewardship Code (2012) emphasised that institutional investors should apply the Stewardship Code to enhance and preserve the value for the ultimate beneficiary or client. One way of analysing the impact of the Stewardship Code on the institutional investors is to determine whether this guideline has been successful in fulfilling its proposed aim through obtaining some indications of the equity fund's performance following the application of this Code. In other words, if the implementation of the Stewardship Code through improving monitoring and voting activities of the investors could positively affect the financial performance of the UK equity funds, it could be argued that the Stewardship Code was successful in reaching its proposed aims.

As aforementioned, among UK asset managers, this study focuses on those that manage UK equity funds. To collect the financial performance of UK equity funds, the individual fund's fact sheets were used, which are publicly available from asset managers' websites. Also, the Morningstar website includes important information related to UK equity funds, including their financial performance. When the equity funds' data could not be found, the Morningstar website was used as a substitute source. Looking at a number of the funds' factsheets, it was found that the factsheet did not use the same definition to present the annual performance of the funds. For example, Vanguard Asset Manager's factsheets defined the annual financial performance as the growth of net asset value (NAV). Whereas, the HSBC Asset Manager outlined the annual financial performance as the discrete 12-month returns.

The Morningstar database used the same definition to present the funds' financial performance: the standardised performance is defined as the rolling 12 months total return on a bid to bid basis. Therefore, to have the same definition of the financial performance in the sample, the Morningstar database was used to collect the required data for this variable.

- Measuring financial performance

This study did not have access to financial performance for all the asset managers. Instead, the financial performance of the funds managed by each asset manager was readily available using the morningstar website. To measure the financial performance for each asset manager, first, the financial performance of all UK equity funds was collected between 2013 to 2017. The stewardship data was only available for 2016, as signatories only published one stewardship statement, restricting the inclusion of financial performance data for the three years from 2015 to 2017. It is, however, likely that the stewardship approach would be consistent over this period (i.e. 2015 to 2017). Second, the size of each fund, representing the total assets in 2017, were collected using the same data source (i.e. morningstar website). Third, the average funds' size was calculated by adding all the funds' size divided by the number of funds. Fourth, the weight of the size for each asset manager was calculated by dividing the size of each UK equity fund by the total amount of assets under the control of the asset manager. This weight of the size was used as a basis to calculate the financial performance of the asset manager. The fifth step was to calculate the weighted average financial performance for each fund by multiplying its average of financial performance to the weight of size. The final step was adding up all the weighted average financial performance of the funds resulting in a figure representing the financial performance for asset managers. Using the weighted average provides one figure showing the financial performance of asset managers for all the funds. Using this figure allows this study to compare the firm-average financial performance with the average firm-level stewardship approach. Hence instead of comparing all the funds' performance with the whole firm stewardship approach, we are able to compare the firm-level financial performance with the firm-level stewardship approach. This study is not aware of any empirical study using this approach to measure the financial performance of the funds.

- Independent Variables

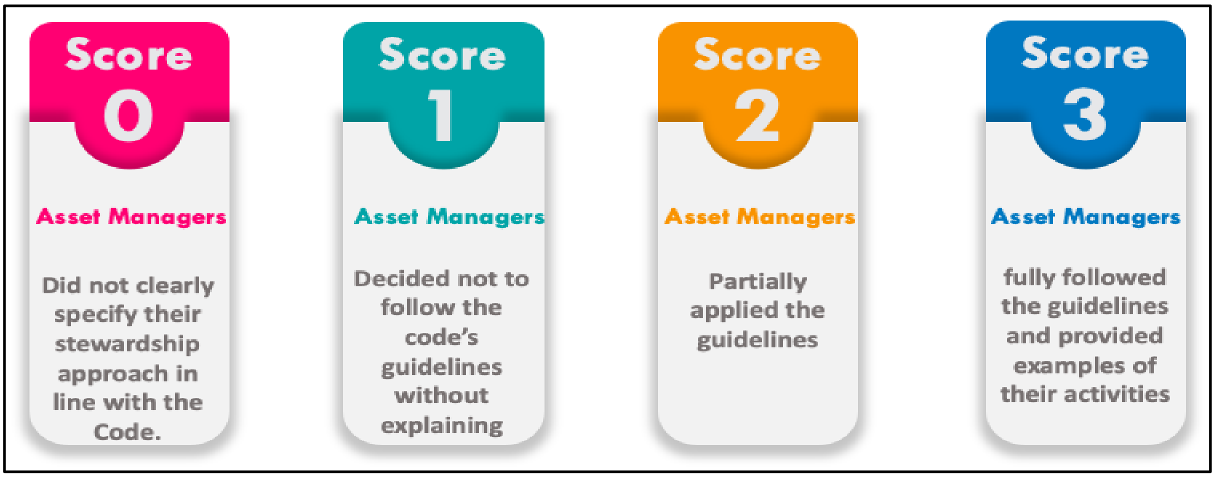
According to the Stewardship Code (2012), exercising voting rights, monitoring the investee corporates and having a purposeful dialogue with companies are considered as the important stewardship activities of institutional investors. Among those stewardship activities, exercising voting rights by the institutional investors has attracted more academic interests. The voting rights have been accepted by many academics as a fundamental shareholder right within corporates, allowing them to either support corporate policies or oppose them (e.g. Goranova & Ryan, 2014; Gifford, 2010; Mallin, 2010; McCahery et al., 2016). Despite academic interest in voting by institutional investors, FRC emphasised that the signatories of the Stewardship Code should include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance. The FRC (2012) defined the engagement as the purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.

During the first stage of this study, monitoring and voting activities of asset managers in their investee corporates will be analysed as independent variables, to determine their impact on the financial performance of asset managers through running a regression analysis. The independent variable is a variable that is measured or observed to assess the effect of the manipulation on the dependent variable (Burns & Burns, 2008). This variable is also known as the predictor variable, the experimental variable or the explanatory variable (Frenz et al., 2011). Monitoring and voting activities represent the application of the Stewardship Code by the institutional investors through following the proposed guidelines of this Code. While this study considered these two as the representatives of the application of the Code, monitoring and voting could have occurred among non-signatories as well as the signatories of the Code. This represents one of the limitations faced when conducting this research. The Stewardship Code devoted four out of its seven principles to monitoring and exercising voting rights, suggesting the importance of these stewardship activities by institutional investors. The FRC has required asset managers to disclose their monitoring and voting activities in their stewardship statements. Therefore, institutional investors' stewardship statements provide a framework that describes an investor's approach to stewardship (FRC, 2017). To measure the proposed independent variables, this study has developed a rating system based on the Stewardship Code guidelines. The next section has explained the rating system in more detail.

- Measuring Stewardship Activities

To measure the quality of monitoring and voting activities of institutional investors, a rating system is developed in this study. To develop this rating system, first, the guidelines of the Stewardship Code (2012) were used as a benchmark to determine the highest and lowest score. The lowest score (i.e. zero) was assigned to asset managers who did not clearly specify their stewardship approach in line with the Stewardship Code. On the other hand, the highest score (i.e. 3) was given to asset managers who disclosed a detailed approach of their stewardship activities, in line with the Stewardship Code guidelines. Figure 4.3 presents how asset managers were rated.

Figure 4.3 Rating System



Fifty stewardship statements of asset managers were analysed to rate the quality of stewardship activities. Tables 4.3 and 4.4 illustrate two examples of this rating approach: SVM Asset Management, a Tier 2 signatory and Black Rock, a Tier 1 signatory.

Table 4.3 Stewardship Rating of SVM Asset Management (Tier 2)

Variables	Stewardship Code guideline	Stewardship Statement of SVM (2016)	Rate
Monitoring			
1. Compliance with CG Code	1. Meetings with the Chairman and other Board members of the investee companies to satisfy themselves that the company's Board and committees adhere to the spirit of the UK CG Code.	1. SVM engage with companies where a company report raises concerns, and usually do this in writing or at a meeting with management or directors. They examine their compliance with the UK Code on CG and will carefully consider any reasons put forward for non-compliance with any aspects of the Stewardship Code. SVM does not actively seek to be made inside as that will affect our ability to trade in the investment.	2
2. Attending AGM	2. Attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.	2. They do not normally attend general meetings as they find that this is not the most effective method of engaging with company boards or management. SVM prefers to make direct contact with management when it feels the need to clarify a company's policy.	2
3. Monitoring the stewardship activity	3. Maintain a detailed database of contact with companies.	3. Did not specify any database in their stewardship statement.	0
4. Consider material risks including ESG	4. Evaluate how companies manage the material ESG risks to their businesses and may engage when there is an indication of a lack of operational excellence in this regard.	4. SVM began managing Socially Responsible Investment (SRI) products in 2006. Since then, the SRI screening service has expanded to include engagement with companies on environmental, social and corporate governance (ESG) issues.	2
Voting			
1. Disclose voting records	1. Institutional investors should disclose publicly voting records and disclose the use made, if any, of proxy voting or other voting advisory services.	1. Where clients require them to disclose details of voting activity this is provided. For all other clients this information is available upon request.	1 1
2. Consider voting against management proposals	2. Institutional investors should not automatically support the Board. If they have been unable to reach a satisfactory outcome through active dialogue, then they should register an abstention or vote against the resolution.	2. Unless a client requires an alternative process, SVM will instruct its custodians to always vote in favour of resolutions backed by the management of a company. This standing instruction will be overridden if they believe that it is not in a client's best interests to vote in favour.	

Table 4.4. Stewardship Rating of BlackRock (Tier 1)

Variables	Stewardship Code guideline	Stewardship Statement of BlackRock (2016)	Rate
Monitoring			
1. Compliance with CG Code	1. Meetings with the Chairman and other Board members of the investee companies to satisfy themselves that the company's board and committees adhere to the spirit of the UK CG Code.	1. According to this asset manager's statement BlackRock will engage with the company and/or use their vote to encourage a change in practice, where company reporting, and disclosure is inadequate, or the approach taken is inconsistent with their view of what is in the best interests of shareholders.	2
2. Attending AGM	2. Attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.	2. BlackRock attends AGMs in person only when they believe they will be able to obtain information material to make their vote decision which could not otherwise be obtained.	2
3. Monitoring the stewardship activity	3. Maintain a detailed database of contact with companies.	3. BlackRock maintains a record of their voting, engagement and other stewardship activities.	2
4. Consider material risks including ESG	4. Evaluate how companies manage the material ESG risks to their businesses and may engage when there is an indication of a lack of operational excellence in this regard.	4. It is stated that BlackRock evaluates how companies manage the material ESG risks to their businesses and may engage when there is an indication of a lack of operational excellence in this regard.	3
Voting			
1. Disclose voting records	1. Institutional investors should disclose publicly voting records and disclose the use made, if any, of proxy voting or other voting advisory services.	1. BlackRock maintains and publicly reports a record of their voting, engagement and other stewardship activities.	3
2. Consider voting against management proposals	2. Institutional investors should not automatically support the Board. If they have been unable to reach a satisfactory outcome through active dialogue, then they should register an abstention or vote against the resolution.	2. BlackRock will vote in favour of proposals where they support the approach taken by a company's management or where we have engaged on matters of concern and anticipate management will address them. BlackRock will vote against management proposals where we believe the Board or management may not have adequately acted to protect and advance the interests of long-term investors.	3

According to Table 4.3, SVM, which is a Tier 2 signatory, received a score of 1 for disclosing its voting activities. The Stewardship Code requires institutional investors to publicly disclose their voting records for the use of both internal and external users. However, SVM decided not to follow this guideline and only publishes voting records for its clients, if they require them. SVM's approach towards the publication of voting records received a score of 1 since they did not comply with the FRC's guideline and the explanation given was inadequate. Compared to SVM, BlackRock as a Tier 1 signatory received a score of 3 since this asset manager fully comply with the Stewardship Code policy by maintaining a public report of their stewardship activities, including their voting records. Considering the last guideline on voting activities, SVM has also received a score of 1. Based on the SVM's stewardship statements, this signatory will not consider voting against unless their clients ask them. Also, it did not provide an acceptable reason for following this approach. In contrast to SVM, BlackRock's statement makes it clear that they follow the Stewardship Code's guideline and consider voting against management proposals. BlackRock also provided some examples of the situations where they would vote in favour or against proposals. According to the rating system, Blackrock received a score of 3.

In addition to monitoring and voting, the total rate of the stewardship activities is also included as an independent variable. This variable is the sum of voting and monitoring activities of asset managers achieved in our rating system.

- Other Variables

In addition to monitoring and voting variables, size and age of the equity funds are also entered in the statistical analysis as the control variables, to address the impact of general fund characteristics on their performance. These variables have been applied in previous studies which investigated fund performance (Chen et al., 2004; Dahlquist et al., 2000; Ferreira et al., 2012; Pollet & Wilson 2008; Thomas & Tonks, 2001; Yan 2008). Fund size is one of the most studied variables among the researchers who investigated the fund performance. Ferreira et al. (2012) proposed that larger funds have some advantages over smaller funds, including having access to more resources, more ability to negotiate with their investee corporate due to their size. Despite these advantages, larger funds might face management challenges. For instance, while smaller funds can focus on a few investment positions, managers of larger funds must continue to look for excellent investment opportunities. Besides, smaller funds are more active compared to larger funds who are more likely to follow a market index such as S&P 500 (Cremers & Petajisto, 2009). Considering the above arguments, the academic evidence relating to this variable is not conclusive. For example, Grinblatt and Titman (1994) found mixed results on the relationship between fund returns and fund size. Whereas, Ferreira et al., (2012) found a negative relationship between the fund size and fund performance in a sample of US funds.

Thus, their finding indicates that smaller funds performed better than larger funds. But in this study, it was found that for non-US funds (e.g. Indonesia, Portugal, and Belgium and lower in the UK, Australia, Canada, France), this relationship is significantly positive. Ferreira et al. (2012) proposed that the reason behind this finding is that funds that performed better were large family funds with economies of scale, enabling these funds to share the research and administrative expenses among funds. Based on the above findings, it is important to control for the fund size as it might affect the financial performance of the UK equity funds which are included in our sample.

Previous studies also considered the maturity of the funds to explore their performance. According to Ferreira et al. (2012), fund age represents the fund's longevity and the management's ability. They proposed that in comparison to older funds, younger funds are more motivated to enhance their performance. On the other hand, these funds face more expenses and might suffer from a lack of experience compared to older funds. Hence, it is essential to include this available in the regression analysis.

Thomas and Tonks (2001) examined whether the characteristics of pension funds, including the fund size and fund maturity, had an impact on their performance. These authors proposed that large funds, due to the size of assets in their portfolios faced less freedom compared to smaller funds, which can take advantage of investing in a wide range of securities. To incorporate the size, this study investigated the sensitivity of the fund returns to the addition of a size premium. They found a significant result for smaller funds. This result was in line with their initial proposition, indicating that it is more difficult for larger funds to take advantage of investing in smaller companies as they have concerns about the liquidity of their investments. Considering the age of funds, this study could not find any difference in the performance between mature and immature funds. In line with them, Ferreira et al. (2012) found no relationship between the age and performance of US mutual funds. In line with the previous studies, total assets of the fund is used to measure the fund's size, and the launch date of the fund is used to measure the age (e.g. Ferreira et al., 2012; Thomas & Tonks, 2001). Including these variables helps to control their effect on the financial performance to only explore the impact of the Stewardship Code on the financial performance of asset managers.

In addition to the above variables, dummy variables were used to analyse the relationship between financial performance and application of the Stewardship Code. A dummy variable is a numerical variable, representing subgroups of the sample in the study. Including a dummy variable in the regression analysis helps to have multiple groups in a single regression equation. Tier of the statements which are determined by FRC is included as a dummy variable, representing two groups of funds in the study; one with high-quality stewardship statements categorised as Tier 1 by the FRC, and another group with lower quality statements categorised as Tier 2. If an asset manager is grouped as Tier 1, it will receive a value of 1 and 0 otherwise.

Another variable used in the statistical analysis is the categories of the funds, including Small-Cap and Large-Cap. This variable, representing another characteristic of funds, found in previous studies investigating the fund performance (e.g. Ferreira et al., 2012; El Ghoul & Karoui, 2017; Gorman, 2003; Thomas & Tonks, 2001). For example, Ferreira et al. (2012, p.523) used Large-cap as "*a dummy variable that equals one if a fund total net asset is below the median SMB (i.e. the difference between the returns on a diversified portfolio of small and large stocks) factor loading, and zero otherwise*". These authors hypothesis that for large-cap funds, there should be less of an adverse fund size on performance compared to small-cap funds. Their findings were in line with this hypothesis, indicating that US international funds which invest more in large stocks (large-cap funds) have more investment opportunities and consequently facing fewer liquidity constraints as they can invest anywhere in the world, which they called liquidity constraint hypothesis. The morning star has clearly stated if the fund is categorised as small-cap or large-cap. Hence, we did not have to do any calculations. Including this variable will help to analyse the impact of application the Stewardship Code on the funds' financial performance based on their categories. So, in another analysis, only the Small-Cap funds were included in the regression analysis to determine if the application of the Stewardship Code has influenced their performance.

iv) Data Collection

Following determining the dependent and independent variables and developing the rating system, all the required data to run the regression analysis were collected through using the available resources. First, the financial performance of UK equity funds along with their size and age gathered by using the funds' factsheets and Morningstar website. In total, the financial performance, size and age of 209 UK equity funds were gathered. Then, each stewardship statement was analysed to rate monitoring and voting activities of the asset manager based on our rating system. The 209 UK equity funds included in the sample, were managed by 50 asset managers. Therefore, it was necessary to examine the stewardship statements of all 50 asset managers, including both Tier 1 and Tier 2 statements. The financial performance and the age of equity funds were available from 2013 to 2017, whereas the data related to the stewardship activities of asset managers were only available for 2016. This is because asset managers published one stewardship statement and only update this if they change their stewardship policies. The latest version of the Stewardship Code published by FRC goes back to 2012, and it has not been updated to date. This leads us to assume that the same level of stewardship activities was followed for three years before 2016. Fact sheets of the equity funds give access to the latest size of the equity funds, being based on 2016 data.

v) Data Analysis

There is a range of quantitative analysis techniques, helping to examine, understand, describe and present the numerical data such as graphs, tables and statistics. After collecting the data, Excel was used to store the data. SPSS was used to run a regression analysis and determine the relationship between the application of the Stewardship Code and the financial performance of asset managers as the signatories of this guideline. The existing studies that investigate the financial performance of funds also applied regression analysis (Choi et al., 2016; Cuthbertson et al., 2016; Ferreira et al., 2012; Thomas & Tonks, 2001).

Applying regression analysis calculates the regression coefficient and the regression equation using the independent and dependent variables. This helps in the determination of any causal relationship between variables, as well as discovering the strength of this relationship (Smith, 2017). All the findings achieved from running the statistical analysis are explained in the next chapter. The following section describes the qualitative method followed in the second stage of this study.

4.2.4 Qualitative Method

As aforementioned, conducting a statistical analysis during the quantitative stage would help this study to find the relationship between the application of the Stewardship Code and financial performance of asset managers who are following the Stewardship Code. On the other hand, using qualitative data helps to develop a theory by getting close to actors in order to examine and understand complex practices (Shah and Corley, 2006). Relying only on the quantitative data does not help to find an answer for the following research questions:

"Question 2. To what extent has applying the Stewardship Code provided non-financial benefits to its signatories?"

"Question 3. To what extent has the Stewardship Code been successful in enhancing the quality of engagement between investors and their investee corporates?"

"Question 4. To what extent has the Stewardship Code been successful in achieving the aims that are proposed by FRC?"

Interviews with signatories of the Stewardship Code were conducted to answer the above questions. Undertaking interviews would help to contextualise understanding by providing opinions on the strengths and weaknesses of the Stewardship Code as well as its impact on the quality of engagement with investee corporates. Also, interviews with signatories assist in exploring the statistical result further (Bryman, 2006). The following sections present the sample, the process of recruiting the interviewees as well as the data analysis approach, which is employed within the qualitative method.

i) Choosing the Sample

In line with the quantitative method, the qualitative approach also includes asset managers in the sample as the most appropriate group of institutional investors for the interviews. Having the same group of investors in the sample helps to better compare and combine the findings of both quantitative and qualitative methods. The FRC categorised stewardship statements into two groups: Tier 1 and Tier 2. Among all asset managers' stewardship statements, 69% of them are classified as Tier 1, and 31% are classified as Tier 2. Considering the different qualities of the stewardship statements, this study was intended to include both Tier 1 and Tier 2 statements in the qualitative sample.

The FRC asked signatories to provide details of a responsible body, in their stewardship statements, which should provide further information about the stewardship activity of their institution. Those who were listed as the contact points in the stewardship statements have various responsibilities including Environmental, Social and Governance risks (ESG) analysts, Head of investment stewardship and Head of CG. These contact details were used to contact the individuals who were responsible for applying the Stewardship Code in their institution and invited them for the interview.

ii) Ethical Consideration

The second methodology stage of this study involves human participants. Therefore, it is essential to anticipate and address ethical issues that may arise when undertaking the study. The ethical issues may occur at different stages of the research including during the design of the study, recruiting the participants, data collection, processing and storing the data as well as analysing and reporting the data (Saunders et al., 2015). First, the researcher assessed the potential risk for the participants of the study as well as recognising any conflict of interests when designing the study. This study is, however, low risk as participants were being interviewed within a work or business context over non-sensitive issues. Second, when inviting the participant, they should be fully informed about the study by providing a participant information sheet (see Appendix A). Third, when the researcher is collecting data, it is essential to address ethical issues that may occur by giving the right of removal to the participants. In other words, the participants should be able to withdraw from the study without giving any explanation. Also, the participant should be ensured about privacy/anonymity rights. Fourth, when storing and analysing the data, the confidentiality and anonymity of the participants should be guaranteed. These matters were emphasised in the participant information sheet. Prior to conducting interviews, this study received formal ethics approval from the Oxford Brookes University Research Ethics

Committee, helping to anticipate and reflect on the potential ethical issues related to this study. The approved ethics form is provided in Appendix B.

iii) Recruiting Interviewees

The first approach to find the interviewees was to contact the individuals directly. In this approach, the invitation emails were sent to the potential participants, explaining the aim of the research and the interview procedure. This was followed by sending reminder emails to those who did not reply to the first invitation email. Besides, the SRI CONNECT website was used for advertising the study and inviting more participants. This website provides an online platform for institutional investors and quoted companies which are involved in sustainable development, providing a good source of contact for this study.

The initial aim was to interview between 10 and 15 signatories of the Stewardship Code, depending on the responses received by the participants. After sending all the invitation and reminder emails, thirteen asset managers agreed to participate in the interviews. Among the different recruitment techniques, directly contacting the individual was the successful approach leading to finding nearly all of the participants for the interviews. Only one of the participants was found using a snowball sampling technique. Only one of the participants is classified as Tier 2, meaning their stewardship reporting is good, but it still needs some improvements. The rest are categorised as Tier 1, showing a high-quality reporting of their stewardship activities. Details of the interview participants are summarised in Table 4.5.

Table 4.5 List of Participants

Participant	Position	Tier	AUM*	Country
A	Head of Investment Stewardship	1	£337 bn	UK
B	Head of Ethical and Responsible Investment	1	£574 m	UK
C	Head of Corporate Governance	2	£4.09 bn	UK
D	ESG Analyst	1	£621 bn	UK
E	Head of Corporate Governance	1	£3376.78 bn	USA
F	Principal in Responsible Investment Team	1	£182.03 bn	USA
G	Head of Governance Research	1	£45.9 bn	UK
H	Stewardship Analyst	1	£26.2bn	UK
I	ESG Integration	1	£36.73 bn	UK
J	ESG Analyst	1	£4.38 bn	UK
K	Head of Corporate Governance and responsible investment team	1	£238342.96 m	Canada
L	Head of Stewardship	1	£655.63 bn	Switzerland
M	Head of Research and leads the integration of sustainability analysis	1	£115 m	UK

*AUM: Total Asset Under Management

These participants were responsible for following the proposed guidelines of the Stewardship Code and preparing the stewardship statements within the institutions they represent. As a result, they should have a thorough understanding of the Stewardship Code as well as the shareholder responsibilities in their investee corporates.

It is notable that the saturation point was reached as no new data emerged from the final interviews. Hence, the sample size was appropriate for this study. The next section provides a description of the data collection process.

iv) Data Collection

After receiving the approval for the interview, the participant information sheet and consent form were sent by email to the interviewees. Then, a follow-up email was sent to arrange interview dates and venues. For the convenience of participants, in addition to the face to face interviews, Skype and telephone interviews were also offered. Face to face interviews were held at participants' offices.

Interviews can be highly structured by asking specific questions per participant or they could be informal, using unconstructed conversations (Saunders et al., 2015). Reviewing the existing papers that investigate shareholder engagement revealed that most of them rely on quantitative data and mainly focus on the relationship between shareholders engagement and the performance of investee corporates (e.g. Cziraki et al., 2010; Filatotchev & Dotsenko, 2015; Johnson & Greening, 1999; Judge et al., 2010; Tihanyi et al., 2003). Only a small number of studies applied qualitative methods to explore institutional investor engagement (e.g. Coffee & Black 1994; Hendry et al., 2007; Tilba & McNulty; 2013). For example, Tilba and McNulty (2013) used 35 in-depth semi-structured interviews to examine the ownership behaviour of pension funds in relation to investee corporates. In line with these, this study used semi-structured interviews, permitting the creation of a list of key questions to be included in each interview. These questions were specifically designed to focus the discussions towards answering the research questions. Despite having this list, the researcher was free to change the order of questions as well as to add or omit a question, depending on the flow of the conversation (Saunders et al., 2015). Answering the interview questions helps to explain the impact of the application of the Stewardship Code on its signatories (i.e. asset managers). To create the first draft of the interview questions, the structure of interview questions found in Tilba and McNulty (2013) was followed. In line with this structure, we included some questions allowing the participants to introduce themselves as well as their institutions. Then a few questions were included to add a history behind the institutions' compliance with the Stewardship Code. After that, the questions were more specifically related to the application of the Stewardship Code, including the motivation behind applying the Stewardship Code, the achievements from using this guideline, any difficulty that demotivated them from a complete application of the Stewardship Code. The statistical findings were also considered to develop some of the interview questions. Following this approach was important as it enabled the researcher to explore the quantitative findings. Below are those questions inspired by the quantitative stage of this study:

a. Are you aware of any difficulties in applying the Stewardship code that prevents you from thoroughly following the guidelines?
b. When performing stewardship activities which activities do you believe are more costly for your institution to accomplish?
c. According to FRC, applying the Stewardship Code has a positive impact on investors. Since being the signatory of the Stewardship Code, what are the positive achievements for your institution, both financial and non-financial?
d. How do you measure the success of your stewardship activities?

All the interview questions are provided in Appendix C.

Each interview lasted approximately thirty minutes to one hour. The interviews were held between October 2017 and April 2018. All the interviews were voice-recorded with the participants' permission. Six of the interviews were face to face, three were telephone interviews, and four conducted through Skype. Following the data collection, the interviews were transcribed and subjected to thematic analysis to explore the interview results, which is explained in the next section.

v) Data Analysis

After completing the 13 interviews, the thematic analysis approach was followed to search for themes that appeared across the dataset concerning the research objectives (Saunders et al., 2019). Thematic analysis is a generic approach used to analyse the qualitative data. The main aim of this approach is to look for themes, emerging from the data set (Saunders et al., 2019). The researcher is required to code the qualitative data to find the themes for further analysis, relating to the main research questions. In applying thematic analysis, the focus was in participants' opinion about the Stewardship Code and their experience as the signatories of this Code. Therefore, the themes emerged inductively from the interview responses. Conducting thematic analysis involved four steps, including coding the data, searching for themes, defining themes and describing the findings.

The first step of data analysis began with transcribing the recorded interviews. In total, 425 minutes of interviews were conducted, resulting in 124 pages of transcription. One of the transcribed interviews is attached in Appendix D. After transcription, reading and familiarising with the content of the dataset was the next important data analysis step. The researcher found this as an essential phase to identify what the data entails and to notice the emerging pattern across the dataset. After familiarising with the data, the coding was applied to organise the responses and categorise the data that has a similar meaning. Due to lack of prior academic studies, the researcher followed a comprehensive coding approach to identify any relevant data to fulfil the main aim of this study within the dataset (Braun & Clarke, 2013). For coding and analysing the interview data, NVivo qualitative data analytics was used (Gibbs, 2002). Using the NVivo enables the qualitative data to be analysed using codes, keywords, word frequencies and theme cross-comparison (Tilba & McNulty, 2013).

Following a complete coding approach, any data that potentially addresses the research objectives were given a code. It is notable that when familiarising with the data, the most occurring patterns were recorded and used later as the initial list of codes. Also, the interview questions were used as a basis to add to the initial list of codes for further analysis (Braun & Clarke, 2006). In line with the complete coding approach, the researcher believed that all the interview responses were essential to answer the research questions thoroughly, therefore, more codes were added when necessary.

When coding was finished, the themes were grouped into six categories, including Asset Manager, Client, Stewardship Code, Exploring Quantitative Findings, Important Response and others. These six categories were considered as the main codes, and the sub-codes covered different aspects of their parent codes. For example, the asset manager's sub-code included the investment strategy of the institutional investor, the role of the participant, the main objective of the institution when managing assets, the date when the asset manager became a signatory of the Stewardship Code and the resources of the asset manager. Compared to the asset manager category, more sub-codes were related to the stewardship code category including reporting, motivation, quality of the stewardship code, achievements, history, performance, stewardship activities, centralisation, formalisation and inspiration. Notably, some of the sub-codes were broken into smaller codes when necessary. For example, the stewardship activities as a sub-code categorised into ten codes including engagement, voting, dialogue, ESG consideration, monitoring, cost, topics, consistency, collective action and measurement. On the other hand, some of the main codes, such as exploring quantitative findings, did not have any sub-codes. Appendix E shows all the main codes and sub-codes developed during the first step of data analysis.

At the end of this stage, all the codes were reviewed again to ensure there was no overlap between these codes. Following this approach helped to extract meaning from all the available data for an in-depth data analysis. After coding all the data, the main themes within the interview transcripts were identified, which will be explained in the next chapter.

4.3 Summary

This chapter outlined the research methodology of this study. The first section explained the researcher's worldview (realism), which shaped the research methodology, and provided justification for the adoption of mixed methods. The second section describes the mixed methods, including the explanatory research design and the rationale for choosing this approach, being an attempt to better understand the application of the Stewardship Code and to explore the quantitative findings further. The third section of this chapter contains details of the sampling approaches and techniques that will be used to analyse both quantitative and qualitative data (i.e. regression analysis and thematic analysis).

The next chapter presents the findings from running a statistical analysis of the quantitative data to determine the relationship between the application of the Stewardship Code and financial performance of asset managers as the main signatories of the Stewardship Code. This is then followed by the results from conducting interviews to determine the impact of the Stewardship Code on the quality of engagement between investors and companies as well as the ownership behaviour of asset managers.

Chapter 5

5. Findings

The Stewardship Code has been recognised as the first guideline in the world, promoting higher quality engagement between shareholders and their investee corporates. According to the FRC, compliance with the Code positively affects signatories, financially and non-financially. There is a lack of empirical evidence around the effectiveness of the Stewardship Code in reaching its proposed aim. Completing the quantitative methodology phase will help to determine the financial benefit from the application of this Code for its signatories. Having access to the financial performance (i.e. dependent variable) and the stewardship activities (i.e. the independent variable) of asset managers who have followed the Stewardship Code allows this study to run a regression analysis between these two variables. This study is not aware of any academic research that investigates this relationship statistically. In addition to applying the statistical analysis, interviews with signatories of the Stewardship Code were conducted to determine any non-financial achievements from the application of this guideline. Combining the findings of both quantitative and qualitative methods enables this study to determine the success or failure of the Stewardship Code in achieving its proposed aim in relation to its signatories. This chapter starts by presenting the results from the statistical analysis and then the qualitative findings from conducting interviews with a sample of those investors described in this chapter.

5.1 Quantitative Findings

The quantitative analysis initially assesses whether there is a relationship between asset managers' financial performance and their application of the Stewardship Code.

5.1.1. Sample Description

Table 5.1 displays the sample description across the 50 asset managers included in the sample. According to the FRC (2016), Tier 1 signatories have provided good quality and transparent description of their stewardship activities, whereas Tier 2 signatories have reported less transparently on their stewardship activities. According to Table 5.1, the mode for the tier of the stewardship statement is Tier 1 indicating the majority (78%) of asset managers within the sample are categorised as Tier 1 signatories, and the remainder (22%) Tier 2. This result suggests that most asset managers within the sample should receive the highest score for their stewardship activities. Based on the applied rating system applied, on average, asset managers received 11/18 points available on their stewardship activities, meaning they received 60% of the overall score. This result is in line with the fact that most asset managers are considered as Tier 1 by the FRC. Besides, the mode for voting scores is 6, indicating that most asset managers received the highest voting score by following the Stewardship Code's guidelines thoroughly.

Table 5.1 Descriptive Statistics

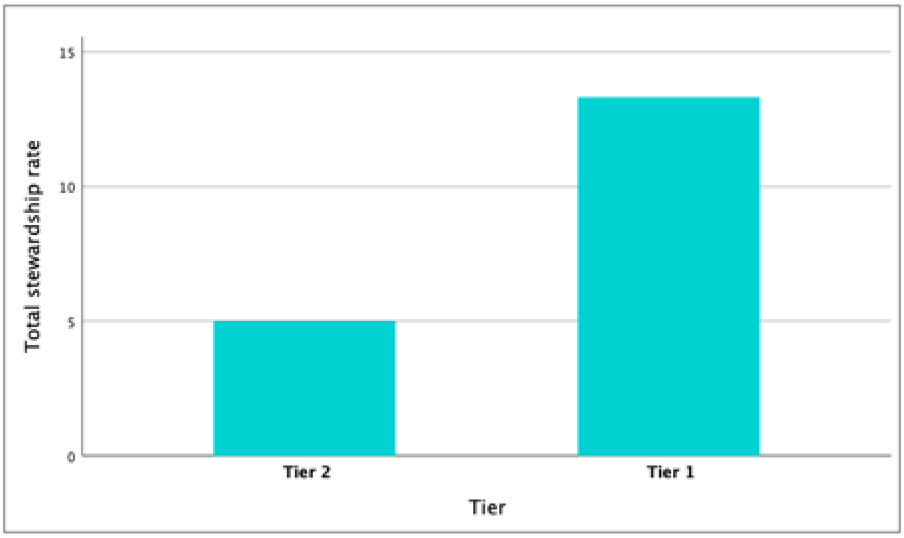
Variables	N		Minimum	Maximum	Mean	Mode
	Valid	Missing				
Performance	50	0	3.6	18.26	8.45	3.60
Tier of statement	50	0	0	1	0.78	1
Sum of stewardship rate	50	0	1	17	11.48	12
Total monitoring	50	0	0	11	7.48	10
Total Voting	50	0	0	6	4.06	6
Average of Size (Mil)	50	0	0.99	5,280	760.37	0.99*
Average of Age	50	0	5.00	46.00	17.19	11.00

*Multiple modes exist, the smallest value is shown

To better understand the data, Figure 5.1 illustrates the total stewardship rates of Tier 1 asset managers and Tier 2 asset managers. This chart confirms that asset managers with Tier

1 stewardship statements have higher stewardship scores compared to asset managers with Tier 2 stewardship statements.

Figure 5.1 Total Stewardship Rate by Tier



5.1.2 Regression Analysis

The first stage of this study aims to determine the relationship between the financial performance of asset managers and their stewardship activities, including monitoring and voting through the application of the Stewardship Code. Running the regression analysis will allow predictions to be made on the possible values of financial performance as the dependent variable from the known values of the monitoring and voting activates as the independent variables in a linear simple or multiple regression. Multiple Regression used in this study is given by:

$$WAAP= \beta0+ \beta1\ TV+ \beta2\ TM+ \beta4\ T+ \beta5\ S+ \beta6\ A +\varepsilon$$

Here, the dependent variable is weighted average annual financial performance (WAAP) and the independent variables are total voting (TV) and total monitoring (TM). Also, tier of the stewardship statements (T) included as a dummy variable as well as the size (S) and the age

(A) which are added as the controlling variables. In this formula ε is the error term. The exact definitions of these variables were discussed in the fourth chapter (section 4.3.3). In addition to multiple regression, we also investigate the correlation between each Independent Variable and the WAAP by using a simple linear regression.

Before running the regression analysis all the assumptions that applied to the simple regression analysis including multicollinearity were met. Pearson correlation table in the SPSS was used to check the multicollinearity between the independent variables. Multicollinearity suggests correlation or multiple correlation that has the power to affect the regression estimates adversely: as the degree of multicollinearity increases the regression model estimates of the coefficients become inaccurate and over inflated. Results are shown in Table 5.2. Correlations greater than 0.7 were identified between the Independent Variables, suggesting the existence of multicollinearity among the Independent Variables. Given that Total Stewardship Rate is the sum of total monitoring and total voting rates (hence the multicollinearity between these variables), when total stewardship rate was included in the regression analysis the other two variables (i.e. total monitoring rate and total voting rate) were excluded.

In addition, a variance inflation factor (VIF) test was undertaken to check for collinearity (Table 5.3). Any variable whose VIF values are greater than 10 may merit further investigation. To test for collinearity the independent variables were entered separately as a dependent variable to check the VIF among variables. Based on the obtained results, all of the VIF results are below 3, indicating no multicollinearity issue among the independent variables.

Table 5.2 Correlation

Variables		Total Monitoring Rate	Total Voting Rate	WAAP	Tier 1	Tier 2	Total Stewardship Rate
Total Monitoring Rate	Pearson Correlation	1	.579**	-.175	.736**	-.736**	.949**
	Sig. (2-tailed)		.000	.229	.000	.000	.000
	N	49	49	49	49	49	49
Total Voting Rate	Pearson Correlation	.579**	1	-.102	.674**	-.674**	.800**
	Sig. (2-tailed)	.000		.484	.000	.000	.000
	N	49	49	49	49	49	49
WAAP	Pearson Correlation	-.175	-.102	1	-.204	.204	-.176
	Sig. (2-tailed)	.229	.484		.159	.159	.227
	N	49	49	49	49	49	49
Tier 1	Pearson Correlation	.736**	.674**	-.204	1	-1.000**	.799**
	Sig. (2-tailed)	.000	.000	.159		.000	.000
	N	49	49	49	49	49	49
Tier 2	Pearson Correlation	-.736**	-.674**	.204	-1.000**	1	-.799**
	Sig. (2-tailed)	.000	.000	.159	.000		.000
	N	49	49	49	49	49	49
Total Stewardship Rate	Pearson Correlation	.949**	.800**	-.176	.799**	-.799**	1
	Sig. (2-tailed)	.000	.000	.227	.000	.000	
	N	49	49	49	49	49	49

**Correlation is significant at the 0.01 level (2-tailed).

Table 5.3 Collinearity Test

	Collinearity Statistics				
	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 5**
	VIF	VIF	VIF	VIF	VIF
Age	1.172	1.154	1.213	-	1.225
Size	1.034	1.062	1.082	1.086	-
Monitoring Rate	2.364	-	1.589	2.255	2.342
Voting Rate	-	2.041	1.651	1,978	1.970
Tier	2.225	1.849	-	2.759	2.778
Dependent Variable	*Voting Rate*	*Monitoring Rate*	*Tier*	*Age*	*Size*

The rest of the regression analysis assumptions are explained in Appendix F. The following section describes the result from running simple, and multiple regression analyses are reported.

i) 1st Model

In the first regression model, weighted average annual financial performance (WAAP) was included as the Dependent Variable in the multiple regression. Then total voting (TV) and total monitoring (TM) were added as the Independent Variables. The Tier of the Stewardship statements was transformed into a dummy variable. Moreover, the age and size were included as the controlling variables to ensure that they did not affect the financial performance of asset managers. Applying a hierarchical multiple regression would help to predict the value of financial performance while controlling for these two potential variables. While the size and age of funds represent the characteristics of the sample, their impact on the financial performance is unwanted. Hence, these two variables are called confounding-covariate variables. To run the hierarchical multiple regression, the function was applied in the SPSS. as well as the age and size which were included as the controlling variables. The result of this multiple regression is presented in Table 5.4.

Table 5.4 First Model

Hierarchical Multiple Regression with controlling variables (Age and Size)

	Model A		**Model B**	
	Coef. Beta	Sig.	Coef. Beta	Sig.
Constant	-	0.000		
Age	-0.058	0.691		
Size	0.152	0.298		
Constant			-	0.000
Age			-0.026	0.870
Size			0.190	0.213
Monitoring Rate			-0.210	0.351
Voting Rate			0.242	0.250
Tier			-0.130	0.591
Sig.	0.523		0.548	

Adjusted R^2	-0.014	-0.020
R Square Change	0.027	0.057
Sig. F Change	0.523	0.441

Model A only includes the size and age of the funds as the predictor variables. The p-value (p=0.523) of this model in the ANOVA table indicates that these two variables cannot predict the value of the financial performance. This finding is in line with Ferreira et al., (2012) who could not find any relationship between the age of the funds and their performance. This is in contrast with other previous studies which identified fund age as a predictor variable in their model (Ferreira et al., 2012; Thomas & Tonks, 2001). Model B includes the Independent Variables as well as the size and age of the funds. According to the p-value of this model (p=0.548), none of the predictor variables made a statistically significant contribution to predicting the outcome (i.e. WAAP of the funds). This finding is the same as the previous articles which doubted the success of the Stewardship Code in achieving its proposed aims (i.e. to benefit institutional investors) (e.g. Arsalidou, 2012; Roach, 2011; Tilba & McNulty, 2012).

ii) 2nd Model

The second simple regression analysis was conducted between WAAP as the Dependent Variable and the total stewardship rate as the Independent Variable. This model aimed to determine whether the value of the Dependent Variable can be predicted by the Independent Variable. The results are presented in Table 5.5.

Table 5.5 Second Model

Simple Regression Analysis-Total Stewardship Rate	
	Model 2

	Coef. Beta	Sig.
Constant	-	0.000
Total Stewardship Rate	-0.176	0.227
Sig.	0.227	
F	1.501	
Adjusted R^2	0.010	

According to the table 5.5, 1% of the variability in the Dependent Variable (WAAP) can be accounted for by the Independent Variable (Stewardship rate) (i.e. Adjusted R Square= 0.01). The ANOVA table, however, illustrates that the 1% association between the Dependent Variable and Independent Variable is not statistically significant (F= 1.50, p-value=0.227). This result suggests that it is not possible to predict the value of Dependent Variable (WAPP) by the Independent Variable (total stewardship rate) through applying this simple regression model. The correlation coefficients table represents the same result, suggesting that there is not a significant correlation between the Independent Variable and the Dependent Variable (beta= - 0.176, p-value=0.227). In other words, by increasing or decreasing the stewardship rate (i.e. Independent Variable), the WAAP of the UK equity funds (i.e. Dependent Variable) will not change. This result indicates that a thorough application of the Stewardship Code did not provide any financial benefits for asset managers as signatories of this guideline. This finding is in contrast with the aims of the FRC proposing that applying the Stewardship Code will benefit institutional investors. Total stewardship rate is the sum of the monitoring rate and voting rate. The next two models include these two variables to run simple regression analysis explained in the following section.

iii) 3rd and 4th Model

The third and fourth simple regression analysis run between the same Dependent Variable (i.e. WAAP) and total monitoring and total voting scores as the IVs. The results from running these two models are presented in Tables 5.6 and 5.7.

Table 5.6 Third Model

Simple Regression Analysis - Total Monitoring		
	Model 3	
	Coef. Beta	Sig.
Constant	-	0.000
Total Monitoring Rate	-0.181	0.229
Sig.	0.229	
F	1.486	
Adjusted R^2	0.010	

Table 5.7 Fourth Model

Simple Regression Analysis - Total Voting		
	Model 4	
	Coef. Beta	Sig.
Constant	-	0.000
Total Voting Rate	-0.020	0.484

Sig.	0.484
F	0.497
Adjusted R^2	-0.011

Running these models illustrate that none of the above simple regression models were statistically significant at p<.05 (3rd model: p-value=.229, 4th model p-value=.484). Therefore, there is no significant relationship between the Dependent Variable and Independent Variables, suggesting that the variance of the WAAP of UK equity funds cannot be accounted for by the monitoring or voting scores of asset managers as the signatories of the Stewardship Code. In other words, disclosing a transparent report on the stewardship activities does not illustrate a better performance among the signatories of this guideline. Hence, asset managers should not expect that applying the Stewardship Code would make any difference in their financial performance, at least over a short period of time. In addition, finding no financial benefit is in contrast with the FRC's claim. Proposing an outcome which is not achievable by institutional investors would discourage them from complying with this guideline. It is notable that these statistical results are in line with the first regression model.

vi) Dummy Variables

In the fifth regression model, the Tier of the stewardship statements transformed into a dummy variable. Then a regression analysis was conducted to determine the impact of this variable on the WAAP. The regression results are presented in Table 5.8.

Table 5.8 Fifth Model

Simple Regression Analysis - Tier		
	Model 5	
	Coef. Beta	Sig.

Constant	-	0.000
Tier of Stewardship Statement	0.153	0.289
Sig.	0.289	
F	1.150	
Adjusted R^2	0.003	

The FRC developed a tiering system in 2016 by focusing on the signatories' statements to determine the best stewardship reporting against the Stewardship Code. Based on this tiering system, it could be argued that Tier 1 asset managers practice their stewardship activities more effectively when compared to Tier 2. On the other hand, the FRC believes that effective stewardship, through following the principles of Stewardship Code benefits companies, investors and the economy as a whole. In contrast with this proposition, the statistical results do not indicate a significant relationship between the Tier of the stewardship statements and the WAAP of UK equity funds (F=1.150, P=0.289). Therefore, Tier 1 asset managers who practised effective stewardship through following the Stewardship Code did not experience better financial performance when compared to Tier 2 asset managers. This result could suggest that some asset managers might disclose a high-quality stewardship report but not practice a high-quality stewardship activity in their investee corporates. Therefore, only relying on stewardship statements alone does not provide a comprehensive measurement of stewardship activities of asset managers.

v) Small-Cap Funds

Another regression analysis was run to only include the Small-cap funds in the sample. This has reduced the sample size from 50 to 19 asset managers who held small-cap UK equity funds in their portfolios. In this regression analysis, WAAP of the funds incorporated as the DV. Also, due to the small sample size, the total stewardship rate was used as the Independent Variable (Table 5.9).

Table 5.9 Sixth Model

Simple Regression Analysis – Small-Cap Funds		
	Model 6	
	Coef. Beta	Sig.
Constant	-	0.796
Total Stewardship Rate	0.155	0.525
Sig.	0.525	
F	0.420	
Adjusted R^2	-0.033	

In this model, the p-value (p=0.525) presented in the ANOVA table indicates that the total stewardship rate cannot predict the value of the financial performance. Similar to the above analysis, the application of the Stewardship Code cannot predict the value of the WAAP for the Small-Cap funds. Therefore, the category of the fund does not make any difference in the final quantitative finding. This finding is in contrast with the previous studies that found a significant relationship between the characteristics of the funds and their financial performance (e.g. Ferreira et al., 2012).

5.1.3 Summary of Quantitative Findings

According to the UK Stewardship Code (2012), effective stewardship activities "benefits companies, investors and the economy as a whole". To investigate the Stewardship Code, this study focused on asset managers, managing UK equity funds to identify the benefits of applying this guideline. Hence, the relationship between the WAAP of asset managers and their application of the Stewardship Code was statistically analysed. As explained above, there was not any significant relationship between applying the Stewardship Code and the WAAP of asset managers. Considering the main objective of asset managers (i.e. to protect and enhance the value for their clients through improving their returns), the obtained statistical result indicates that asset managers could not benefit from applying the Stewardship Code financially in the short term. This finding is against what the Stewardship Code aimed for, specifically benefiting companies, investors and the economy as a whole.

It is notable that the Dependent Variable only measured the WAAP during three years before 2017. The FRC, however, emphasised on the long-term impact of the Stewardship Code by proposing that "*the Code aims to enhance the quality of engagement and help to improve the long-term returns to shareholder*s". Long-term financial performance data, therefore, could produce different statistical trends to those indicated here. Besides, this study is aware of the limitations when conducting a statistical analysis, including the sample size or missing any important variables in the regression models. By only having asset managers in the sample, the study has limited the generalizability of the findings to other groups of institutional investors, including asset owners and service providers (Creswell, 2014).

Moreover, the financial performance of asset managers was measured using the weighted average performance of their UK equity funds. Hence, using other measurements might provide different results. Besides, to measure the financial benefit of the Stewardship Code, we only focused on the annual financial return, whereas exercising the stewardship activities could result in a reduction of risk. In other words, applying the Stewardship Code could lower the volatility faced by investors. The available data did not allow this study to investigate this relationship further.

In conclusion, focusing on the financial benefit is not enough to determine whether the Stewardship Code has been successful in achieving its proposed aims, including enhancing the quantity and quality of the engagement. Therefore, conducting interviews with asset managers is essential to better understand the Stewardship Code and to fulfil the following aims: i) the interviews would help to find an explanation for the statistical results and to explore them further; ii) interviews help to determine the non-financial benefits of applying the Stewardship Code, which could not be included in the statistical analysis; iii) it is essential to find the motivation of asset managers behind applying the Stewardship Code. The interview findings are presented in the following section.

5.2 Qualitative Findings

Invitation emails were sent for signatory of the Stewardship Code and invite them to participate in this study. Based on the quantitative findings, applying the Stewardship Code has not brought any positive financial results for its signatories, in a short period, despite the promise of the FRC. This raises the importance of conducting interviews with signatories of the Stewardship Code to investigate further the quantitative findings as well as determining any non-financial outcome achieved from applying this guideline by them. In total, thirteen individuals agreed to participate. After recording and transcribing the interviews, they were analysed in detail to identify the main emerging themes. Thematic analysis was applied to determine these themes, which is explained in the following section.

5.2.1 Main Themes

Analysing interview responses revealed four main themes:

i)Motivation

ii)Impact of Applying the Stewardship Code on Engagement

iii)Benefit of applying the Stewardship Code

iv)Quality of the Stewardship Code.

The first theme (Motivation) emerged when asset managers were explaining the catalyst for applying the Stewardship Code and engaging with investees corporates in general. The second key theme emerged when the asset managers were asked about the impact from applying the Code on their engagement. Analysing this theme revealed that a majority of asset managers (80%) emphasised that no significant change in practice had resulted from applying the Stewardship Code in their institution, financially and non-financially. After finding that most of the signatories did not notice any significant difference from applying the Stewardship Code, it was essential to focus on the responses that revealed the “Benefits” from applying this guideline. The final key theme that emerged from the interviews was the “Quality” of the Code from asset managers’ point of view. All of these key themes are explained in more detail in the following sections.

i) Motivation

Given that the statistical results indicated no significant relationship between applying the Stewardship Code and the financial performance for asset managers, it was essential to investigate further asset managers' motivations for applying the Stewardship Code. The central theme of motivation is divided into "motivation in engaging with investee corporates" and "motivation for applying the Stewardship Code". Themes, sub-themes and frequency of occurrence are illustrated in table 5.10.

Table 5.10 Motivation Sub-Themes

Sub-themes 1	Sub-theme 2	Frequency of occurrence
Engagement Motivation	• Understand the business	53%
	• Agency problem	30%
	• Helping investee corporates	46%
	• Clients	30%
	• Social media	15%
Apply the Stewardship Code	• Public recognition	7%
	• Clients	15%
	• Not to be an outlier	7%
	• Easy to comply	7%
	• Encourage responsible behaviour	7%

- Engagement Motivation

Respondents were asked to explain their motivation in engaging with investee corporates without necessarily focusing on the Stewardship Code. The responses were categorised into

"Understanding the business", "Agency problem", "Being a responsible investor", "Helping the investee corporates" and "Clients", as the sub-themes. All of these sub-themes are explained in more detail below:

- Understanding the business

More than half of the respondents expressed their engagement motivation as a way to understand the business of the investee corporates better. For example, when participant H was asked about their motivation in engaging with their investee corporates, the answer was:

"... *hopefully gains like a deeper understanding of the company-specific issues that may or may not be financially material"*.

This participant mentioned the corporate culture as an example of using the engagement to understand the business of their investee corporates and stated that:

"*The values around corporate culture … So, things like are people happy? Are people giving the right training? Do they feel like they're in an environment that they want to stay in? You can really find these things out by engaging in companies to an exten*t" (participant H).

Participant L emphasised building a good relationship with their investee corporates and developing a deeper understanding of the business as a motivational reason for engagement:

"The main aim of our engagement is to get to know some of our companies better. That's the first approach that we take. We want to know the companies in which we invest and understand as much as we possibly can about and not just about their financial results but to build a relationship with those companies over time".

Understanding business operations and strategy was also considered a key reason for engagement by participant I, who highlighted that this was central to their investment approach:

"... we've always been an active investing house, so that means that we do not follow the benchmark with the index necessarily but that we want to make a specific investment in

different companies. So that means also to get a better understanding of companies also makes it quite important that you meet with them on a regular basis."

Like participant I, participant M referred back to their investment approach:
"We have a relatively long holding period for stocks in our portfolio, so we tend to hold companies, I think on average at the moment around six years that we hold companies. So, if you are going to hold the company for that length of time, it makes sense to understand them".

Based on this theme, some asset managers found that engagement is necessary to understand the business of their investee corporates better, to help inform investment decisions and provide additional information beyond that which can be determined from the financials. This was deemed particularly important if holding periods are medium to long term.

- Helping investee corporates

The next key theme that emerged was to help investee corporates. A majority of respondents (6 out of 13) stated that they engage with investee corporates in order to help investee corporates improve their CG practices and perform better. For example, participant G reported that:

"I don't want you to leave thinking now our stewardship approach is about scrutiny and monitoring, no, we want companies to do well. Companies are not the enemy. We need the return, we back these people, we love them, yeah, and that's good. Sometimes these conversations can dwell on the negatives, that's not what (name of the institution) is about, that's not why we invest in the company, we are active, we are not activist".

On the other hand, while participant K stressed delivering long-term sustainable shareholder values, he added that:
"*… those companies that have either poor practices or higher risk if we reach out to talk with those companies, alert them to the risk, make suggestions sometimes to how they might change or improve their practices*".

This sentiment was echoed by participant J:

"So mainly it is that the better run the company, hopefully, the better the company will do. And so, we would like to engage with companies in order for that to happen".

In summary, nearly half of asset managers believe that through engagement they can help investee corporates to perform better and consequently benefit themselves through improving shareholder value in the long term. It is notable that although the financial benefits have not been directly quoted: these returns have been implicitly mentioned by participants (e.g. J and G) when they were explaining engagement motivation.

- Agency Problem

Reviewing previous academic studies that investigate shareholders engagement revealed that shareholders could help to reduce the agency problem through closing the existing gap between investors and their investee corporates (Mallin, 2010; Shleifer & Vishny, 1997; Solomon, 2013; Stapledon, 1996). In line with these academic findings, 4 out of 13 participants referred to reducing the agency problem as one of their motivations behind engaging with their investee corporates. For example, participant E mentioned aligning the interest of shareholders and the investee corporates as the reason behind their engagement and stated that:

"Corporate governance is about the agency problem. How do I know if I give my money to you that you manage it in my best interest and not yours …. So, our job, our fiduciary duty is to make sure that the businesses we invest in are being run in the best interest of their owners, our clients, and not the managers".

Participant D also addressed the agency problem in his interview and added that:
"When we identify gaps, or we believe that there is a risk that can have a potential credit quality impact. And as a fixed income investor, we are concerned about things that can impact credit quality, and we will ensure that one way we mitigate that risk is by engagement with companies".

Moreover, when participant H was explicitly asked “When you are engaging with investee corporates do you find any gaps between your expectations and your objectives from the investee corporates’ objectives or management objective?” he responded that:

“… to an extent investor expectations and company expectations haven’t been in line, but they’ve been brought more closely together because now investors are engaging in these topics of companies getting a bit of new answer on talking about these issues and also where engaging we are kind of learning how to approach these issues” [sic] .

Participants found engaging with the investee corporates helpful to resolve the agency problem through closing the existing gap between their interest and the investee corporates’ interest. This finding is inline with the traditional academics literature, proposing that institutional investors, as the largest group of UK shareholders could ensure the managers are following the same interest as the shareholders and help to reduce the agency problems that may exist in their corporates (e.g. Shleifer & Vishny, 1986).

- Clients

In addition to the above motivations, 30% of the respondents highlighted adding value for their clients as the motivation behind engaging with their investee corporates. Participant C, for example, stated that:

“... *the reason that we engage with these investment companies and try to promote responsible CG and best practice of CG is because we do think that we can make more money for our clients that way*”.

This was also reflected by participant K, who stated that:
“... we think that we can use our position as a shareholder to really improve corporate practices and as a result, deliver better long-term shareholder value…”.

Solomon (2013) argued that institutional investors, to some degree, engage actively with their investee corporates. According to this article, institutional investors are more interested in competing with other institutions to win clients through having effective engagement strategies rather than worrying about other intuitions benefiting from their activities (i.e. free rider problem). This key theme suggests that the asset owners are aware of the importance of shareholder engagement in the investee corporates and keep asset managers accountable for their stewardship activities. This appeared to be particularly so with regards to engagement on social responsibility and corporate governance issues, as voiced by participant I: *"…our clients, I think, also have a large demand for an asset manager who is really looking to sustainability practice, CG issues, etc., also from a reputational issue".*

This theme indicates that asset managers do not only publish their stewardship statements to meet the requirements of the FRC. Instead, they also have to show to their clients how they are exercising their stewardship activities.

- Social Media

Finally, two asset managers mentioned the increasing impact of social media when explaining their motivation behind engaging with the investee corporates. For example, participant E stated that:

"… I think social media, 24 hours of news, is much higher: to do bad stuff around the world and get away with it compared to 10, 20, 30 years ago. So, there is a lot more profile and more visibility around these issues".

Also, the second participant (I) stated that:
"… a lot of the pension funds can basically, they get a lot of heat from the media and from their beneficiaries about how they're invested, and why on a variety of topics on controversial weapons or sustainability matters etc.".

These responses suggest that asset managers are concerned that not engaging in the investee corporates could attract negative attention from social media and adversely affect their reputation.

Finding from the above sub-themes indicates that asset managers emphasised non-financial factors over financial factors when explaining their motivation in engaging with their investee corporates. These included understanding the business of their investee corporates better, reducing the agency problem, meeting client expectations and finally, responding to pressure from social media.

In summary, the engagement motivations stated by participants revealed that only two participants mentioned value creation for clients. It is notable the emphasis of those participants was on long-term value creation for their clients. Since the application of the Code is linked with engagement, this finding is in line with the statistical result where no significant relationship between applying the Stewardship Code and the financial performance of asset managers was identified. After finding the engagement motivations, the interviews were investigated to find the reason behind applying the Stewardship Code, which is explained in the following section.

- Motivation of applying the Stewardship Code

In addition to the above themes that explained the motivation behind engagement with the investee corporates few participants specifically explained the motivation behind applying the Stewardship Code. When participant E stated that the Stewardship Code did not help their fund to improve their stewardship responsibilities he was asked: What is the point in being a signatory of the Stewardship Code if you were doing the same thing before?". This participant categorised the motivation behind applying the Stewardship Code into a public recognition, requests by existing clients, attracting new clients, not wanting to be an outlier, easy to comply and to be a signatory of the CG Code. Participant E stated that:

"*I think we have also had a growing subsidiary of clients who are specifically asking about things like the UNPR, the principles of responsible investment, you know do you sign to these principles, which we do by the way and, are you a stewardship signatory?"*

More importantly, this participant discussed attracting new clients by following the best practices by saying that:

"…there is a huge industry around matching clients to asset managers. So, clients with a pool of capital all do a search for a fund manager... The first point of contact you get, I think, with an RFP (i.e. request for proposal) refer of the proposal, which is like a big questionnaire which a client or a consultant will be sent to us and say on a whole bunch of issues about your investment process and your compliance … and increasingly they are asking about ESG and the Stewardship".

Another interesting explanation found in the response of participant C, who raised two reasons for implementing the Stewardship Code including to encourage responsible behaviour amongst asset managers and to demonstrate best practice to clients:

"And the reason we signed up to the Stewardship Code was because we want to encourage other investors to take the same responsible attitude…. we also wanted to be able to demonstrate to our clients, you know, that we follow the best practice and to demonstrate that we are signed up to all the best practice documents".

When explaining the motivation behind applying the Stewardship Code, asset managers did not mention improving the quantity or quality of their engagement. This finding indicates that the Stewardship Code has not been successful in achieving its primary aim proposed by the FRC (i.e. to enhance the quality of engagement between institutional investors and investee corporates).

ii) Impact of Applying the Stewardship Code on Engagement

The next key theme was evident in more than 80% of the interviews where asset managers highlighted that applying the Stewardship Code did not have any significant impact on their engagement behaviour, or their engagement policies. For example, when respondent B was asked whether applying the Stewardship Code helped to improve engagement practices the answer was: *"…the Stewardship Code coming along did not really change that commitment if that makes sense".*

Also, participant A stated that: *"… the Code did not actually change any of our behaviours because we were doing it anyway".*

Participant C provided another example of no significant change:
"I would not say it helped to improve it, no. We've always been quite hard on our engagement with boards, and that aspect of things has not changed. You know since the Stewardship Code was introduced and promoted".

Based on the latest review of the Stewardship Code by FRC (2017), it was concluded that "the quality and quantity of stewardship has improved since the Code was introduced in 2010". This theme, however, illustrates that the majority of participants agreed on finding no impact on their engagement activities from the application of the Stewardship Code. Following the appearance of this focal theme, it was essential to look at the reasons given to explain why the Stewardship Code has not changed engagement policies or behaviours. That led to the following sub-themes (Table 5.10).

Table 5.10 Engagement in the Stewardship Code: Sub-Themes

Sub-themes 1	Frequency of occurrence
Already doing it	84%
Good access already exists	23%
Lack of fundamental change in proposed principles	7%

- Already Doing it

Most of the signatories surveyed could not find a significant change from applying the Stewardship Code to their engagement since they have always been committed to performing their stewardship responsibilities. When participant E was asked about the impact of the Stewardship Code on their engagement policy, the answer was:

"It did not change anything that we were already doing."

In fact, the participants emphasised on their long history of engagement, which goes back to the time before the publication of the Stewardship Code. According to respondent L, the Stewardship Code could not help them to improve their engagement to a great deal and added that:

"... we have been engaging with investee companies here in the UK since 1997, so we have a long history of knowing the companies in the UK in which we invest for our clients and engaging with these companies. We published our first responsible investment document in 2002. So, we've got quite a history".

Also, participant J included their history of engagement when explaining the impact of the Stewardship Code, saying that:
"I think we probably knew and had been doing a lot of engagement … prior to sort of having the Stewardship Code as a thing … that we would...look at in a company".

In line with that, participant C emphasised on their history of voting and stated that:
"No, I think we've always done this certainly I mean (name of the institution) has run ethically aware mandates for 40 years we've been making active use of proxy votes in all markets at least since 1984 when the famous Avon letter was published in the US which defined voting rights as an asset and made it an obligation of asset managers to exercise those votes".

When most asset managers could not name any significant change from applying the Stewardship Code, a majority of them (84%) highlighted their long history of engagement that goes back before the publication of this guideline. This finding suggests that the respondents of this study have practised an effective engagement in their investee corporates, resulting in not finding a significant change from applying the Stewardship Code on their quality of engagement. It is notable that this finding is in contrast to the existing evidence, proposing that shareholders have not acted as responsible owners in their investee corporates (e.g. IMA, 2009; Reisberg, 2015; Walker Review, 2009). This argument

was one of the main reasons behind the publication of the Stewardship Code. Hence, finding this theme could challenge the validity of the Stewardship Code.
It was assumed in this study that by including both Tier 1 and Tier 2 a range of approaches to engagement would be investigated given the different qualities of stewardship reports. To find the participants for interviews a self-selection sampling method was adopted, resulting in having mainly participants with Tier 1 statements. Due to these limitations, it is difficult to generalise this finding to the whole signatories of the Stewardship Code. Therefore, this finding could be different among asset managers with lower quality statements (i.e. Tier 2).

- Good access already exists

In addition to talking about the history of engagement, some of the respondents discussed good access as the reason behind finding no significant impact from applying the Stewardship Code. According to participant E:

"We are very lucky because we are who we are, and we are as large as we are, we have very good access. We never found it to be problematic to see whomever we want to see because we are very often large shareholders".

Therefore, participant E believed that the Stewardship Code could have been helpful for smaller investors with limited access to their investee corporates. He explained that:
"collective engagement under a number of different groups happening now … collective engagement for smaller shareholders is getting easier to do as a result of the Code because it encourages under the principles via as it is. So that is how it helped smaller managers".

Participant H, who came from a small institution, stated that the Stewardship Code had helped to improve engagement through collaborative engagement. While participant H highlighted a history of engagement, he argued that:
"We got to fill this principle, so we signed up to this collaborative engagement, and since we started it's been incredibly effective from the regard that you are in a room with tonnes of

maybe much bigger … investors … companies do have to take you seriously, and I think that improves the quality of dialogue and then also we learn from each other".

Previous academics emphasise that the size of institutional investors is key when explaining engagement practices. For example, Shleifer and Vishny (1986) found that size and ownership of the large shareholders provide sufficient incentive for them to monitor their investee corporates. Also, Micheler (2013) posited that asset owners are unlikely to engage in their investee corporates or receive enough attention from their investee corporates if they have small investments. In line with these articles, 23% of asset managers in this study highlighted fund size as an explanatory variable regarding why applying the Stewardship Code has not changed their engagement activities. According to these participants, the size of their investments already provided good access to the Board of directors, facilitating accountability when necessary.

- Lack of fundamental change in proposed principles

Among all the participants, participant A referred back to the origin of the Stewardship Code and stated that:

"And the UK Code was born out of an existing Code called the Institutional shareholders' committee...the ISC and those principals evolved from that. So, it has been a long-standing set of principles for a number of large institutional investors."

According to this participant, the Stewardship Code could not change their engagement because it has been developed from an existing Code (i.e. ISC, 2002), which existed even before the financial crisis happened in 2008. This statement is in line with Roach (2011) who argued that the Stewardship Code could not make a dramatic change in the institutional investors since it is based on a prior guideline (i.e. ISC), however, was not hugely popular among the investors. Compared to the ISC, the Stewardship Code has more regulatory power. In fact, the Walker review asked the FRC to be responsible for the new Code for the institutional investors as it was believed that FRC as an independent regulatory would be more successful in encouraging the investors in applying the Stewardship Code. Still, the foundation of the Stewardship Code principles is based on the ISC Code. The other difference between the ISC and Stewardship Code is that the FRC provided more details on how to exercise the stewardship activities, which were very brief in the ISC Code. While the FRC has been more successful in attracting the institutional investors to apply this guideline, only complying with a guideline does not guarantee a high-quality engagement. Furthermore, seven main principles of the Stewardship Code are the same as the ISC Code, so it can be argued that if the ISC was not successful in encouraging active engagement, how could the FRC ensure that the Stewardship Code would be any more effective?

Findings around this theme illustrate that the Stewardship Code did not encourage asset managers to increase the quantity or quality of their engagement activities. This finding is in contrast with Arsalidou (2012) who proposed that the importance of the Stewardship Code is to assist investors in performing their stewardship duties effectively by enhancing their monitoring and engagement in their investee companies which makes the Stewardship Code a pioneering regulation. The participants of this study generally stated that their long history of exercising the stewardship activities, having good access to the investee corporates and the lack of innovation developed within the Stewardship Code are the reasons behind not finding a significant change in engagement since applying the Stewardship Code. This finding is in contrast with the FRC, which proposed that the Stewardship Code will help to enhance the quality of engagement between investors and their investee corporates. On the other hand, this finding raised the question of “why apply the Stewardship Code if asset managers are already engaging in their investee corporates?” This question will be investigated in the following section.

iii) Benefits of applying the Stewardship Code

According to the previous theme (i.e. Engagement), most of the respondents have not changed their engagement behaviours or policies due to applying the Stewardship Code. Therefore, it was essential to investigate the benefits (financial and non-financial) of applying the Stewardship Code for asset managers. Although a few respondents found it difficult to address any direct achievement from applying the Stewardship Code, some positive changes were recognised from being a signatory of this Code. The main themes that emerged from reviewing the answers are included in table 5.11.

Table 5.11 Benefit: Sub-Themes

Sub-themes 1	Sub-themes 2	Frequency of occurrence
No Direct Benefit	NONE	30%
Non-Financial Benefits	● Reporting ● Other ○ Raise awareness ○ Encourage other countries to publish their own guidelines ○ Framework for engagement	23% 16% 8% 23%

- No Direct Benefit

4 out of 13 participants believed that although they considered their engagement beneficial, they cannot directly associate that to be a signatory of the Stewardship Code. For example, participant B stated that their engagement activities are driven by their clients' requirements and not the Stewardship Code. According to this Participant:

"So, I can talk lengthily about how our engagement has made meaningful change happen. I just don't think that is driven by the Stewardship Code. It is driven by what our clients want to see. It is driven by the firm commitment of this company, as the active ownership and dialogue all lead to the right outcome".

In line with that, the participant I explained that: *"I am not sure if I can directly relate back our achievements to be very different since the inception of the Code to be fair. I think what we typically do is we try to meet the expectation of our clients with our investment's needs".*

Participant D went even further and reflected that the Stewardship Code had not brought any achievements for their institution since they were already doing that. This participant believed that the Stewardship Code is not relevant to the current industry environment since it achieved its proposed aims, and everyone is doing it. He then provided some explanation around the Stewardship Code being irrelevant for asset managers and stated that:

"The Code, as it exists today, is not relevant to the issues that we are facing as an investor community: the risks are going to be more relevant aren't necessarily so clearly included in the Stewardship Code. The other issue we are facing is that it is too focused on equity investors. So arguably, the Stewardship Code is too narrowly focused and that is probably why it is ineffective for a house like (name of the institution) because we are a fixed income house".[5]

To investigate the reason behind applying the Stewardship Code, this participant was explicitly asked if they apply the Stewardship Code because they do not want to be an outlier. It is notable that this response did not provide any reason behind applying the Stewardship Code, which was claimed to be irrelevant to their business. Instead, he emphasised on the Stewardship Code not being relevant again and stated that:

"The Code as it exists today is not relevant to the issues that we are facing as an investor community. The risks that are going to be more relevant are not necessarily so clearly included in the Stewardship Code. The other issue we are facing is that it is too focused on equity investors. We are fixed income house as I mentioned and we have not disclosed our voting activities which is fine cause there is some voting. But there is so much weight put towards being an equity investor that it fails to consider these whole other asset classes."

Notably, these four participants are categorised as Tier 1, meaning they have followed the guidelines of the Stewardship Code thoroughly and provided transparent stewardship statements. Although asset managers emphasised on the benefits of stewardship activities, they proposed that those benefits are not due to the application of the Stewardship Code. Finding this theme is in line with the previous finding where the majority of asset managers stated that applying the Stewardship Code has not improved the quality or quantity of their

[5] This study did not explore signatories' responses with different asset classes. But it is notable that the newest version of the Stewardship Code (2020) has expanded its policies to address this issue. Principle 12 of the Code (2020) provided reporting expectations for signatories with listed equities as well as others such as fixed income investments.

engagement with the investee corporates. Besides, this theme has a close connection with the motivations behind applying the Stewardship Code which was discussed before (i.e. Public recognition, Clients, Do not want to be an outlier, Easy to comply & Encourage responsible behaviour). Those motivations can be used to explain why these asset managers still apply the Stewardship Code even if it is not considered to provide any tangible benefits for their institution. On the other hand, this finding could suggest that the legitimacy of the Code has encouraged institutional investors to apply the Code, despite not recognising any direct benefit from its application.

- No Financial Benefit

Exploring the responses revealed that all of the participants highlighted to some extent a lack of any direct positive financial benefits arising from applying the Stewardship Code. For example, participant C added:

"We have had reasonably good performance over the last five years. We are ...in the top quartile. I am not sure if I put that down to the fact that we are a signatory of the Stewardship Code. It is the fact that we've carried on doing what we've always done, and it's been effective".

Similar thoughts were raised by participant E:

"But whether our fund performances improved as the result of the Code? Probably not. Because I think it is an activity, we've always been doing, it predates the Code actually".

Participant G emphasized the difficulty in finding a causal relationship between the financial performance of the fund and acting as a responsible investor. This participant specifically highlighted a lack of adequate information to explain this causal relationship:

"It would be very difficult to spill that out … without asking them (i.e. fund's clients) … when they are buying your funds asking how much of this money you are giving us is because of the performance of the fund you buy or how much is it to fulfil the remit".

Participant H argued that although applying the Code should have a positive impact, it would be difficult to attach it to the Stewardship Code specifically. He stated that:
"From a financial point of view, I think ...the relationship doesn't break down because it's a little bit hard to distinguish, I think if you do carry out your stewardship activities effectively, I think it does have financial returns. By fundamentally understanding your companies better, you can make better investment decisions and that if you make better investment decisions if you are good investors that results in better financial returns".

The FRC proposed that the Stewardship Code aims to help improve long-term risk-adjusted returns to shareholders through improving the quality of engagement between investors and companies. This theme is in contrast to the FRC's claim, indicating that asset managers have not seen any positive relationship between applying the Stewardship Code and their financial performance. In fact, these asset managers find it difficult to attribute their enhanced performance to be a signatory of the Stewardship Code. This result is in line with the initial statistical finding where no significant relationship between applying the Stewardship Code and the annual financial performance of asset managers was confirmed.

- Non-financial Benefits

Most of the participants (70%) agreed on the non-financial benefits from applying the Stewardship Code such as better reporting of their engagement activities to their clients, improving the engagement culture and inspiring other countries to publish their Stewardship Code which are explained below:

  - Reporting

Reporting emerged as one of the positive non-financial benefits of applying the Code by most asset managers. The interviewees stated that the Stewardship Code improved their stewardship reporting and made them more transparent about their stewardship activities. For example, respondent E said that:

"We did not have a public engagement policy which we now build around Stewardship Code disclosure. So, there were some changes around the documentation".

This response shows the positive changes in reporting as a result of applying the Stewardship Code. In line with that, participant C stated that their reporting has improved after being a signatory of the Stewardship Code:

"... we are very clear about, and how investors should report periodically on stewardship activity, so I think this is an area where prior to the stewardship coming out you know we probably were weak, and that is the part of our business that we have strengthened as the result of the Stewardship Code".

Some of the participants stated that the Stewardship Code enabled them to explain their stewardship activities to their clients. For example, participant F stated that:

"...when our clients ask us, what are we doing, yeah, we are able to respond positively. So that has some benefit. But it is hard to quantify".

Asset managers found applying the Stewardship Code beneficial in reporting their stewardship activities to their clients. This finding suggests that applying the Stewardship Code has helped asset managers to improve communication around the stewardship activities and how they exercised their stewardship responsibilities to protect the interests of their clients. Therefore, the Stewardship Code has helped asset managers to build a better relationship with their clients. Hence, it was successful to partially fulfil some of its purposes.

- Other

The other non-financial benefits mentioned by participants included providing a framework for engagement, encouraging other countries to publish their version of the Stewardship Code and to raise awareness among investors. For example, participant E stated that:

"It provides a framework for us to talk about how we thought about these issues and it is a recognition publicly that we are doing the stuff that we were always doing".

To summarise, almost all of the participants emphasised that they cannot find a direct positive relationship between applying the Stewardship Code and financial performance of their institution. On the other hand, the participants stressed the non-financial benefits of applying the Stewardship Code, explicitly reporting their stewardship activities. Exploring the benefits of the Stewardship Code for asset managers provided support for the initial statistical result where a significant relationship between the annual financial performance of asset managers and their stewardship activities was not found (F= 1.50, p-value=0.227). Based on this theme, asset managers do not think about financial benefits when applying the Stewardship Code. Besides, asset managers only found the Stewardship Code helpful as a framework to organise their stewardship activities and in preparing a better report for their clients.

vi) Quality of the Stewardship Code

After finding that some of the participants could not find any direct benefits from applying the Code, they were asked about their opinion on the quality of the Stewardship Code. In doing so, the participants were asked to discuss their opinion on the strengths and weaknesses of the Stewardship Code. After reviewing the participants' responses, four sub-themes were identified (see table 5.12).

Table 5.12 Strengths and Weaknesses of the Stewardship Code: Quality Sub-Themes

Sub-themes 1	Sub-themes 2	Frequency of occurrence
Strength	• Not prescriptive/Comply or Explain • Long term focus	23% 7%
Weakness	• Box-ticking approach • Measuring success	46% 30%

- Not prescriptive/Comply or Explain

To discuss the strengths of the Stewardship Code, only one theme emerged: that the Stewardship Code is not prescriptive and permits a comply or explain the approach. For example, according to participant G:

"I think it is what highlights the engagement under the Stewardship Code. It is not defined very sort of prescriptively, and that a deliberate design. The idea is to ensure that there is an

open step dialogue … the FRC did find a checklist of ... issues against which the investor should be engaging, and we certainly see that as one of the strengths of the stewardship Code".

While participant K mentioned not being prescriptive as a strength, he explained that this feature allows a level of freedom for the shareholders to decide about their stewardship activities:
"I really think it is important to allow shareholders to figure out what works best for them you know in light of the particular asset class or the particular fund's mandate, so I think that is really a strength that I would not want to see that change".

Participant E emphasised not being prescriptive as a positive feature of the Stewardship Code. He proposed that this feature has allowed adaptation of the Stewardship Code by other countries:

"I never thought in my career we would see much material change, you know Japanese board never had independent directors, let alone female directors, you know it is unthinkable, and that is starting to change now. And that is the result of a lot, but it is partly the results of Stewardship Code, proliferating around the region. They are not too prescriptive, they just encourage and formalise your obligation to do what you were going to do anyway".

The focus of this study was on UK asset managers. Therefore, this is an interesting finding suggesting a positive impact from the application of the Stewardship Code on CG of foreign corporates. According to this participant, although the impact of the Stewardship Code on their engagement practices is insignificant, it might have been successful in making significant improvements on the ownership behaviour of foreign investors. Participant E believed that following a non-prescriptive approach could help to encourage foreign investors to follow the guidelines of the Stewardship Code. This approach allows investors to apply those principles that are relevant to their business and explain those that are not. This finding is in contrast to the existing studies that criticised the Stewardship for having a domestic focus and ignoring foreign investors (Arsalidou, 0212; Cheffin, 2010; Reisberg, 2015). It is notable that the positive change on CG of foreign corporates could have been driven by UK investors investing in those corporates. Although this is an interesting finding, it is difficult to conclude that applying the Stewardship Code has changed the ownership behaviour of foreing investors.

According to 23% of the participants, not being prescriptive is one of the strengths of the Stewardship Code, providing freedom for the signatories to exercise their stewardship activities based on their own institutions' interest. It is notable that this positive feature of the Stewardship Code is enhanced by the 'Comply or Explain approach'. This means that asset managers do not have to follow all the principles of Stewardship Code but may explain why they did not comply. As aforementioned, participant D stated that although the Stewardship Code is not relevant to their institution, the comply or explain approach allows their institution to follow the Stewardship Code and publish their stewardship statements. In line with this argument, participant E stated that:

"*The beauty of the Code is that it is not too prescriptive, it's seven broad principles saying this is what you should do, it is on comply or explain basis which is the cleverest thing that Cadbury did, you know if it is not appropriate to your business model don't do it but tell us why and let your clients decide what they want to do as a result. So that is the reason it gained attraction. I think a big detailed rule book would be problematic".*

After reviewing this theme, it was revealed that some of the respondents emphasised on the "comply or explain" approach as one of the strengths of the Stewardship Code, permitting freedom to follow the principles of Stewardship Code relevant to business needs. This finding is in contrast with some of the previous studies which criticised the "comply or explain" approach affecting the quality of the stewardship report adversely. For example, Solomon (2013) proposed that shareholders feel that it is better if companies report on positive ways that they are following the governance principles instead of disclosing examples of non-compliance. Also, Arsalidou (2012) argued that firms do not use the comply or explain model effectively to adjust their governance to their changing circumstances and instead focus simply on the choice of whether or not to comply. In an article by Masters and Burgess (2010), the director of corporate governance and reporting for the Investment Management Association argued that a comply or explain approach would motivate some asset managers to get involved even if this engagement was not in the best interests of their clients. It is notable that in the latest review of the Stewardship Code (2017), the FRC has some concerns over the quality of the stewardship statements indicating that asset managers did not follow this approach effectively. Therefore, all the above arguments challenge not being perspective, specifically the “comply or explain” approach as the strength of the Stewardship Code.

- Long term focus

Another strength of the Stewardship Code, mentioned by participant A, was that it encourages long-term focus:

“The strengths are that it just … emphasise the responsibility of investors to manage capital for the long-term and what that it entails”.

This finding is in line with the primary objective of the Stewardship Code, which was to promote shareholder engagement and create a long-term investment culture on behalf of institutional investors (Arsalidou, 2012).

- Being Reviewed by a Regulatory Body

Reviewing the participants' responses revealed the final strengths of the Stewardship Code, being that it is reviewed by a regulatory body. According to participant K:

“It is good that it is overseen by the regulator, and there is some bonus to demonstrate how you’re applying it you know as opposed to just signing it and doing nothing to implement the principles, so I think it’s good that signatories are expected to at least file a general statement describing how they are implementing the principles”.

Therefore, this participant believed that being reviewed by the FRC is one of the strengths of the Stewardship Code. In the latest review of the Stewardship Code, the FRC emphasised that they are not able to review each individual engagement and rather they reviewed asset managers’ stewardship statements. This review resulted in the tiering system developed by the FRC recently.

- Weaknesses

In addition to the strengths, the following themes emerged as the weakness of the Stewardship Code described below:

  - Box-Ticking Approach

Nearly half of the respondents emphasised on the box-ticking approach either directly or indirectly as one of the weaknesses of the Stewardship Code. Participant L directly talked about the box-ticking approach and stated that:

"...And I think the downside of the Stewardship Code is potentially it leads to an exercise in box-ticking, I don't think it does that, but that's the potential of the areas that could be of concern".

Participant (E) explained how some participants followed a box-ticking approach:
"I know for a fact that plenty of people who are saying that they are doing a lot, but their activity is something rather different. So that's, those same issues are actually weaknesses, you know the fact that you can opt out of it, the fact that some people you know sign up and do nothing".

It was an interesting answer indicating that some signatories do not practise the same stewardship activities that they disclose in their stewardship statements. This finding could be applied to explain the statistical finding where no significant relationship was found between the financial performance of asset managers and the Tier of their stewardship statements. Based on this statement, some asset managers may provide a high-quality stewardship statement to protect their reputation among their rivals and clients. On the other hand, this finding suggests lack of an effective compliance audit by the FRC, representing a weakness of the Stewardship Code. Participant E later identified the meaning of stewardship by asset managers as the reason behind following a box-ticking approach and stated that:
"I think it is very easy to pick up the phone and talk to a company and ask them some simple questions and then call it stewardship and that's not how we define it, we define

stewardship as ongoing dialogue and an ongoing relationship, it's not about saying I picked up the phone, I've made a phone call, therefore, I made my responsibilities we see it as much more than that".

In line with this, participant M observed potential issues concerning the potential low-quality application of the Stewardship Code:
"… there might be a reputational risk. Then you will fulfil the requirements of the stewardship Code as soon as cheaply as you can because it is just compliance".

This participant believed that:
"...the way that the whole Code is presented, constructed is very much a kind of compliance thing which helps raise the bottom, raise the floor, but it doesn't help raise the ceiling. So, I think that's a weakness, A major weakness".

The box-ticking approach was also raised as a concern in the FRC report (2014). The FRC report commented that after the growth in the number of signatories, they received some reports that accused proxy advisors of following a "box-ticking" approach in the absence of effective engagement with companies. According to FRC (2014), investors should not just tick the box but commit to adopt and report against the principle of the Stewardship Code with appropriate explanation. To address the poor quality of the statements, the FRC developed a tiering system which rated the statements into Tier 1 and Tier 2 and subsequently deleted Tier 3 signatories from the list of the signatories. Emerging this theme within the dataset indicates that this issue has not been resolved since the latest review by the FRC in 2017.

- Measuring Success

The Stewardship Code (2012) sets out the principles of effective stewardship by investors. Therefore, the outcome of applying the Stewardship Code should be an improvement in stewardship activities. Notably, the interviewed asset managers included measuring the success of the stewardship activities as one of the weaknesses of the Stewardship Code. In fact, one-third of the participants believed the Stewardship Code has not been clear about measuring the success of their engagement with the investee corporates. For instance, participant B stated that:

"What's much more interesting is that actually how do you take what it is that you are really trying to achieve for a company and then measure the progress that you are actually having with that. So, what are the outputs of your stewardship programme and I don't know if the Stewardship Code really does that I don't quite know how they could do that".

Based on the above comment, the Stewardship Code has not made it clear for the signatories how they can make sure whether the outcome of their stewardship activities have been successful or not. Participant F stated that:
"...But certainly, from the 'weakness' point of view, the enforcement side of it is getting more specific about what is expected as far as best practice or good practice, that it is the principle, so we do that kind of assessment. But we just made up our own approach for this".

Participant H argued that although providing a guideline for investors has been one of the strengths of the Stewardship Code. It could also suggest a weakness as well:
"...it does not offer really any guidelines on ... what good stewardship looks like or what effective stewardship looks like. So, while we do explain the conceptual framework that's good it doesn't explain what's out in the field and what's out in like practice work...should they really be telling you what's good stewardship, I think they should, but some people might say they shouldn't."

In line with the above findings, one-third of the respondents posited that they find it difficult to measure the success of the stewardship activities. For example, participant A stated that:
"...I think there's no single clear metric that you can look at, so, you have to look at ... underlying indicators and there are a few of them. So, we would look at our voting record, and we would see to what extent our companies are improving over time ... And we try to track the number of times that we requested something from a company, and they've gone on and implemented something consistent or similar".

While participant D emphasised the difficulty of measuring the stewardship activities, he explained that:
"We are not looking for a binary result such as the company is responding or it's not, and we can turn that up … we don't really see it as success or failure because even if we don't get information from a company that's still useful information. The aim of doing our engagement is to get confidence on risk".

Later this participant added that their goal of stewardship activities is not measurable since they aim to enhance their decision making and reduce the risk of their investment.

Compared to the above respondents, 60% of asset managers stated that they developed their system of measuring the stewardship activities. It is notable that all of these measuring systems incorporate qualitative measurement through monitoring and tracking engagement activities. Only respondent C mentioned using the performance to measure the success of the stewardship activities:
"...ultimately we measure it by our investment performance. ...we perform well or whether we perform badly. Because for us our stewardship activities are an important means by which we add value for our clients. So, if we are underperforming … obviously, things are going wrong, and one of the things that could go wrong is the fact that our stewardship engagement is not achieving what it should achieve."

In contrast, participant E stated that although the financial performance could be a good measurement, it is difficult to measure the success of stewardship activities:
"So, the visible output is the financial performance, and that's quite a hard thing to evidence on its own because it is mixed with many other factors and it's longer-term issues as we said … But other than that, it is quite hard to assess to quantify its success".

In summary, this theme indicates that the Stewardship Code has not provided a clear guideline either on defining or on measuring the success of the stewardship activities for its signatories. This theme could explain the previous finding where the four out of 13 participants believed that although they considered their engagement beneficial, they cannot directly associate that to be a signatory of the Stewardship Code. In other words, if asset managers are not able to measure the success of their stewardship activities, it would also be difficult to determine any benefit from exercising those activities. On the other hand, lack of measuring guidelines might make it difficult for the signatories to monitor and improve their stewardship activities when necessary.

Furthermore, some of the signatories stated that they do not look for measuring the success of their stewardship activities by analysing their financial performance. According to these asset managers, financial performance is a result of many factors and not only the stewardship activities. These findings correctly address the statistical outcome where there was no relationship between applying the Stewardship Code and the financial performance of asset managers.

5.3 Summary

According to the FRC website, the UK Stewardship Code aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders. During the second methodology stage, asset managers were asked to discuss their opinion on the application of the Stewardship Code which helped to investigate whether the Stewardship Code has been successful in reaching its proposed aim (i.e. enhancing the quality of engagement by institutional investors). After analysing the interview responses, the majority of the participants stated that the Stewardship Code did not help them to enhance the quality or quantity of their engagement with the investee corporates. This finding indicates that the Stewardship Code has not been able to reach its proposed aim claimed by the FRC. According to the respondents, having a long history of engagement before being listed as a signatory of the Stewardship Code was the main reason behind this finding.

Later, the participants were asked about their achievement by applying the Stewardship Code, which they found difficult to explain. While these participants acknowledged the importance of engagement with the investee corporates for their institutions, they did not think it was directly due to the application of the Stewardship Code. According to the FRC (2012), effective stewardship through applying the guidelines of the Stewardship Code will benefit companies, investors and the economy as a whole. By contrast, based on the interviews, asset managers do not believe that the Stewardship Code has provided any significant benefits to them. Notably, all participants emphasised that they are not aware of any financial benefits from applying the Stewardship Code. This finding is in line with the initial statistical result of this study. Some of the participants explained the non-financial benefits of the Stewardship Code, specifically that it encourages them to prepare better stewardship reports for clients and provides a framework for engagement activities.

The other important finding related to specific motivations that drive asset managers to apply the Stewardship Code. Most participants referred to their clients when explaining the reasons, as well as pressure from social media and not wanting to be an outlier. This response suggests that these asset managers apply the Stewardship Code to protect their reputation which unfortunately leads, at times, to a box-ticking approach (i.e. where the signatories only follow the guidelines to tick the box without practising effective stewardship activities). Many interviewees recognised the box-ticking approach as a weakness of the Stewardship Code, a finding that is in line with the primary concern proposed by FRC (2016) in the latest review of the Stewardship Code. In 2016, the FRC attempted to deal with this issue by developing a tiering system. Whereas, the finding of this study illustrates that the issue still exists.

Furthermore, no signatories interviewed mentioned any financial motivation behind applying the Stewardship Code, indicating that these asset managers do not look at the Stewardship Code as a guideline to improve their financial performance. In fact, some of the signatories argued that they intended to improve their decision making and to reduce the risk when applying the Stewardship Code. This result is also in line with the statistical finding where there was no relationship between applying the Stewardship Code and the annual financial performance of asset managers.

In addition to the above findings, one-third of the respondents declared that they do not know how to measure their stewardship activities and determine whether their actions have been successful or not. Some participants blamed the Stewardship Code for not being clear on giving guidance around measuring the stewardship activities. Based on this finding, if asset managers cannot measure their stewardship activities, it would be a challenge for them to identify the achievements of applying the Stewardship Code. This argument can explain the previous finding where four asset managers could not find a direct benefit from being a signatory of the Stewardship Code.

Among the 13 participants only one of them is categorised as Tier 2. Analysing this participants' interview revealed that his responses were generally the same as the other participants who are listed as asset managers with Tier 1 stewardship statements. Still, the fact that the majority of the participants interviewed were categorised as Tier 1 makes it difficult to generalise the above findings to those asset managers with Tier 2 stewardship statements. This limitation, along with the important qualitative and quantitative findings, is discussed in the next chapter.

Chapter 6

6. Discussion

In light of the financial crisis, the Stewardship Code was published, emphasising on the importance of institutional investors' role in their investee corporates. The Stewardship Code provides a set of principles for investors on how to conduct their stewardship responsibilities effectively. The Stewardship Code claims to be the first of its kind in the world and has inspired other countries (such as Japan, Malaysia and South Korea) to publish their own stewardship policies. The FRC states that the aim of the Stewardship Code is to enhance the quality and quantity of the engagement between investors and companies, benefitting investors, companies and the economy as a whole. As the responsible body, the FRC reviews the Stewardship Code and its application by the institutional investors regularly. In the first review of the Stewardship Code (2011, p1), the FRC was impressed with the number of signatories stating that "the sign-up to the Stewardship Code by over 230 asset managers, asset owners and service providers in its eighteen months of life was beyond our expectations". Three years later, the FRC review (2014) confirmed that the Stewardship Code was going in the right direction to fulfil its main objectives including encouraging a higher number of investors to engage in their investee corporates, increase the quality and quantity of engagement and to increase the accountability of the investors towards their clients. The review of the Stewardship Code for the period 2015 - 2016, raised concerns over the quality of stewardship reports. In particular, it concluded that statements describing the stewardship approach taken by the businesses producing the reports did not in fact provide sufficient information to enable readers to understand what steps were being followed by the signatories. According to the FRC review (2015, p.12):

"Overall the quality of reporting against the Code does not give a clear enough picture of the approach to stewardship. Insufficient clarity by signatories can make it difficult for clients to assess managers and their different approaches to stewardship".

This concern has resulted in developing a tiering system where the stewardship statements categorised in Tier 1 (i.e. reported good quality and transparent description of their stewardship activities) and Tier 2 (i.e. reported less transparently on their stewardship activities).

Apart from the FRC review, there are no empirical studies that have reviewed the Stewardship Code independently to determine its success in fulfilling its initial aims. Moreover, the FRC reviews did not illustrate the impact of the Stewardship Code on the quantity or quality of the investors' engagement. To close the existing gap, this study aimed to understand the impact of the Stewardship Code on the financial performance of asset managers as well as their engagement behaviour. The obtained results found in this study are discussed in this chapter.

6.1 Description of Quantitative & Qualitative Findings

This study found that there was no significant relationship between applying the Stewardship Code and financial performance of asset managers as the main group of signatories. Besides, asset managers proposed that their engagement behaviour has not changed as a result of applying the Stewardship Code. These results obtained by applying a mixed methods approach. First, a statistical analysis was run between the WAAP of asset managers and their application of the Stewardship Code. Then, asset managers, as signatories of the Stewardship Code, were interviewed to explore their opinion on the application of this guideline. The results indicate that although applying the Stewardship Code has brought some non-financial benefits (e.g. better reporting to clients), it has not enhanced the financial performance of asset managers. These results are discussed in the following section in light of the existing academic literature.

6.2 Discussion of Quantitative Findings

Determining the financial benefits of exercising stewardship activities is very important. According to Reisberg (2015), difficulty in measuring the value of engagement return is one of the factors that demotivates investors from effective engagement. After comparing the firm average financial performance with the average firm-level stewardship approach, it was found in this study, that there was not a significant relationship between WAAP of asset managers as signatories of the Stewardship Code and their stewardship activities. The statistical analysis illustrates that asset managers who invested more effort into their stewardship activities did not find a higher performance compared to asset managers who invested less effort. In other words, applying the Stewardship Code did not cause a significant financial benefit during the last three years for its signatories. To compare the finding of this study with the existing academic evidence, the empirical evidence around shareholder activism were reviewed. shareholder responsibilities and their impact on the governance of corporates has been a popular and widely debated topic among academics and policymakers (Bebchuk, 2005, 2007; Becht et al., 2002; Cadbury Code, 1992; Greenbury report, 1995; Micheler, 2013; Myners Review, 2001). According to Tihanyi et al. (2003), institutional investors, due to their significant ownership, have the incentive to monitor the management as well as having the power to impose their desired changes that they think is beneficial in their investee corporates. In line with this, Agrawal and Knoeber (1996) proposed that institutional investors prefer to increase activism as a method to exercise their power in corporates since it is not easy for them to follow a divestment approach due to the size of their investment. Reviewing the existing academic studies, it was found that the majority focused on firm-level outcomes of shareholder activism. It is notable that the results of these studies are not conclusive. While the first group of authors found no link between shareholder activism and performance (e.g. Black, 1998; Carleton et al., 1998; Gillan & Starks, 2007; Karpoff, 2001; Karpoff et al., 1996; Prevost & Rao, 2000; Smith 1996; Wahal, 1996), the second group reported a positive link between the two variables (e.g. Becht et al., 2009; Brav et al., 2008; Greenwood & Achor, 2009; Klein & Zur, 2009, 2011).

The quantitative finding of this study is in line with the first group of authors who found no link between shareholder activism and financial performance of their investee corporates. The financial performance of investors depends on the financial performance of their investee corporates. Therefore, the finding of this study also suggests that signatories of the Stewardship Code could not have a positive impact on the performance of their investee corporates through performing their stewardship responsibilities. For example, Wahal (1996) evaluated the effectiveness of pension funds' activism on their targeted corporates.

Although he found that active pension funds could change the governance structures, activism could not create a significant improvement in share returns or performance of investee corporates. The efficiency of institutional investor activism was also challenged by Karpoff et al. (1996), who reported that investor proposals had a small and insignificant effect on share value and operating returns. The findings of these studies indicate that institutional investors could not enhance the financial performance of their investee corporates through their active engagement. Accordingly, if institutional investors were not successful in enhancing the performance of their investee corporates, they were not able to enhance shareholder returns (i.e. did not improve their own performance).

This quantitate finding is in contrast with the second group of authors who reported a positive link between shareholder activism and outperformance of the invested funds. Betcht et al. (2009) explored the shareholder activism of Hermes UK Focus Fund, a UK pension fund, and found a positive link between this fund's good performance and its activism. That study only included one fund, making it difficult to generalise the findings to others. It is notable that other studies which reported a positive link between shareholder activism and financial performance faced criticism. Goranova & Ryan (2014) reviewed shareholder activism studies found that those that reported a positive impact on performance mainly focused on hedge fund activism (e.g. Becht et al., 2009; Brav et al., 2008; Greenwood & Schor, 2009; Klein & Zur, 2009; Klein & Zur, 2011). Hence including other types of funds could result in a different result.

In addition to the above limitation, it was found that existing studies of shareholder activism mainly focused on one type of engagement: specifically shareholder proposals (e.g. Carleton et al., 1998; Cziraki et al., 2010; Gillan & Starks, 2000; Hadani et al., 2011; Karpoff et al., 1996; Prevost & Rao, 2000; Smith, 1996). This finding was also observed by Filatotchev and Dotsenko (2015), who also highlighted that most of the prior studies investigated shareholder activism in the US. Consequently, if other countries were investigated, the result could be different.

The current study has addressed these limitations through considering different types of stewardship activities (i.e. voting, monitoring, and having a purposeful dialogue with investee corporates) and including different types of UK equity funds. Still, the final results illustrate no link between performing stewardship activities and improved financial performance during the last three years for signatories of the Stewardship Code.

Despite the popularity of shareholder responsibilities among academics, evidence on the application of the Stewardship Code is very limited. A small number of academic studies were found which tried to explain the potential impact of the application of the Stewardship Code for its signatories (Çelik & Isaksson, 2014; Cheffins, 2010; Michealer, 2013; Reisberg 2016; Tilba & McNulty, 2013;). It is notable that these studies did not address any financial benefits and mainly focused on non-financial benefits. The conclusion of these studies indicates that fostering a better quality engagement by investors after the launch of the Stewardship Code would be unlikely. For instance, Reisberg (2016) argued that to perform an effective engagement, investors have to develop a careful design and arrange some procedures for monitoring, meeting and intervening in investee corporates when necessary. Reisberg stated that there are some traditional barriers such as engagement cost, preventing the success of the Stewardship Code to enhance the quality of engagement. The impact of the Stewardship Code on the quality of engagement will be discussed later when explaining the qualitative findings of this study.

The final sources to compare the quantitative findings of this study are the FRC reports. FRC, as the official regulator, stated that effective stewardship benefits investors, companies and the economy as a whole. According to the FRC, applying the Stewardship Code will result in better returns to shareholders by encouraging a higher quality engagement between investors and companies. The statistical findings of this study suggest that the Stewardship Code has not been successful in enhancing the quality or quantity of investor engagement by applying the Stewardship Code. The Walker Review (Walker, 2009) asked the FRC to review the application of the Stewardship Code annually and publish a report to present its findings. Analysis of the FRC's annual reports from 2011 to 2018 revealed that they had focussed on the quality of stewardship statements rather than the extent to which the Stewardship Code has fulfilled its proposed aims (i.e. whether the application of the Stewardship Code has benefited its signatories). Developing the tiering system by FRC in 2016, which categorised the signatories' stewardship statements into Tier 1 and Tier 2, has been the result of this focus. Despite claiming a higher financial return for its signatories, reviewing the FRC reports did not help to determine the success in reaching this aim. A lack of focus on the financial impact could be due to difficulty in measuring the financial benefits of engagement. Despite this difficulty, the investors are more likely to apply the principles of

Stewardship Code thoroughly, if they know that this would bring positive financial benefits for their institutions (Raisberge, 2015; Michealer, 2013). According to Michealer (2013), difficulty in measuring the financial benefit of active engagement as one of the reasons behind the lack of interest in active ownership as well as lack of demand by asset owners. Therefore, FRC as the responsible regulator should seek to measure and report the financial return for the signatories who perform effective stewardship. This might increase the number of signatories of the Stewardship Code as well as encouraging more effective practice of stewardship activities by the existing applicants of this guideline.

Notably conducting a statistical analysis does not reveal the reason behind finding no relationship between the application of the Stewardship Code and financial performance of asset managers. Besides, focusing on the financial impact of the Stewardship Code alone does not help us to fully understand the success of this guideline in reaching its proposed aims. The next section will discuss the qualitative findings which help to address these concerns.

6.3 Discussion of the Qualitative Findings

To further investigate the statistical findings and to determine the non-financial outcomes from applying the Stewardship Code, this study conducted interviews with asset managers as the main signatories of the Stewardship Code. The participants were asked about benefits from applying the Stewardship Code, specifically the impact of the Stewardship Code on their engagement activities.

i) Engagement

When the Stewardship Code was published in 2010 the FRC proposed that it aimed to enhance the quality and quantity of engagement between investors and companies. In contrast to the FRC's proposition, a majority of the participants (80%) agreed that applying the Stewardship Code has not changed their engagement with investee corporates significantly. This finding implies that the Stewardship Code has not been successful in fulfilling its initial aim. This finding contrasts with the Stewardship Code review in 2016, which claimed that both the quantity and quality of the engagement had improved since the publication of the Stewardship Code. It is notable that the FRC found this result by analysing a sample of signatory statements. But the Stewardship Code has been associated with some issues that might negatively influence the success of this guideline. The Box-ticking approach adopted by institutional investors has repeatedly been raised as an issue by the FRC, concerned that some signatories followed a “box-ticking” approach without performing effective engagement. Following a box-ticking approach is not a new phenomenon, and it has been raised as a concern since the CG guidelines have been introduced. For example, Lord Young (1995) proposed that although improving accountability and transparency are essential for companies, the additional rules developed by Cadbury (1992) could result in box-ticking exercise rather than genuine commitment to implement the spirit of the Cadbury Code. Nearly half of the respondents of this study emphasised on the box-ticking approach as a key weakness of the Stewardship Code. This finding indicates that the box-ticking approach is still an issue affecting the quality of stewardship reports. This was predicted by Arsalidou (2012) given that stewardship is not the main concern of investors. This argument challenges the FRC’s finding reported in its reviews (i.e. positive impact of the Stewardship Code on the quality and quantity of the investors’ engagement).

Apart from the FRC report, there is a lack of academic literature evaluating the Stewardship Code, exploring stewardship statements or that has directly interviewed signatories of this Code. After a close review of the existing academic literature, a small number of studies found which explored the Stewardship Code by applying existed arguments and secondary data (e.g. Çelik & Isaksson, 2014; Cheffins, 2010; Gilson & Gordon, 2013; Reisberg, 2015; Tilba & McNulty, 2013). In line with the finding of this study, all the previous studies failed to find a significant impact from the Stewardship Code on the engagement behaviour of institutional investors. For example, Reisberge (2015) explored the achievements of the Stewardship Code by analysing the arguments which were advanced before as well as the issues related to this Code. According to Reisberg, there are some significant obstacles preventing the success of the Stewardship Code, such as engagement cost and dismissing overseas investors as one of the major groups of shareholders. In line with Reisberg, Cheffin (2010) criticised the Stewardship Code for not considering the shift in the ownership pattern from domestic to foreign investors. In contrast to this argument, one of the participants of this study (i.e. Participant E) praised the Stewardship Code for making improvements in the ownership behaviour of foreign investors, resulting in a better CG system in their companies. Cheffins (2010) concluded that transforming the passive behaviour of the shareholders by applying the Stewardship Code is not very likely. Besides, Çelik and Isaksson (2014) argued that active engagement by investors depends on their business model. They proposed that if the engagement does not fit within the business model of investors, public policies and voluntary standards are likely to have little impact on institutional investors. Çelik and Isaksson (2014) also stated that ignoring foreign shareholders when developing the policies could affect the effectiveness of the Stewardship Code. The finding of this study is inline with concerns of the existing literature, indicating that applying the Stewardship Code has not changed the engagement behaviour of asset managers significantly.

It is notable that the reasons provided by participants for reporting no significant impact from applying the Stewardship Code are different from the above studies. The first important theme emerged when looking at the reasons was "already doing it". The majority of the participants (84%) specified their long history of engagement to illustrate they were already engaging in their investee corporates before the publication of the Stewardship Code. This unexpected finding is in contrast with most of the empirical studies criticising the institutional investors for their passive ownership behaviour, specifically during the financial crisis (Robert & Monks, 2011; Solomon, 2013; Crespi & Renneboog, 2010; Monks & Sykes, 2002; Myners, 2001, 2009). Lord Myners (2009) addressed this issue in his speech shortly after the banking crisis and described the institutional investors as the "absentee landlords" who contributed to "ownerless corporations". In line with that, Walker (2009) stated that failures of the Board and directors might have been addressed effectively if major investors had acted as responsible owners and had been engaged in their investee corporates. Also, Arsalidou (2012) proposed that lack of monitoring the Board by the pension funds and insurance companies was one of the main reasons for the failure of companies during the financial crisis. In line with the above academic findings and as a response to criticism around ineffective shareholder engagement during the financial crisis, the FRC published the Stewardship Code in 2010. Therefore, finding that the participants of this study have always engaged in their investee corporates could suggest that publication of the Stewardship Code was not based on a valid reason.

There are some arguments that might challenge the validity of this finding. First, participants of this study mainly emphasised on the quantity rather than the quality of their engagement. Having voting policies or practising voting rights at AGMs does not indicate that asset managers were actively engaged in their investee corporates. This argument is in line with Mallin (1996) who found that, although most of the fund managers voted on all issues, it does not mean that they were acting responsibly. Mallin found that some of the fund managers followed a box-ticking approach and voted without considering the issues carefully. Second, 4 out of 13 participants stated that they have good access and resources, helping them to deliver effective engagement in their investee corporates. According to the FRC report (2011), lack of resources is one of the barriers for the shareholders to perform an effective engagement. Also, Micheler (2013) posited that asset owners are unlikely to engage in their investee corporates or receive enough attention from their investee corporates if they have a small investment. Therefore, finding that participants of this study had a good level of engagement in their investee corporates could be due to their resources and level of access.

In conclusion, finding that the Stewardship Code has not been successful in enhancing the quality of engagement between institutional investors and investee corporates indicates that the Stewardship Code has failed to fulfil one of its significant objectives. This finding suggests that the FRC did not consider the abilities and resources available to different groups of all investors when developing its principles. According to the participants of this study, high quality engagement has always been practised by them in their investee corporates, although this opinion may be taken with some skepticism. Consequently, for Tier 1 investors, not being able to notice a difference in their engagement practices could negatively affect their future stewardship activities. The current version of the Stewardship Code (2012) gives these investors a signal that they are doing well, which might demotivate them to make further improvement in their investee companies. It is notable that on the 30th of January 2019, the FRC published a consultation on a new draft of the Stewardship Code and received over 100 responses from the stakeholders. On the FRC website, it is stated that:

"*To ensure the Code will drive distinctive and high-quality stewardship reporting, we are undertaking targeted outreach to test changes to our proposals on activities and outcomes reporting before publishing the revised Code later in 2019*".

Based on this statement, it seems that the focus of the FRC is again on the quality of stewardship reporting. Whereas, high quality stewardship statements do not guarantee high quality engagement practices (Participant E; Under the box-ticking approach theme). One way of addressing this issue is that the FRC get involved and closely monitor the exercising of stewardship activities by a sample of investors, both Tier 1 and Tier 2. Also, the FRC needs to have a constructive discussion with such investors and update its principles to address any shortcomings they faced as a result of their investigations. Following these approaches would make the FRC demand stronger and more effective engagement, helping both Tier 1 and Tier 2 investors to improve their practices constantly. Accordingly, the participants of these studies did not find significant improvements on the quality of engagement since becoming a signatory of the Stewardship Code. This then raises the question “why these investors still follow the Code?” i.e. what is their motivation?

ii) Motivation

After finding that the Stewardship Code has not helped investors to improve engagement behaviours, it was important to determine the motivation behind applying the Stewardship Code. Five of the participants stated that they apply the Stewardship Code because clients are aware of the Code and demand it. Therefore, asset managers could use their stewardship statement to show that they are actively engaging in their investee corporates. This finding is in line with Hendry et al., (2007) who interviewed UK and EU fund managers and found protecting client investment, as well as meeting their demand, were motivators behind engaging in activism. On the other hand, the FRC report (2011) recognised the lack of client demand as a barrier to practising active engagement. Hence, in contrast to FRC (2011), the findings of this study provide some evidence that clients are aware of the stewardship responsibilities of asset managers and explicitly demand these.

In line with the statistical findings which revealed no significant relationship between the application of the Stewardship Code and financial performance, asset managers who participate in the interviews did not mention any financial motivation behind engaging in investee corporates through applying the Stewardship Code. Moreover, when the participants were asked to explain any financial benefits derived from applying the Stewardship Code, no participant provided any compelling evidence. This finding is in contrast with Hendry et al., (2007), who concluded that the main motivation behind shareholder activism by fund managers is to maximise profit and to maintain a competitive position in the investment market. Hendry et al. (2007) interviewed fund managers, whereas this study conducted interviews with the individuals responsible for applying the Stewardship Code and preparing the stewardship statements. Therefore, the difference between the responsibilities of these two groups could result in different findings.[6]

iii) Explaining the statistical results

Finding no financial motivation helps to explain the initial statistical results when there was no relationship between applying the Stewardship Code and the WAAP of the asset manager ($F= 1.50$, p-value=0.227). Participants of this study explained that they are not aware of any financial benefits from applying the Stewardship Code. These participants argued that financial performance is influenced by many factors and attributing it to only one factor (i.e. engagement) was not a convincing argument. In line with this finding, asset managers find it difficult to explain how they measure the success of their stewardship activities. Five of them blamed the Stewardship Code for not providing adequate guidance, whereas four respondents proposed that the engagement is a long-term process making it difficult to measure.

The current version of the Stewardship Code (2012) has provided a brief definition of stewardship activities without providing any guidelines on measuring them against the principles of this Code. This could demotivate the signatories of the Stewardship Code as they are not able to assess their success in applying this guideline. Although the current tiering system has been a good effort by FRC to address this issue, the main focus of this system is on the quality of stewardship reporting rather than the quality of stewardship activities. One approach to address this issue is to require the investors to provide detailed reports on their engagement activities, including some real examples showing both successful and unsuccessful outcomes. The investors' stewardship report should reflect on those engagement practices to determine the factors that lead to success or failure in

[6] The fund managers that were interviewed by Hendry et al. (2007) were senior managers (chief investment officers, heads of UK or European equities, heads of research and senior fund managers) from eleven of the twenty largest UK asset management companies. These senior fund managers were responsible for corporate governance activities. However, this does not imply that they would be directly involved in engagement activities of their institutions. In fact, these senior managers could have a team of corporate Governance experts to carry out the engagement responsibility (Hendry et al., 2007).

exercising shareholder responsibilities. As aforementioned, the FRC just proposed a revision to the UK Stewardship Code (2019) based on the consultation with the stakeholders: *"successful engagement is not a requirement of disclosure against this Provision, but signatories should be able to indicate their perceived success and how this has been measured against stated objectives*" (FRC, 2019, p.16).

The FRC has still not provided a guideline on how the investors should measure their stewardship activities. Instead, the signatories of the Stewardship Code are encouraged to measure and report their success in engagement themselves. This is the first time that FRC included measuring the achievement from an application of the Stewardship Code in its report. In the future, it would be interesting to see institutional investors reporting measures of stewardship activities. Future research could then evaluate these reports to determine whether the FRC has been successful in reaching its aim.

iv) Agency Problems

Around 30% of the interviewees stated that they exercise their stewardship responsibilities to reduce agency problems that exist between investors and corporates. Therefore, these respondents claimed they act as owner and used their engagement as a tool to align their interest with the investee corporates. This finding is in line with Shleifer and Vishny (1986), who investigated the free-rider problem, suggesting that large shareholders, due to the size of their investment, have enough incentive to monitor their investee corporates. Therefore, institutional investors as the largest group of UK shareholders could ensure the managers are following the same interests as shareholders and help to reduce the agency problems that may exist in their corporates. In line with this, when participants were asked about finding an agency gap between their own interests and the interests of their investee corporates, the majority of the respondents agreed on the existence of such a gap. But, at the same time, they emphasised that it is getting better compared to a few years ago. This finding indicates that asset managers who follow the Stewardship Code are not only aware of the agency problems but also act as a responsible owner to reduce or eliminate them. This finding is in line with the traditional empirical studies which conceptualised relationship between the shareholders and corporations as agents and principles whose interests are not in line (Anabtawi, 2006; David et al., 2001; Gillian & Starks, 2000; Hoskisson et al., 2002; Johnson et al., 2010; Mallin, 1994; Myners, 2003; Ryan & Schneider, 2003). Accordingly, institutional investors as the principals are motivated to engage in investee corporates to ensure accountability of the managers as the agents. More recently, the academics began to question the validity of this description (e.g. Tilba & McNulty, 2013; Hendry et al., 2007; Davis, 2008, 2009; Jackson, 2008). For example, Tilba and McNulty (2013) found that only a very small number of well-resourced and internally managed pension funds behaved as owners in investee corporates through exhibiting engaged ownership behaviour. As aforementioned, most of the participants of this study mentioned that they have a good level of access and resources, helping them to perform their engagement responsibilities effectively. Therefore, the ownership behaviour of asset managers interviewed for this study may not be in line with other asset managers. This will make it difficult to generalise the behaviour of this study's participants to all the groups of institutional investors. Besides, nearly all of the respondents agreed that most of the investee corporates usually cooperate with them when they are performing their stewardship responsibilities.

These findings indicate that both investors and companies are aware of the potential agency problem that may exist in their relationship and are working together to minimise any conflicts that may arise due to the agency problem. Therefore, the relationship between investors and companies has evolved from a simple agent-principal relationship to a relationship which is based on engagement, discussion, and understanding each other's expectations. In the current period, even the small institutional investors can raise their voice through collective engagement, introduced by the Stewardship Code. It is very likely that this improvement in the agent-principal relationship happened over time as the awareness of accountability raised among both investors and their investee corporates. The publication of the Stewardship Code might have played a role in increasing this awareness among institutional investors. Even so, it is difficult to link this outcome to the publication of the Stewardship Code. Specifically, after finding that application of the Stewardship Code has not enhanced the quality of engagement between participants of this study and their investee corporates.

Hence, this study does not investigate the relevance of agency theory, but that the push for collective engagement has reduced some agency problems for the smaller investment houses. This study found the engagement of investors in their investee corporates has played a significant role to eliminate the agency problem. Nevertheless, since the history of engagement goes before the publication of the Stewardship Code, this study cannot directly relate reduction in the gap between investors and corporates to the publication of the Stewardship Code.

v) Reporting

Although the participants emphasised that no financial impact was evident from applying the Stewardship Code, most of them agreed that the Stewardship Code had improved their stewardship reporting. This finding indicates that asset managers use the Stewardship Code as a framework to report and explain their stewardship activities to their clients. This finding is in line with the FRC review (2014) indicating that the Stewardship Code is going in the right direction to improve the accountability of the investors towards their clients. It is notable that the low quality of stewardship reporting, which is raised as an issue by FRC itself could negatively affect the accountability of the investors towards their clients. According to the FRC, providing transparent stewardship reporting by institutional investors is likely to benefit clients as well as the investee corporates of institutional investors. Having access to a high-quality stewardship statement enables the client to make a more informed decision in relation to choosing a suitable institution with a management approach that is in line with their requirements. In addition, investee corporates are able to see the subjects that are important for their major shareholders and make them more likely to practice their ownership responsibilities. Furthermore, driving a stewardship statement by the asset owners makes asset managers aware of the expectations of their clients. In conclusion, the Stewardship Code has been successful in helping asset managers to provide better stewardship reporting for their clients.

6.4 Summary

Statistical analysis revealed that there was no significant relationship between applying the Stewardship Code and weighted average annual performance (WAAP) of asset managers. Looking at the FRC reviews, it is not clear how the application of the Stewardship Code could benefit the shareholders financially. Less than a decade since the publication of the

Stewardship Code in 2010, it is essential for the FRC to investigate and report the financial benefits of exercising effective stewardship activities.

Focusing on the financial impact during the statistical analysis did not distract this study from exploring the non-financial benefit from applying the Stewardship Code for its signatories (i.e. enhancing the quality of engagement between investors and companies). After undertaking interviews with signatories of the Stewardship Code and analysing the results, this study could reach two main findings:

1. It was found that the Stewardship Code did not enhance the quality or quantity of engagement by asset managers who are applying this guideline, specifically asset managers categorised as Tier 1 by FRC. The participants proposed that before being a signatory of the Stewardship Code, they were already engaging in their investee corporates. Hence the Stewardship Code was not successful in achieving the primary aim proposed by FRC (i.e. enhance the quality of engagement between investors and companies). This finding indicates that developing of the stewardship policies were rushed after the financial crisis by relying on the ISC guidelines while only considering institutional investors who did not have a high-quality engagement in their investee corporates. Considering all the time and resources that the signatories put into complying with the Stewardship Code, it is important for them to see and be able to measure their achievements from the application of this guideline. Therefore, the FRC should review the policies again to set more ambitious requirements that would inspire all institutional investors to enhance their level of engagement.
2. Most participants found that preparing a more transparent stewardship report for their clients was the main benefit of applying the Stewardship Code. This finding suggests that applying the Stewardship Code has helped asset managers to improve their communication with their clients around the stewardship activities. Apart from a positive impact on their reporting, asset managers found it difficult to talk about other benefits from applying the Stewardship Code, specifically financial benefits. This qualitative finding was in line with the statistical analysis when no significant

relationship was found between applying the Stewardship Code and their institution’s financial performance.

Through mixing both qualitative and quantitative findings, this study proposes that, if asset managers cannot see the benefits of applying the Stewardship Code, they would not devote additional resources and effort into improving engagement practices but instead comply via a signatory to tick the box. Given the uptake in the number of signatories, asset managers do not want to remove themselves from the list of the signatories as this would identify them as an outlier among their competitors and disappoint their clients. In order to improve engagement with the principles of the Stewardship Code, the tangible benefits identified by the FRC (i.e. enhancing the quality and quantity of engagement) need to be easier to measure and monitor. Currently, this is problematic as most participants failed to identify such benefits. To overcome this problem, the FRC should conduct a thorough review of signatories’ application to determine the outcome and benefits of the Stewardship Code for institutional investors. Currently, the FRC reviews the Stewardship Code based on the stewardship statements. Although this issue was not directly explored in this study, some respondents claimed that they know a number of signatories whose statements do not represent their stewardship activities. Therefore, the FRC should not only rely on the investors’ statements when reviewing the Stewardship Code. It is essential that the FRC as a responsible regulator to review the application of the Stewardship Code more closely by talking to the investors and investee corporates, observing the engagement between investors and corporates and monitoring the preparation of the stewardship statements. This will help the FRC to identify what they have achieved from introducing the Stewardship Code and what has missed that need to be achieved. The next chapter presents a conclusion drawn from conducting this study.

Chapter 7

7. Conclusion

The FRC, as the responsible regulator, has provided an annual review of the Stewardship Code and published a series of reports which are publicly available on its website. Reviewing these reports revealed that the stewardship reporting of the signatories varies significantly, which has been raised as the main issue by FRC in all of the published reports. Notably, these reviews could not provide a thorough investigation of the application of the Stewardship Code. On the other hand, the academics have not paid enough attention towards this guideline as this study found very little evidence around the outcome of the effectiveness of the Stewardship Code. Nearly a decade after the publication of the Stewardship Code, it is essential to review the application of this guideline to assess its success or failure in reaching the proposed aims. To close the existing gap, this study aimed to explore the implementation of the Stewardship Code to determine its outcome for the institutional investors both financially and non-financially. The main aim of this study was to investigate the success of the Stewardship Code in reaching its proposed aims, including benefiting its signatories both financially and non-financially. To reach this objective, four research questions were developed, and these are discussed in turn below.

7.1 Research Question 1

Research Question 1. "Has applying the Stewardship Code provided any financial benefits to its signatories?"

The first research question was developed to determine the financial benefits of applying the Stewardship Code for its signatories. A quantitative method was conducted to determine the relationship between applying the Stewardship Code and weighted average financial performance of asset managers with UK equity funds in their portfolio. The statistical analysis provided no evidence of financial benefits for signatories sampled: being a signatory of the Stewardship Code did not financially benefit asset managers over the period 2014-2017. In line with the previous academic studies that investigated the institutional investors' financial performance, size and age were also included in the statistical model to control for their impact (e.g. Ferreira et al., 2012; Thomas & Tonks, 2001; Yan 2008). Since the emphasis of the FRC is on the long-term impact of the Stewardship Code, running this analysis in a few years could bring a different result.

7.2 Research Questions 2 & 3

Research Question 2 "To what extent has applying the Stewardship Code provided non-financial benefits to its signatories?"

Research Question 3 "To what extent has the Stewardship Code been successful in enhancing the quality of engagement between investors and their investee corporates?"

To explore the non-financial outcome of the Stewardship Code, the second and third research questions were developed. To answer these questions, a qualitative methodology was applied in the second phase of this study. During this phase, interviews with asset managers who are following the Stewardship Code were conducted. These asset managers were asked to give their opinions on the application of the Stewardship Code and explain the impact of this guideline for their institution both financially and non-financially.

To answer the second question, the participants were asked about the non-financial benefit of applying the Stewardship Code. Twenty three percent of the participants stated that applying the Stewardship Code has helped them to provide a transparent report on their stewardship activities to their clients. Other participants mentioned non-financial benefits include promoting long-term investment approach, inspiring other countries to publish their Stewardship Code as well as providing a framework for investors to engage in investee corporates. Investigating other themes revealed that the compliance approach of the Stewardship Code (i.e. comply or explain approach) allows the investor to be active shareholders as long as it suits their business model. Therefore, while the Stewardship Code provided a set of principles for the investors on how to engage in their investee corporates, in the end, it is the investors' decision to follow these guidelines or not. According to participants E, this approach has motivated foreign investors to follow its guidelines, which has helped to improve the CG system of foreign companies. The other non-financial benefit is encouraging long-term investment culture among the institutional investors, which was started by participant A.

The answer to the third research question is negative, as 80% of the participants stated that applying the Stewardship Code did not have any significant impact on their engagement behaviour or their engagement policies. The majority (84%) of these participants stated that the Stewardship Code had not changed the quality of their engagement since they were already committed to perform their stewardship responsibilities before being a signatory. The sample of this study, which mainly includes Tier 1 asset managers, could explain this finding. Twenty three percent of these participants added having good access to necessary resources helped them to stay as an active investor even before the publication of the Stewardship Code. Therefore, this finding could be different for smaller asset managers with access to fewer resources. One of the participants (participant A) blamed the principles of Stewardship Code for lack of a significant change in their engagement practices. According to this participant, these principles are mainly adopted from the ISC Code (2002), and hence have not changed to represent the current business environment in which institutional investors are performing.

7.3 Research Question 4

Research Question 4 "To what extent has the Stewardship Code been successful in achieving the aims that are proposed by FRC?

Answering the last question requires mixing the quantitative and qualitative findings to determine the success of the Stewardship Code in reaching its proposed aim (i.e. the financial benefit for signatories of the Stewardship Code and enhancing the quality of their engagement). Although the application of the Stewardship Code has brought some non-financial benefits for its signatories (e.g. better stewardship reporting to clients and encouraging better engagement by foreign investors), it has failed to enhance the quality of engagement as well as to bring any financial benefit for asset managers. Based on the statistical findings, there was no relationship between the WAAP and the stewardship activities of the signatories. In line with this finding, the interview revealed that the participants could not provide any example of their financial benefit from applying the Stewardship Code.

According to the participants of this study, a lack of guidelines in measuring the success of the stewardship activities, not having a financial incentive when engaging with the investee corporates and, the difficulty in linking the financial performance to engagement were found as an explanation for the statistical findings. The participants found it hard to explain how they measure the success of their stewardship activities. This finding illustrates that participants of this study are applying the Stewardship Code without realising its outcome for their institution. Hence, it would be very likely that they tick the box without exploring how they can make a change in their existing engagement approach in order to enhance their existing practices. In addition, asset managers of this study engage in their investee corporates to protect and enhance value for their clients. Moreover, they mentioned the importance of engagement to understand the business in which they want to make an investment to reduce any potential risk.

Furthermore, the majority of the respondents stated that they did not find any improvement in the quality of their engagement as a result of being a signatory of the Stewardship Code. Looking back at the statistical and interview findings, this study concludes that while the Stewardship Code has been partially successful in making an improvement in some areas of asset managers' engagement (e.g. stewardship reporting) it has failed to fulfil its main objectives.

7.4 Contribution to Knowledge

Investigating the first research question allows this study to contribute to the existing academic studies that investigated the determinants of shareholder financial performance. The statistical findings of this study indicate that shareholder engagement cannot predict the value of their financial performance. In other words, institutional investors do not engage in their investee corporates with financial motivation. Conducting interviews with signatories of the Stewardship Code also resulted in the same finding. Majority of the investors found it difficult to mention any financial achievements as a result of their stewardship activities by following the Stewardship Code. Understanding the business of the investee corporates, reducing the agency problems and helping the investee corporates to improve its CG system are among the popular answers for the main motivation behind asset managers' engagement. Considering limited academic evidence around the financial impact of adopting an active engagement approach, the finding of this study firstly contributes to the understanding of the shareholder engagement on their financial performance.

Answering the second and third question contribute to the existing academic studies in relation to the motivations behind being actively engaged in the investee corporates and the outcome of this engagement on asset managers.

At the time of writing the author was unaware of any academic literature investigating the application of the Stewardship Code by its signatories. Therefore, the answer to the last question of this study contributes to understanding the impact of the Stewardship code as a guideline for the institutional investors who are following this Code. Since asset managers with UK equity funds are the primary audience of the Stewardship Code, these findings can be attributed to other signatories as well. The findings of this study therefore have great potential to make a practical contribution, helping the policymakers who are responsible for developing and reviewing the guidelines. This has been explained in more details in the following section.

Finding a theme around the agency problem revealed that while asset managers are aware of this problem, they apply their ownership responsibilities to close the agent-principal gap. According to agency theory, shareholders can act as an important CG mechanism to close their interest with the managers. This theory assumes that managers are self-interested individuals who are very likely to follow their own interests rather than the interests of their shareholders. In this study, there is no evidence to support this assumption about management behaviour. Instead, a significant majority of asset managers agreed that managers of their investee companies usually cooperate with them to resolve concerns. They stated that both the investors and investee corporates are aware of the importance of shareholder engagement. Hence exercising stewardship activities by institutional investors is expected and taken into account by the managers. This finding is in contrast with the main assumption of agency theory. During the interviews, managers of investee corporates are portrayed as rational individuals and cooperate with their investors when they are practising their stewardship activities. On the other hand, this finding is inline with Stewardship Theory, which assumes that directors can be trusted to act as stewards of shareholder interests (Clarke & Branson, 2012). Hence, while signatories of the Stewardship Code monitor and control managers' activities, they were able to trust managers to act on their behalf. On the other hand, shareholders would like to help investee corporates to perform better through their engagement. This relationship between investors and managers is a constructive relationship based on trust and understanding. Therefore, while the finding of this study does not deny the importance of Agency Theory, it is more towards the Stewardship theory which considers managers as less opportunistic and more as a trustee of shareholders (Mallin, 2010). It is notable that the Stewardship theory does not consider directors as completely unselfish and this is where the exercise of stewardship activities become important for institutional investors.

7.5 Implications for policymakers

Looking at the current reviews by FRC, the outcome of the Stewardship Code for its signatories is not clear. More importantly, the participants of this study stated that it is not clear for them how to measure the success of their stewardship activities through the application of the Stewardship Code. Therefore, it could be argued that if the FRC proposes a guideline to measure stewardship activities, institutional investors could realise the impact of applying the Stewardship Code in their institution. Providing this guideline enables investors to compare their engagement activities with what is expected from them, encouraging them to enhance the quality of their engagement.

The current FRC reviews are completed mainly by focusing on a sample of stewardship statements. Whereas, some of the participants of this study mentioned that they know some asset managers whose stewardship reports are not the same as their engagement activities. This is in line with the box-ticking approach followed by some signatures which are raised as a concern by the FRC. This would challenge the reliability of the findings within the FRC reports. Hence, it is crucial for the FRC to change its current approach in reviewing the application of the Stewardship Code. For example, the FRC could run regular meetings with signatories of the Stewardship Code to get their opinions on the strengths and weaknesses of this guideline. Moreover, the FRC should observe and measure the engagement between investors and companies to make a comparison between stewardship activities and stewardship reporting of the Investors. One of the participants in this study has not found the Stewardship Code relevant as he believed it is mainly focused on investors with equities in their portfolios. Another suggestion to enhance the quality of the current Stewardship Code (2012) is to expand its principles to cover other asset classes. More importantly, asset managers of this study made it clear that Stewardship Code could become more ambitious as most of these investors didn't have to change their ownership behaviour after becoming a signatory.

Very recently, the FRC has published a consultation on the draft 2019 UK Stewardship Code on 30 January 2019. The updated version of the Stewardship Code will be released late 2019. On the FRC website, it is stated that the new Stewardship Code aims to *"increase demand for more effective stewardship and investment decision-making which is aligned to the needs of institutional investors and clients".* This movement by FRC shows that the policymaker is aware of the current issues, and it would be interesting to see if they have addressed them in the new version of the Stewardship Code.

7.6 Limitation

This study has faced a number of limitations. Firstly, the Stewardship Code is a relatively new guideline making it difficult to assess any long-term impact at present. In a few years when longer-term financial data of the Stewardship Code' signatories are available, it would be interesting to perform this study again to determine if the result changes or stays the same.

Secondly, during the statistical analysis, the selection of variables will have a significant impact on the findings in determining the relationship with the financial performance of asset managers. Care was taken to review the extant literature to ensure that appropriate variables were selected, however, some important variables may have been overlooked. Thirdly, due to lack of resources, this study had to rely on the stewardship statements to measure the application of the Stewardship Code. On the other hand, there is a possibility that asset managers report high-quality stewardship activities in their report without performing them effectively. This is in line with the box-ticking approach raised as a concern by FRC.

Fourthly, although this study contacted all the UK asset managers, only 13 of them agreed to participate in this study. One issue with this self-selected sampling technique is that these participants, who decided to participate in the study themselves, could be very passionate about this guideline or equally may have a strong dislike towards it. Therefore, their responses could result in a bias. Increasing the sample size could enhance the reliability of the final result and help to explore the Stewardship Code more thoroughly.

Fifthly, among the 13 participants, only one of them was categorised as Tier 2 (i.e. reported less transparently on their stewardship activities). Most of these participants stated that they had good access and resources, helping them to practice their responsibilities in their investee corporates effectively. Hence, including interviews with more signatories with Tier 2 stewardship statements would allow this study to generalise the findings to all signatories of the Stewardship Code more confidently. Besides, participants volunteered themselves to be interviewed. So, it is possible that we only surveyed the most progressive asset managers who do not portray all the signatories of the Stewardship Code.

Finally, the signatories of the Stewardship Code only published one stewardship statement on the FRC website. As this study did not have access to previous reports a comparison of the quality of the reports since the publication of the Stewardship Code was not permissible.

7.7 Future Research

To address the above limitations, any future study investigating the Stewardship Code should try to include a more balanced sample, including both Tier 1 and Tier 2 signatories. This would allow future studies to have access to a wide range of views around the Stewardship Code and focus on the inclusion of other types of signatories, such as asset owners and service providers. It would also be interesting to run an interview with the policymaker (i.e. FRC) to incorporate their views on the application of the Stewardship Code and provide a thorough analysis of this guideline.

This study was mainly focused on UK asset managers. As aforementioned, other countries such as Japan and Malaysia have introduced similar guidelines as to the Stewardship Code for their institutional investors. So, the same study could be run in other countries with similar guidelines to determine the success of their Stewardship Code in reaching the proposed aims. Publication of the new version of the Stewardship Code will provide an opportunity for academics to investigate this subject again. To investigate the financial impact of applying the Code, this study has used risk adjusted returns which were available for UK asset managers. However, through the interviews, some participants (e.g. participant D) mentioned that engagement with the investee corporates had helped them to minimise their investment risk. Hence, the impact of applying the Code to minimise the risk for its signatories is another aspect that could be investigated in future studies. Besides, considering the regression analysis results, the adjusted R squared figures were low. Increasing the sample size might help to overcome this problem in future studies.

The new Stewardship Code (2020) has provided a clear definition for Stewardship which was missing in the previous version of the Code. According to the FRC, Stewardship is defined as *"the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society"* (FRC, 2020). As aforementioned, the FRC mainly relied on the stewardship statements to assess the success of the Code. However, the FRC proposed that its main focus now turns away from stewardship statements towards the stewardship activities and their outcomes. Another key change in the new version of the Code is the process of adding an institutional investor as a signatory. The FRC website makes it clear that being accepted as a signatory of the Code is not as easy as it was before. The FRC has developed an assessment framework, helping them to decide whether an organisation has met their expectation to be added to the list of signatories. Considering these new changes, conducting the same study in future will help to determine whether the new Stewardship Code could address the problems associated with the previous version of this guideline such as the box-ticking approach, a lack of guidelines on measuring stewardship activities and having no significant impact on active investors.

Appendix

Appendix A

Participant Information Sheet

“An analysis of the relationship between the Stewardship Code and financial performance of UK equity funds”

You are being invited to take part in a research study to investigate the UK Stewardship Code. Please take time to read the following information carefully to understand why the research is being done and what it will involve in more detail.

What is the purpose of the study?

The Stewardship Code was launched by the Financial Reporting Council (FRC) in 2010 to promote better quality of engagement between institutional investors and their investee corporates. The FRC posited that effective stewardship benefits companies, investors and the economy as a whole. The aim of this PhD study is to determine whether the application of the Stewardship Code could affect the institutional investors both financially and non-financially.

As a part of the study, I have analysed data about the financial performance of selected UK equity funds to assess the impact of the processes that they have put in place to comply with the Stewardship Code. Interviews with representatives of institutional investors will help me to contextualise this study by providing opinions on strengths and weaknesses of the Code and how it has or could help them to improve engagement with investee corporates. The whole process of this study will last for three years (2015 to 2018).

Why have I been invited to participate?

You have been invited to take part in this study because your company has signed up to the Stewardship Code and you are listed as the contact point in the stewardship statement. Your contribution to this study helps to further my understanding of Stewardship Code and how it affects institutional investors.

Do I have to take part?

It is your decision whether or not to take part in this study. If you decide to be part of this research, you will be given this information sheet to keep and be asked to sign a consent form. If you decide to take part you are still free to withdraw at any time and without giving a reason.

What will happen to me if I take part?

If you decide to take part you will be invited to participate in a face to face semi-structured interview, via invitation email. The interview will be arranged at a time that is convenient to you and will be either at your office premises or a public place. Although we aim for a face to face interview, we can also consider a skype interview. The interview will last no longer than an hour and is a one-off event. At the beginning of the interview some general questions will be asked such as sharing a bit about your background, your role and responsibilities in your institution. During the interview, you will be asked to provide your views on your experiences of working with the Stewardship Code.

With your permission, the face to face interview will be voice recorded and any information that you provide will be anonymised. Like the face to face interviews, the Skype interview will only be audio recorded, using the available programme on the computer (QuickTime Player), and a voice recorder with your permission. The interview transcript will be sent to you for approval, upon your request. When the study is completed, a summary of the final findings will be sent to you upon your request via email.

Will what I say in this study be kept confidential?

All your personal information including your name will not be recorded on the interview and will be kept strictly confidential (subject to legal limitations). The researcher will ensure the participants' personal information remains confidential through the de-identification of data during the coding process. The interviews will be voice recorded for the purpose of this study and will be kept securely at all times. A transcript of the interview will be sent to you for approval, upon your request. If you prefer, we would be happy to take notes instead of voice recording. The interview data will be stored in Google Drive, for which the University has a security agreement, and the researcher's laptop will be encrypted to secure the data. The data collected will only be used for the purpose of dissemination of research.

The data generated during the research will be retained in accordance with the University's policy on Academic Integrity and kept securely in paper or electronic form for a period of ten years after the completion of a research project.

What should I do if I want to take part?

It is up to you to decide whether or not to take part. If you do decide to take part you will be asked to sign a consent form. If you decide to take part you are still free to withdraw at any time and without giving a reason and any unprocessed data collected will be withdrawn from the study. If you would like to participate in this research project, or need further information, please get in touch by replying to the email address below. I will contact you in order to arrange an interview at a time that is convenient for you.

samaneh.elmi-2015@brookes.ac.uk

What will happen to the results of the research study?

The results of this research will be prepared and analysed to complete a doctoral degree at Oxford Brookes University. The completed dissertation will be stored at Oxford Brookes University library. It is the intention of researchers to present papers at doctoral conferences and publish journal papers from the findings of this study. A summary of the final results will be provided to participants upon request.

Who is organising and funding the research?

This research is being conducted by Sameneh Elmi, PhD student, Accounting, Finance and Economics

Department, Oxford Brookes University. The researcher has been awarded an Oxford Brookes University 150 Research Studentship. The PhD is supervised by Dr. Samantha Miles svmiles@brookes.ac.uk, Dr. Sandra Einig, seinig@brookes.ac.uk and Dr. Rebecca Hawkins, rhawkins@brookes.ac.uk.

Who has reviewed the study?

The research has been approved by the University Research Ethics Committee, Oxford Brookes University.

Contact for Further Information

Please do not hesitate to use the following contact details for further information:

Researcher

Samaneh Elmi, Email: samaneh.elmi-2015@brookes.ac.uk

Supervisors

Dr. Samantha Miles, Email: svmiles@brookes.ac.uk

Dr. Sandra Einig, Email: seinig@brookes.ac.uk

Dr. Rebecca Hawkins Email: rjhawkins@brookes.ac.uk

Also, if you have any concerns about the way in which the study has been conducted, you should contact the Chair of the University Research Ethics Committee on ethics@brookes.ac.uk or the supervisory team on the email addresses above.

Thank you for taking time to read the information sheet.

Date

11.09.2017

Appendix B

Ethics Approval

OXFORD BROOKES UNIVERSITY

Dr Samantha Miles
Director of Studies
Department of Accounting, Finance and Economics
Oxford Brookes Business School
Wheatley Campus

8 August 2017

Dear Dr Miles

UREC Registration No: 171133
An analysis of the relationship between the Stewardship Code and financial performance of UK equity firms

Thank you for your email of 7 August 2017 outlining the response to the points raised in my previous letter about the PhD study of your research student Samaneh Elmi and attaching the revised documents. I am pleased to inform you that, on this basis, I have given Chair's Approval for the study to begin.

The UREC approval period for the data collection phase of this study is two years from the date of this letter, so 8 August 2019. If you need the approval to be extended please do contact me nearer the time of expiry.

Should the recruitment, methodology or data storage change from your original plans, or should any study participants experience adverse physical, psychological, social, legal or economic effects from the research, please inform me with full details as soon as possible.

Yours sincerely

Dr Sarah Quinton
Chair of the University Research Ethics Committee

cc Sandra Einig and Rebecca Hawkins, Supervisory Team
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Appendix C

Interview Questions

Interview Questions

The following questions are developed to be asked in semi-structured interviews with signatories of the Stewardship Code. These questions assist to understand the impact of the Stewardship Code on quality of the institutional investors' engagement, including their dialogue with their investee corporates and to determine whether application of the Code has a non-financial benefit for the signatories.

- ***General Questions***
  1. What is the main aim and strategy of your institution when managing assets on behalf of its clients?
  2. How does your institution ensure that it protects and enhances value for its clients?
  3. What is your role in (name of the institution) and how it relates to Stewardship Code?
- ***History of their compliance to the Stewardship Code***
  1. What was your institution first response to publication of the Stewardship Code in 2010 by FRC?
  2. Considering your institution's engagement policies, do they differ significantly from the engagement policies before following the Stewardship Code? (already doing it)
- **Application of the Code**
  1. What is the main motivation of your institution in engaging with investee corporates?
  2. Did applying the Stewardship code help to improve your engagement with investee corporates? How? (already doing it)
  3. When following the guidelines of the Stewardship Code, what do you see as the strengths and weakness of the Stewardship code?
  4. Are you aware of any difficulties in applying the Stewardship code, preventing you to thoroughly follow the guidelines?
  5. When performing the stewardship activities, which activity do you believe is more costly for you institution to accomplish?
  6. Do the investee corporates usually cooperate with you in applying the following the Stewardship Code guidelines?
  7. When engaging with investee corporates, do you feel there is any a gap between your expectations and the management's objectives?
  8. Apart from the FCA (Financial Conduct Authority), who requires you or expect from you to follow the Stewardship Code guidelines and publish a stewardship statement?
  9. According to FRC, applying the Stewardship Code has a positive impact on investors. Since being the signatory of the Stewardship Code, what are the positive achievements for your institution, both financial and non-financial?
  10. How do you measure success of your stewardship activities?
  11. How do you ensure all the funds within your institution follow the same engagement policy and perform their stewardship activities effectively?
  12. Since being signatory of the Stewardship Code, do you still find it relevant to your business?

Appendix D

Interview transcription (participant B)

1. So, could you please tell me What is the main aim and strategy of your institution when managing assets on behalf of your clients?

   We are asset managers, we manage about 8 million pounds sterling of both long- and short-term monies for UK's charities, churches and local authorities and principally, you know we are here to deliver the best possible risk adjusted return for our clients. You know they give us the money to manage to kind of fund their activities, so we are fundamentally here to do that. I guess what we believe is that embedding environmental and social and governmental factors in a meaningful way, they can genuinely alter portfolios will help us do that. So, we do that firmly through the lens of this will deliver better shareholder returns and we see embedding ESGS also including stewardship factors so actually going to ask to talk to companies again is a standard part of our approach.

2. How does your institution ensure that it protects and enhances value for its clients?

   Sorry what in particular?

3. Because the stewardship Code states that when you are performing the stewardship activity you should do it in line with the object that you protect and enhance value for your clients at the same time?

   So, we fundamentally believe that, like what I said, the stewardship will lead to better risk adjusted returns over the long term, but we also recognise that actually a lot of these things are long-term gains. So, it's very difficult to measure short-term incremental performance gains from the back of it. So, our stewardship work has kind of two aims of up to it; one we work with companies with the risk issues that they face today and two we want to try, to some extent it sounds naive: build the future that we believe will stay with the company, jump right ? in the future. So, for example we found a firm that firmly believes that limiting temperature to below a (?) certain degree is the right thing to do for asset management reasons is not for my own reasons. Of course, that is true as well. So, going back to your question, we believe fundamentally that is what we are accounted to do. we also recognise that actually, stewardship is a resource like any other and our clients are paying for that resource and that means that we have to deal to demonstrate that our engagement has been meaningful. And has led to changes in behaviour. We might not necessarily be able to argue that it's link to financial change behaviour like as I said these are long-term issues but fundamentally we want to demonstrate that we spoke to a company about label standard, they've gone away, and we pointed out where we want the change to happen and then they are gone away with those change and improve their approach. So, we want to be able to say we've done this, led to this impact and that's what I think we can demonstrate that we are delivering value to our clients.

4. When you said that it will have an impact on your long-term performance, how long does it?

   Again, we don't measure that. And fundamentally we think you know to require (?) it is anonymous, I think a lot of this short term out of stuff for ESG is a complete waste of time. Because actually fundamentally what we are saying is that sustainable market and sustainability is fundamentally important delivering long-term investment return and therefore to be quite frank we are not particularly interested in whatever one quarter of return was better than the second course of return and whether the stewardship to present had any ability to do that. What we do really is that if we can see when the companies have fallen down and be able to help them readdress that issue and that should help them perform better than the long-term.

5. What is your role in your institution and how it relates to Stewardship Code?

   Ok, so I head up our responsible stewardship investment team, our report to our chief investment officer who you just met, and I have a team of 4 people beneath me. We were pretty poorest team. We were a cross better kind of marketing team as you would expect but our investment management team to make sure embedding these issues that we want to but fundamentally our role and our specialism is stewardship.

6. How long have been in this role?

   I've been here 7 and a half years.

7. Are you aware of your institution's first response to publication of the Code in 2010 by FRC?

   Yes, I am. I was here yes we did publish our first response and it was a very positive experience.

8. So, you started in 2010?

No, we were doing stewardship a long time before that. You know the ESG, the history goes back to 50 odd years, active ownership and engagement has been a huge part of what we do for a very long time. Our clients have values and we usually try to take our clients values into the Boardroom in the companies that we invested in. What the stewardship Code did was make sure that we start building proper policy governance (?) a while we did it. So, the first response that we had which lived for, the aim was to update it annually, lived for about 5 was our first attempt to codify how we do this and Why do we think it relates to investment management.

9. Considering the recent engagement policies of your institution, do they differ significantly from the engagement policies before following the Stewardship Code?

I think they grow in sophistication. I am not sure if that’s the Stewardship Code who's done that. Stewardship Code has helped us, but it is not a driver how we change things. So we have recognise that actually meaning for engagement that change practices you know the stewardship engagement the CCLA ,USB so be able to continue to stand out of our competitors we had to invest in it, we had to professionalise in it, and there is a huge areas that are still not good enough and quite clearly that relates to reporting, we’re not good enough in reporting how we’ve got on, we’re not good enough to telling our story to how we prioritise the companies to engagement, not, and we will see that’s the pieces of the work that we have to do. So, the stewardship report, the stewardship code response very helpful codifying has not necessarily been the driver in changing what we do. so, we’ve already been doing lots of this stuff in the way that they wanted us to do it.

10. What is the main motivation of your institution in engaging with investee corporates?

To help our businesses develop a more sustainable business model. So, you know that ranges from taking long-term issues like climate change, making sure that the companies we’re interested in we engage in, we invest in are addressing the challenges that the transitions to the current economy will have also noting saying where things like poor corporate governance, poor approaches to managing kind of label practises, etc. could lead to the company underperforming and helping them fix those issues but also you know I am head of responsibility investment function we do, our investment team do a huge amount of stewardship in company meetings and trying to address strategy and performance where we find something wrong strategy or performance we absolutely will be working with company but like many active managers we tend to use, you know we tend to ? company very quickly when we have a problem with strategy

11. You know it's historically been argued that there is a gap between the director's interests and shareholder interest. So, I am just wondering if you still see, you know, compared to the previous years, have you seen a development, or do you still see the gap or whether the Code has helped you to close this gap?

    I don't know. I think what we have seen much more is the use of executive pay schemes that absolutely align the shareholder value with directors, and you know you may (?) what we have seen in this graph of variable pay has done exactly the opposite of that. It is incentivised by a very short-term performance structure. It is incentivising completely the wrong behaviour or maybe we would see alignment as being much more plot going back to something like salary as you may (?) because that would lead to better holistic decision making. So again, I don't think sitting here at CCLA, sort of pretty unique case, that really changes the way that we see the world. If I were sitting somewhere else, one of our I could be arguing the exact opposite.

12. Did applying the Stewardship code help to improve your engagement with investee corporates? How?

    Again, I don't think it's really made much difference to the way we engage with companies.

13. OK, why do you think it didn't help?

    Because again you know, I mean the stewardship code you're quite wright it came into effect through realise that there is an agency gap in between companies and directors, people who run the companies and also recognise that actually what was happening goes to the key report was that active managers were selling rather than telling companies that they had problems with strategy. Now for us we've always been a long-term investor, we've always believed having a partnership with the companies that we're investing in we see them as usually beneficial relationship because what's good for us is good for them and what's good for them is good for us and therefore we've always see sought to have this ongoing dialogue, the sharing the views. So, the stewardship code coming along did not really change that commitment if that makes sense. It's great other people doing it, but it just meant that we continue to do what we've always done of talking to the companies about the risk that we see and saying when we think they are falling behind the best practice

14. So when you go to the FRC website or when you read the Stewardship Code you get the idea that the Code was published to you know enhance the engagement to improve the engagement but so far most asset managers, head of the CG they told me that it hasn't changed their engagement?

    I think obviously no one likes admitting that someone else has made them change something. But what I think what the stewardship code is saying and what I think is the case here is that you have a leadership group who were a leadership group before. So, the people who were doing the good thing before the stewardship Code are now doing the better stewardship but the people who were not doing very much in stewardship before, still aren't doing very much. So, you have a leadership group, you basically just help the best get better.

15. When following the guidelines of the Stewardship Code, what do you see as the strengths and weaknesses of the Stewardship code?

    I think yeah the Code is very difficult, because what the code measures, well it is not particularly measures but the tiering measures, is what your process is doing so what are the model that you go through and quite frankly if you start like a speaker system if you start off with a rubbish record and put it through a really great speaker, it's still rubbish. So, if you don't have a great process, you don't have good people or very good commitment to stewardship then actually you still are going to have rubbish stewardship and the stewardship Code doesn't really help with that. What's much more interesting is that actually how do you take what it is that you are really trying to achieve for a company and then measure the progress that you are actually having with that. So, what are the outputs your stewardship programme and I don't know if the stewardship Code really does that I don't quite know how they could do that but if you look at say the principle for responsible investment annual survey what annual assessment process that the investors need to go through, then it's much more based upon how good is your stewardship as opposed to what are the government process that you go for, that we're ? doing that.

16. Are you aware of any difficulties in applying the Stewardship code, preventing you to thoroughly follow the guidelines?

    Not here. No, if you are being honest. I think one of the problems that active managers face broadly is whether stewardship is a selling point or not. Because one of the points, it is not necessarily in the stewardship code, but one of the points that affect the stewardship is great collaboration with other investors and quite frankly if you are trying to use your stewardship as a way of selling who you are as an organisation and why you are better than the last thing you want is to work with your competitors who are also trying to do that. So, there is a competitive tension issue here but at the same time if stewardship becomes part of why people choose different asset managers you create a kind of race to the top should lead better engagement being done so I can say that collaboration point a difficulty for managers who are competing against each other who might see the stewardship as one of the things that their best asset managers competitors differentiator means the collaboration can be difficult sometimes.

17. When performing the stewardship activities, which activity do you believe is more costly for your institution to accomplish? I mean voting, monitoring the investee companies, having continuous dialogue with them.

    I think all of those things are relatively easy. I mean you can deal with all of those things on the cheap as it were (?). What is expensive and what is difficult is having the (?) of people who can build up genuine relationships with companies to the point when the companies trust them to make changes to what their strategy is. So actually, yeah fundamentally our approach to voting is that we have voting policies, our voting policies are applied by voting provider ISS, they create the Board (?) research for us. So, in essence that is very cheap. What cost of money is having somebody whose very good at voting, who understands the actual (?) of why a tick box approach might not suits for certain company, so why you know we might say a joint chairman and chief executive is bad practice why absolutely might work for certain company and altering our process then being able to talk to that company about that. That’s what is expensive, it’s not voting, it is doing it well. But again, it's a problem because fundamentally if people were saying tick box approach to voting to try to suit a kind of Stewardship Code box then you are actually driving inappropriate behaviour, because people are really starting to (?) properly. Similarly monitoring can be very simple it can just be the case of data phase and see where the company is going. But again actually what takes time and what's more expensive is that we be able to pick up on the new answers on the different way that the managers team to talk you out to what is it they trying to achieve and therefore being able to articulate back us to that progress or not to progress and what we have to do. So, it's actually, on paper, is actually, on paper the code is easy to fulfil. In practice if you get to do it well it takes very high-quality people and high-quality people cost a lot of money. But again, it's going to the point of what you are trying to achieve. If you are trying to achieve compliance with the stewardship code, it's very easy to do if you are trying to genuinely change the corporate behaviour that's a very different kettle of fish.

18. So does the FRC concern that?

The FRC, again I am telling very naively the stewardship is a great thing, it's a great thing that exists but the FRC do not have the resources to do it properly. So, the FRC, you know if you compare the FRC to the PRI, the PRI is much better staffed and still they don't have the ability to do as the FRC has got to look at what's going on across every piece and every company and therefore their ability to actually do this in a meaningful way is really diminished. Again, like us if you are going to do the stewardship properly you have to build the resources to be able to have the relationship. The FRC just don't have the ability to get the resources to have the relationship to look at all the asset managers or all the stewardship code signatories objectively. I think what the tiering did was hugely beneficial but what we are saying again is because it's basically issues to paper, people who care grow irritating back up to those with the first tier. Because we need to get an output based on the base model rather than a policy base model.

19. So how do the investee corporates usually cooperate with you in applying the Stewardship engagement activities?

Really interesting. I mean so again I come out this ESG side as opposed to performance and strategy. what we find is that always there is always someone in the company who is working on what it is that we want to be working on and again the first point is that we are investors and therefore we want the company to do well, and therefore there is an inherent alignment between we never tell the company to do something that we think is backward for the business because ? face. So we have inherent alignment they are going back to that point that we always find that there is someone in the business whose trying to do what we trying to do and part of our work is about trying to find that person and then part of our work is to build a relationship with that person and then trying to help that person to get the buying the company to do that. So what we find is that cause we are relatively small (?) high profile organisation that we have the ability to attract the intention of CEOs and chairs and when we attract the ability of CEO and chairs, we can champion a piece of work that can move up the agenda (?) what's going on and we had that's how we build a relationship and trying to make sure we continuingly being there seeing on the side as a critical friend.

20. So it is written on the FRC website that the FCA (Financial Conduct Authority) requires you to publish your statement, is there anyone else, for example clients any other organisation that requires you to publish your stewardship statement?

A lot of our clients ask us to see our stewardship statement in RFPs. And again, that's part of it because we'll have clients that are looking for that. But no not necessarily. I must say the FCA thing is on one hand very good but on the other hand again drive this tick boxing approach cause the FCA as far as I am aware brought us into coming back to the fact that stewardship was going to be (?) premade mandatory by the EU, so that (?) us to creating this FCA provision that you had to give a response to the stewardship Code your response can be, we don't think that stewardship applies to our business, so we do not have to do anything. So, you know it works both ways.

21. I think you already answered this, but I am going to ask this again; According to FRC, applying the Stewardship Code has a positive impact on investors. Since being the signatory of the Code, what are the positive achievements for your institution, both financial and non-financial?

Yeah, I do think that I already answer this. Again, I can talk about the positive achievements that our engagement (?) and our engagement also you know is the ESG factor but also what our clients want to do. and you know our clients are big, producing the living wage for instance, they think that the living wage is very important so we over the period of five years talk to over thirteen FTSE 100 companies (?) doing about the wage at the end of that engagement programme 11 of them become a (?) to the living wage employer so we manage to drive that change. Similarly if we are concern about carbon (?) we took for years and years and years we've taken what's the carbon disclosure project now called CDP climate change rankings that used to rank companies from A to Es now A to D, under the old model we engage with any FTSE 350 company who haven't scored C grade we worked with an academic institutions to test how our engagement was working at the time there was about 76 FTSE 350 companies who genuinely companies (?) with the investment trust who had not got that C grade the university that we worked with split those two, split those 76 companies to test the control group we did not engage with and a test group we did, about 56 companies that we engaged with during the period of test about 26, 27 of the FTSE 350 companies that we engaged with improved their CDP score. The university was able to say 94% of the confidence rate that change wouldn't happen without us. So, I can talk lengthily about how our engagement has made meaningful change happen. I just don’t think that is driven by the stewardship code. It is driven by what our clients want to see, it is driven by the firm commitment this company has as the active ownership and dialogue all lead to the right outcome. And that sounds a bit wishy washy but fundamentally it’s what we believe.

22. How do you measure the success of your stewardship activities?

So, we try and have a very clear ask of companies. So, we are trying to know exactly what it is that we want the company to do and when we know that we can say whether the company is done it so or not. So, like what I said with the CDP piece of work, is the case that whether the objective's third party assessment process, then rank the company from A to E basis, now A to E. And we could actually say if you had a D now got a C and that’s the engagement success. Severally we did an engagement piece of work that we did with our clients’ values is very clear (?) from which foundation it is. If you hadn’t got there it wasn't a successful engagement if you had got there it was a successful engagement. So, it is a case of being upset with the (?) expectation that we are trying to achieve and then see if the companies have done better. That’s it. Because lots of our work, trying to kind of make the sustainable future for the companies, we need to, you know we are not necessarily testing the performance outcome we think that’s slightly separate from what we follow. so that you know we are not interested in (?) performance but it is very interesting academic evidence that you are trying to suggest that engagement does. (?) our paper for instance.

23. How do you ensure all the funds within your institution follow the same engagement policy and perform their stewardship activities effectively?

Because we are a relatively small company, it’s all done by my team. So, you know we do everything essentially so it’s not particularly hard for us to work , if we were to grow then that’s a different thing but you know for us it’s pretty easy monitoring data making sure we are doing things that we should be doing reports on. So, we do have a responsible investment committee that might just progress across everything that we do (?) stewardship to make sure that things are happening in the way that they said would happen.

24. Ok, that was the end of questions. Do you have other things to add or anything that I haven't asked you?

Well it depends. Ok, so what's your research question?

25. It is analysing the impact of the stewardship Code on financial and non-financial performance of the asset managers.

Ok, I don't think so. I think it is interesting that you have a selection of people like us that you want to talk about it, people who do it and what we really interested is to find out why people aren't doing the stewardship well,

26. The people who haven't applied the code?

Yeah the people who have done it, no I don't think there is that much else to talk about really.

Appendix E

Interview Coding

Parent Code	Sub Code 1	Sub Code 2	Sub Code 3	Sub Code 4
Clients	Enhance Value	1. Bottom Up 2. Top Down		
Gap	Agency Problem			
Asset Manager	Investment	Strategy		
	Ownership Behaviour	1. Active owner 2. Attitude towards risk 3. Responsible owner		
	Resource			
	Role	Length of position		
	Stewardship Team			
	Objective			
	Signatory			
	Perspective	Long term perspective		
Stewardship Code	Reporting	1. Comply or explain 2. Clients 3. FRC 4. Other		

	Motivation	Clients		
		Competitors		
		Minimise risk		
		Principles	Box-ticking	
		Attract new clients		
		Confidence		
		Self-motivated	Aspirational	
		Framework		
		Behaviour		
		Easy		
		Social media		
		Value		
	Tiering	Weakness		
		Strength		
		Improve		
	Contrast			
	Quality of the SC	Not significant	Already doing it	
			Equity focused	
			Not relevant	Everyone doing it
			Access	

			Consistent performance	
		Significant	Change	1. Disclosure 2. Behaviour 3. Environment 4. Proxy voting 5. Resources
			1. Financial 2. Communication 3. Quality of engagement 4. Access 5. Historical failure 6. Investment	
		Unsure		
		Difficulties	Collective engagement	Acting in concert
			1. Conflict of interest 2. Escalation 3. Resources 4. Constrained 5. Proxy voting 6. Reporting	
		Weakness	Box-ticking	
			Improve	1. ESG focus 2. Resources

				3. Focus on other asset classes 4. Outcome driven
			Measure success	
			Regulatory body	Resources
			Disclosure	
			Evidence	
			Risks	
		Strength	1. Not prescriptive 2. Principle based	
		Accountability		
	1. Compare 2. Access 3. Formalising 4. History 5. Inspiration 6. Performance			

	Stewardship activity	Engagement	Investee corporates	1. Do cooperate 2. Don’t cooperate
			Parallel	
		1. Voting 2. Dialogue 3. ESG consideration		
		Measurement	1. Performance 2. Objectives 3. Regulatory Bodies	
			Unsure	Don’t measure
		Consistency		
		Cost	1. Voting 2. People 3. Time	
		1. Monitoring 2. Collective action 3. Topics		
Explore Quantitative Findings				

Appendix F

Assumptions of the Regression Analysis

The following points explain how this study meets all the essential assumptions of the regression analysis:

- **Sample Size:** The first assumption that was required to consider before running the regression was to have at least 15 records for each independent variable included in the regression analysis. This assumption has been met in this study since the sample size is 50 and the maximum number of independent variables that could be included in the regression is 3. It is notable that this assumption is applicable if the dependent variable is normally distributed. The next section presents the distribution of the dependent variable.
- **Distribution of the Dependent variable:** To check whether the performance is distributed normally or has a skewed distribution, the ratio of skewness to the standard error of skewness is applied. The closer the ratio to zero, the more confident we are that we have a reasonable approximation to normality. Using the value of 2.58 as the cut-off between the marginal acceptability of normality and non-normality. Considering the skew ratio of 3.63, the annual financial performance of the equity funds is not normally distributed since the skew ratio is well above 2.58.

Table A.1 Skew Ratio

	N	Skewness	Std. Error of Skewness	Skew Ratio
	Valid			
WAAP	50	1.223	.337	3.63

To transform skewed distributions to normality, a square root transformation was applied in the SPSS. After the transformation, the normality test was run. The result of the normality test is presented in the following table:

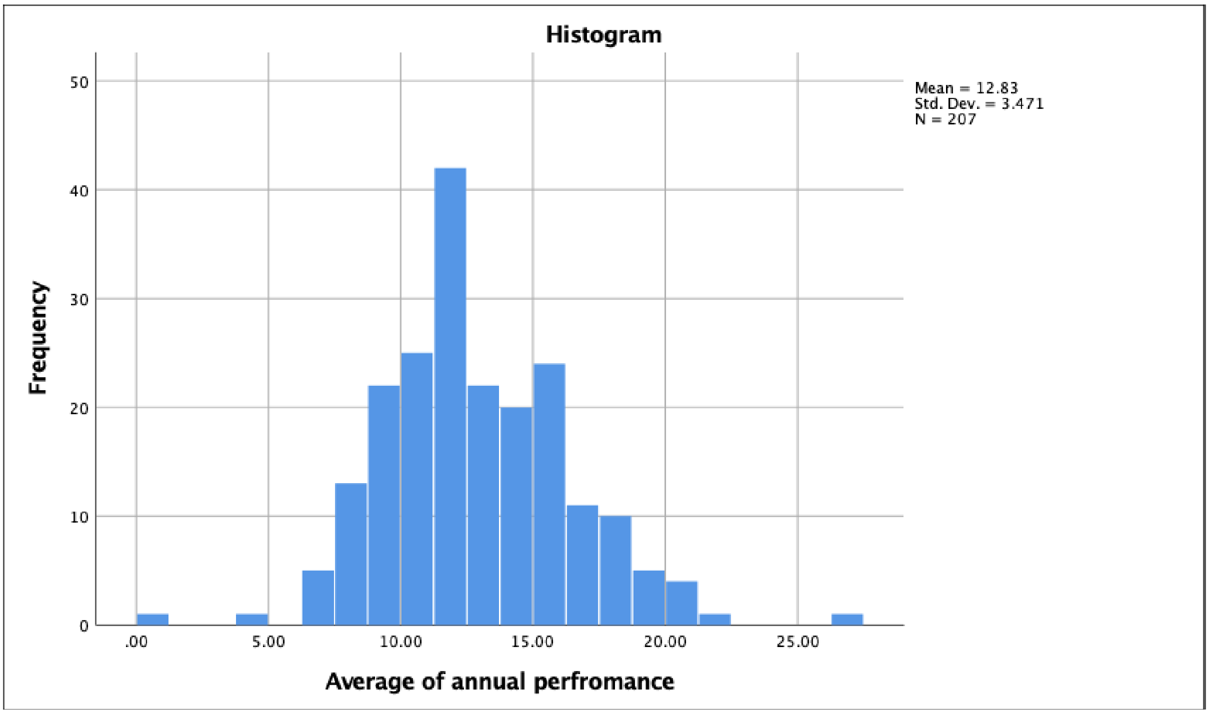
Table A.2 Normality Tests

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
performance	.092	50	.200*	.970	50	.239

The null-hypothesis of this test is that the population is normally distributed. Thus, on the one hand, if the p-value is more than the chosen alpha level (0.05), then the null hypothesis is rejected and there is evidence that the data tested are not from a normally distributed population. Here P-value (0.239) is more than 0.05 so the null-hypothesis is accepted, and WAAP is normally distributed.

- **Outliers:** Then, the normal distribution of the DV was considered to look for any outlier (i.e. a score that is very different from the rest of the scores) that could negatively affect the distribution of the data. Based on the following histogram, there are some data that could be considered as outliers.

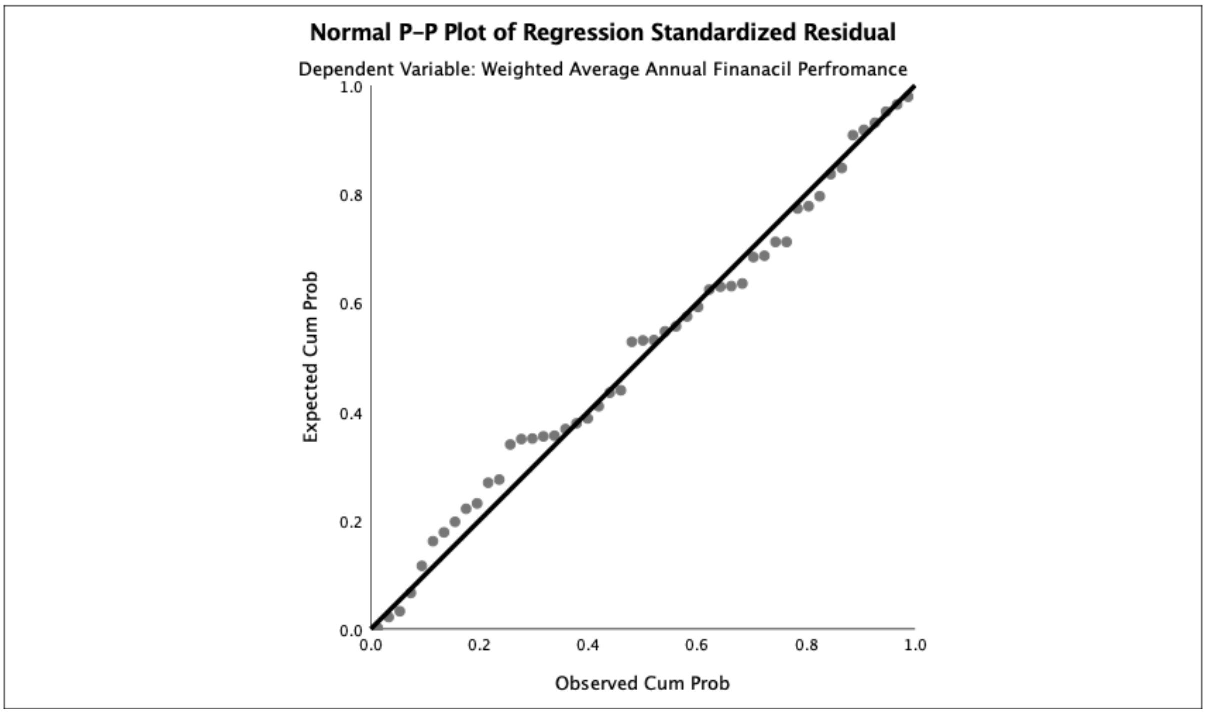
Figure A.1 Normal Distribution



To identify the outlier, Z scores of the Dependent Variable were calculated using the SPSS. Z scores are standard scores and therefore can be directly compared with each other as they represent comparative positions on the same scale. Since we have not used the same range of rating scores for all these variables, using Z scores enable us to compare them across different distribution. In addition, using Z score helps to identify the outliers for the age of equity funds. The Z scores should be between -3 to 3 and any score outside this range is identified as an outlier. One outlier case (12) was identified and deleted from the dataset.

- **Linear Relationship:** To check the assumption that there is a Linear relationship between the Dependent Variable and IV, the probability plot was used. Based on this plot, although there are some deviations here the points are generally following the regression line.

Figure A.2 Linear Relationship



Normal P-P Plot of Regression Standardized Residual
Dependent Variable: Weighted Average Annual Finanacil Perfromance
Expected Cum Prob
Observed Cum Prob
0.0
0.2
0.4
0.6
0.8
1.0

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