The ‘invisible’ hand: Views from UK institutional investors.

Purpose – Investors are called to be good stewards/trustees of their investments, often on behalf of third parties. In light of this fiduciary responsibility, and the conundrum of public criticism potentially impacting on share price, this paper uses the basis of the UK governance code to explore what important dialogue investors really have with their holdings to support good governance.

Design/methodology/approach – Semi-structured telephone interviews with eight institutional investors explores governance issues and investor company dialogue giving insights in to aspects of the importance of their part in the UK corporate governance code.

Findings – Rather than being sleeping lions, investors positively engage with companies, with regular communication being high on their agenda and not always via the AGM. There is a preference to do so ‘hidden’ over the glare of publicity or via share dumping. Thus we often do not see their actions around their fiduciary duties as often they avoid public criticism or any visibility that could do reputational harm and decrease company value.

Research limitations/implications – This dialogue was just pre the point of the exposure of the financial crisis, however it shows the importance that investors give to taking their responsibilities seriously. Importantly, it provides a springboard for further debate following the financial crises and the updates of the financial environment.

Practical implications – Even though policy seek engagement, the nuances of the investor dialogue are under explored compared to visible quantitative metrics. This dialogue assures that investors are active, even if their engagement is not public and can be deemed as hidden.

Originality/value – Complementing studies this paper explores a qualitative approach, uniquely sharing insights in to a hidden and little explored world of fiduciary dialogue.

Keywords – Corporate governance, institutional investors, shareholder activism

Paper type: Research paper

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The 'invisible' hand: Views from UK institutional investors.

1. Introduction

Corporate governance and in particular shareholder activity has become ever more dominant in the press with growing interest in the shareholder vote and shareholder engagement. Within the UK, the UK Corporate Governance Code (Financial Reporting Council, 2016) is deemed to be the gold standard for 'best practice' and listed companies are urged to either 'comply' with the code or 'explain' their governance structures accordingly. Since its introduction, (the first version of 'The Combined Code' was published in 1998 (Hampel, 1998a, Hampel, 1998b)) studies have looked to see the level of corporate compliance and research shows for the UK this has been steadily rising (Conyon and Peck, 1997, Grant Thornton, 2007, Grant Thornton Governance Institute, 2016). There has however, been early years debate about the role of the institutional investor as an effective monitor of governance aspects of the corporate company (Jensen, 1993). The presence of institutional investors in the stock market is not uncommon and whilst investor forums such as the Association of British Insurers and the National Association of Pension Funds advocate that investors are proactive in their monitoring role, little has been published beyond the realms of quantitative studies about investors' actual dialogue, yet best practice documents deliver a number of suggestions around methods that institutional investors might use. Recommendations such as voting at the AGM, shareholder proposals at meetings and engaging dialogue with the company should all help the investor monitor their investee companies (Financial Reporting Council, 2010). Furthermore, methods showing visible engagement give a greater sense of monitoring, however, in practice it is only recently that the visibility of such engagement is being discussed. With corporate investors acting nationally and globally, their contribution towards governance mechanisms is often examined in a quantitative way, thus any more qualitative dialogues still remain more hidden (Chung and Zhang, 2011). For example, previous quantitative studies have been published examining investor activity via proxy statements (Bannister *et al.*, 2011), via the annual general meeting (Rajyalakshmi, 2014) and dissenting votes/comments relating to specific issues (PricewaterhouseCoopers, 2015). One such example of this would be the 'say on pay' protests around executive compensation (BBC, 2017, Yeomans, 2017).

The lack of understanding around actual 'dialogue' leaves us with the constructs of what we know, against what might be practiced. In relation to this, gap this paper explores the following research question: How does the institutional investor actively engage with the companies it invests in, above and beyond document examination? Thus this paper contributes to the literature by providing insights in to what is less transparent and often hidden from the public view for the UK. Taking qualitative interviews, it complements what we know already from the objective quantitative literature around shareholder activism and probes into investors' views on what items of good governance practice they believe are important, effective and how they, as investors engage in this dialogue. It further provides a starting point, due to the dramatic effects of the 2008/09 financial crisis for others to take forward in an engaging dialogue in contrast to many publications to date, which have relied on secondary sources to thematically analyse institutional investors activities. Such questions fully remain relevant regardless of time and gives a more insightful view to the realities of balancing the view of institutional investors as they consider both their fiduciary responsibility and their consideration of any alignment to good practice in the areas of board composition, the separation of role of the CEO/Chairman, board independence and executive pay. Views on the level and usefulness of their dialogue were sought to contribute and complement the more public engagement via proxy agencies and the formality of votes at the AGM. This included both types of communication and the reaction (and actions) of institutional investors when they are dissatisfied with management practices thus incorporating a key issues of best practice, that of engaging in a 'dialogue' with the company.

2 Theoretical framework

Key to the modern floated company is the dispersed ownership of shares, with many investors being a minority and considered anonymous. Since the early seminal times of Berle and Means (1932) society has been warned of the implication of self serving managers at the helm of our large corporations. Indeed high profile cases of corporate failure such as The Bradford and Bingley collapse, or the fall in share prices when profit warnings are announced all serve to remind us of the powerful position of the executive and what can go wrong in terms of corporate governance failure. In a theoretical context, much of the governance debate centres around agency theory which is characterized by the divorce of ownership and control, where the principal/agent problem arises (Jensen and Meckling, 1976). This problem creates a divergence between the principal (the owners of the company) and the agents (executives who are mangers running the company) (Fama, 1980). However the role of the institutional investor can be seen in a wider perspective than just owners, particularly as the extent of their ownership might have wider implications on the economic stability of the market and the economy of the country as a whole (Hawley and Williams, 2000).

Furthermore, there are perspectives that the relationship between investors and firms has two differing aspects. The first of these is in relation to their role as owners and thus have to be responsible to safeguard their investments (O'Barr and Conley, 1992). The other is around business relationship with the firm which gives the ownership stake a different level of power due to being in some particular aspect dependent on the firm for business (Finkelstein, 1992). A resulting factor of this latter perspective is that the business relationship might lead to some levels of co-operation rather than monitoring (Heard and Sherman, 1987). Thus such influences could pose conflicting relationships on the institutional investor (Heard and Sherman, 1987).

According to Steele (2005), the responsibility of institutional investors to participate in invested companies is borne from the pressure posed by employees of companies and other organisations that have contributed their pension fund for investment. However even in this context, institutional investor activism pre the financial crisis has been rare (Bainbridge, 2005). Whilst reactionary methods of simply selling shares by institutional investors rather than dialogue have been debated (Admati and Pfleiderer, 2009, McCahery *et al.*, 2016), generally this step is not encouraged and selling large shareholdings would be viewed (by some) as grossly irresponsible and a more responsible approach would be shareholder active investment.

Indeed, the developments of the last 25 year of corporate governance in the UK show that it has always been advised to maintain a healthy shareholder/company dialogue. Even in light of this, there has been some levels of dissatisfaction and debate that this has not necessarily happened or been taken seriously (Easterbrook and Butler, 2014, Monks and Sykes, 2002). There have also been reported issues within the press where attempts have been made to engage directly and where there are institutional investors engaging, companies have a tendency to perform better (Krikorian, 1991, Larcker *et al.*, 2007).

2.1 Institutional Investors – Visible or invisible?

Institutional investors can be defined as a heterogeneous group of organisations, including banks, public and private pension funds, mutual funds, and insurance companies who are able to exercise influence over companies where they hold investments (O'Barr and Conley, 1992). Furthermore, for the UK, the Myners Report (2001) states that institutional investors include occupational pension funds, insurance companies, investment trust and other financial institutions and the UK Stewardship Code (Financial Reporting Council, 2012a) adds to this by the incorporation of asset managers. Across the globe institutional investment has taken the largest part of equity investment in most countries due to the effect of globalization where capital can move freely in acquiring portfolio of investment (Solomon, 2007).

These institutions, according to Myners (2001) have dominated the equity market in the UK as their stake continues to grow over the years (Office for National Statistics, 2017). They become more and more significant in any economy as their share proportion rises and thus they play a role that cannot be ignored but should be recognised and valued. Indeed Smith, Swan and Gallagher (2007) argue that the effectiveness of corporate governance in this context is dependent on institutional investors. Whilst Myners (2004) stated that institutional ownership is rising at the expense of a decrease in individual share ownership, this has a greater positive effect on the monitoring role such large institutions are able to provide. At the end of 2008, the year of this study, the UK Stock Market was valued at £1,158.4 billion (Office for National Statistics, 2010) even though this has seen a drop of £19,506 million - potentially due to the financial unrest. On further inspection, there have been significant changes in ownership patterns from the mid sixties to 2008 (the year of this study). The predominant growth being the ownership of UK companies by investors located around the world, rising from 7 per cent in 1963 to 40.5 per cent in 2008. Gillan and Starks (2003) would argue this to be a positive step as foreign institutions often bring a more active perspective due to a lack of 'local country loyalty', but for the UK this has been at the cost of individual ownership of shares (Office for National Statistics, 2017). In the UK individual ownership has decreased from 54% in 1963 to 12.8% in 2006. There was a rise however between 1993 and 1994, although this increase according to Malin (2007) can be attributed to the privatization of public companies in the UK in the early nineties. Of course, these are just pre the financial crisis, however, even though the value of UK quoted companies at the end of 2016 is worth a total of £2.04 trillion, there is still the growth on shares held by financial institutions, up 1.5% between 2012-14, and a further 1% to 2016 (Office for National

Statistics, 2017).. Generally this increase is attributed to more investment in pensions by individuals. Also, contribution towards pension funds embraces a means of pooling risk together through collective investment and with tax advantage (exemptions from capital gain and income tax was an identified reason for the surge of pension investment). These changes in structure are also reflected by Myners (2001, 2004).

Much of what is known to date around institution investors follows the pattern of being visible. For example, many have a highly visible corporate governance profile and Bebchuk *et al.* (2017) reminds us of the pull for such firms between a stewardship approach and agency perspective. There is the call for a pathway to more long term approach, where the investor voice is expressed as engagement (McNulty and Nordberg, 2016) or via creating engagements that become more 'routine' approach (Martin *et al.*, 2007). With the mix of policy, best practice and professional body guidance the investors involvement in governance has a complex perspective and can become multifaceted and dynamic (Aguilera *et al.*, 2015).

2.2 Institutional investors' influence and their involvement in corporate governance

According to Hellman (2005), beneficiaries expect maximum level of returns from fund managers, and therefore should ensure that managers of firms deliver good corporate governance in order to maximize shareholders value. Furthermore, institutional investors have incentives to show concern for corporate governance as part of their fiduciary duty as they are bound by law to act in the best interest of their own investors (clients) (Black, 1990) and protect the investment of other peoples' money (Krikorian, 1991). The price for not taking this on board would be considered a breach of contract with their beneficiaries (David and Kochhar, 1996). David and Kochhar (1996) further point out that increased levels of investments by institutional investors have made it more difficult to sell off shareholdings without depressing the market. Thus rather than selling shares, active participation in company engagement should be advocated. Whilst this might be deemed time intensive and perhaps costly, the rewards from a share performance point of view should also be considered (Atrill, 2006). Atrill (2006) provides evidence that open dialogues can create further opportunities for shareholder value as this provides a means to influence the company on strategy and policy decisions. However public criticism of companies by institutional investors is not wise as it might be damaging on the share price. Rather than public criticism, institutional investors should be encouraged to participate in 'focal lists' (a list of companies that are not performing up to expectations and are rated standard or poor) as a way of acting on their concerns. This type of engagement has sometimes lead to the removal of members of the board (Malin, 2007). Not only is there the participation in listings, but some institutional investors use corporate governance rating systems to gain information, for example Governance Metrics International. Governance Metrics International covers the analysis of ranking several countries according to their level of corporate governance. This is particularly relevant for the UK as the growth of international investment in companies occurs. Similarly, the transparency of such lists can act as a positive encouragement for governments of counties to improve corporate governance practice whilst also giving indicators for investors as to where to invest, i.e. both from a company and a country perspective.

Other examples of investors flexing their role as activists have been the refusal to participate in right issues. Boards of directors might call for a rights issue, by issuing additional shares to existing shareholders in order to raise extra funds. Keasey *et al.* (2005) argue that non participation due to governance issues can be a method of influencing the Board as it can become difficult for the board to run the company effectively without adequate finance. However, it should be noted that this method can only be used if/when there is need to raise funds.

3 Key aspects of the UK corporate governance framework

Corporate Governance can be defined as the mechanisms by which companies are controlled, directed or made accountable (Keasey *et al.*, 1997). Governance though can have many aspects in many international contexts. This study focuses on the UK, as such; the key underpinning aspects of what constitutes good governance has been drawn from a UK context and heavily relies on the different iterations of the UK Corporate Governance Code (previously the Combined Code). A word of caution must be mentioned here in that, whilst this is considered best practice, it does not in essence constitute a legal framework as it operates on a ‘comply or explain’ basis, i.e. the principles of the code might not be followed if an alternative may be justified in particular circumstances and good governance can be achieved by other means (for a fuller discussion on comply or explain see Financial Reporting Council, 2016, Financial Reporting Council, 2012b).   This research was carried out at the time that the 2008 Combined Code was effective, however even though we now celebrate the 25 anniversary of governance codes in the UK, the above was still common practice then, but for consistency with the data, the following section gives an overview of the key aspects that underpin this research and were main features in the Combined Code on Corporate Governance at that time.

3.1 Board composition and structure

All iterations of the governance code provide for every company to have a board that will take responsibility for the success of the company. Also the board should separate the role of chief executive from that of the chairman, which must not be occupied by the same individual. "There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision" (Financial Reporting Council, 2008:A2, p12.).

There should be a balance between executive and non-executive directors in order to avoid an individual having control over board decision, the size of the board should be adequate for the business need of the company and also to ensure that appointment to the board is done by nomination committee with a succession plan in place to fill any vacancy that arises. The appointment of directors should be voted by shareholders in the first annual general meeting (AGM) and the interval between re-election should not exceed three years. Non-executive directors are also expected by The Code to decide the remuneration packages for executive directors. However, the best practice recommended by The Combine Code (2008) might be insufficient to guarantee good corporate governance. Dalton and Dalton (2006) argue that certain issues are necessary to ensure effectiveness of the board. Such issues include 'Independence in spirit as well as structure'. Indeed Bathala and Moon (1995) believe that institutional investors should ensure a high proportion of independent non executive directors to monitor management. Similarly, Pass (2004) regards non executive directors as a monitoring tool, safeguarding the interest of shareholders by ensuring that executive directors act in a responsible way.

3.2 Committees and institutional investors on executive remuneration

All investors thought that the existing committee structures of nominations, audit and remuneration provided effective forums and that effective governance meant good proportions of non-executive directors with the correct skills on these committees. Due to the growth of press coverage on executive pay around this time, this was probed further. Pay to the point of this study had been steadily increasing in the UK (PWC, 2008) with the increase often being attributed to the need to enhance global competition by ensuring levels of pay that will retain directors (Conyon, 2000). A further area for concern to all shareholders has been the structure of executive pay (Allcock, 2012, Filatotchev *et al.*, 2007) and generally even though compensation contracts are said to reduce agency problems between shareholders and managers (Fama, 1980, Fama and Jensen, 1983) pay has risen far in excess of inflation (Mishel and Davis, 2015). Even the requirements to present a remuneration report for approval by shareholders in the annual general meeting (The Directors' Remuneration Report Regulations, 2002) appears to have done little to prevent such rises although Hendry, Sanderson, Barker and Roberts (2007) would argue that this regulation creates an opportunity for more shareholder activism. Indeed in theory, equipping institutional investors with this right to vote should ensure more accountability from management (Cubbin and Leech, 1983).

However, recent research is still open to debate. For example, early research (Cosh and Hughes, 1997) show that institutional investors have no influence on the level of pay for directors, whilst others simply attribute size of the company rather than institution investors as being the determinant of pay levels (Dong and Ozkan, 2008). David, Kochhar and Levitas (1998) concluding that investors have significance influence on directors (CEO) remuneration but this is linked to their business relationship status. In pressure resistant institutions with no business relationship with investee companies will reduce the director’s pay but increase long term benefit (share options). The increase in long term benefit tends to align shareholders interest in maximizing the value of the organisation. On the other hand, pressure sensitive institutions will support an increase in director’s pay mainly because of fear of losing business relationship if they oppose it. Strivens, Espenlaub and Walker (2007) further contribute to the debate establishing that the presence of large shareholdings from institutional investors have an impact on decreasing salaries and bonuses but not decreasing benefits. Also they stated a direct relationship between bonuses and performance of investee companies and that the institutional investors will ensure that bonuses paid to directors are linked with the performance of the company and thus avoid a company paying for poor performance.

Other publications show that greater levels of shareholdings by institution investors help tie executive pay to performance (Almazan *et al.*, 2005) and that there are significant and positive relationships between institutional investors and levels of share option grants

(Ozkan, 2011). Thus the effectiveness of pay mechanisms and the contributory factors that institutional investors have is still open to debate.

3.3 Institutional investors and investor / company dialogue

The board is expected to maintain dialogue with shareholders and also to maintain communication with them. One of the recommendations of all versions of The UK Governance Code (formally the Combined Code), is that, the board of directors should facilitate communication with shareholders. Myners (2001) focused on the need for institutional investors to take an active role in monitoring underperforming companies and to encourage shareholders activism, and also ensuring good corporate governance. In light of this report proposals were made in the UK encouraging the role of institutional investors in using their votes, constant dialogue and interaction with the management of the firm they have investment in.

Any such dialogue often lands at the hands of the chair or senior independent directors. Non executive directors are expected to communicate with major shareholders through face to face contact, opinion survey, brokers briefing etc. In support of good practice, Hermes Pension Management Limited (2008), encourage companies to seek an honest, open and on going dialogue with shareholders. As part of this they desire the communication of not only the plans companies are pursuing but the likely financial and wider consequences of those plans.

4 Research design

This study used qualitative semi structured interviews, allowing the insights and perceptions institutional investors to be captured. The sample for this research was created from following up on a quantitative piece of research where the final item on a questionnaire was an invitation to participate in research via an interview. Respondents were asked to indicate name and contact details for such participation. Eight UK investment companies responded with fund manager names and contact details, thus data are drawn from 8 telephone semi structured interviews with fund managers in large institutional investor companies in the summer of 2008. Interviewees were advised that their comments would be records and transcribed, but anonymised for research purposes. The interview questions were divided in to three parts. The first part, and the most structured part of the interview was concerned with general information on the particular type of institutional investor, aiming at identifying the volume of equity owned in the UK and which type of market they have invested, as such questions identifying sample descriptors, for example, ‘How would you categorise your company in terms of the type of institutional investor you are?” “What is the quantity of your holdings, and in what types of markets?”. Such market categorization helps to identify the level of holdings in large listed companies. Furthermore, a direct question was asked “Do you have any type of business relationship with any of the companies you invest in?” This was important to identify arguably any business relationship with their portfolio companies might affect objectivity in the monitoring relationship.

The middle section sought to identify how institutional investors considered governance and what they looked for in their investment companies, which was the opening question. Follow up probe questions were prepared, and these comprised main of “how important is xxx to you?”, for example, “how important is the separation of the CEO and Chairman role?”. Many of these derived from and replicate the sections of the relevant UK corporate governance code and the identification of good governance practices. Items probed in the dialogue again were themed in to areas covering aspects of board composition/board independence, the separation of the role of the CEO and chairman, committee structures and investors’ views on linking executive remuneration to performance. The middle section also asked for considered the use of their vote in shareholders meetings and the influence they have on any appointment of executive directors.

Lastly questions around dialogue, including types and levels of communication between institutional investors and their portfolio companies. The aim of this part was to identify the level of communication that exists between institutional investors and portfolio companies and also to identify the level of management that institutional investors communicate with this section was framed by asking “How do you maintain communication with your portfolio companies?”. Depending upon responses further items were asked such as “what means do you use to communicate with portfolio companies?”, “how often might this be?”, “what level of their organisational structure does this tend to be with?”.
Importantly this was followed up with a question probing we also sought to identify the reaction of institutional investors when they are dissatisfied with management practices.

Due to the semi-structured nature of the interviews, full transcriptions were then themed to incorporate the discussions against the sectional objectives of this paper. Whilst different institutional investors commented in a different order, the themes were very apparent thus overcoming any comparability weaknesses in the inquiry of the topics covered in these discussions.

Part one of the questions established contextual information for the investor, this gave context and confirmed the nature of the investor participating. Table one below, shows this in light of the eight companies participating. Unfortunately and although no identified companies are shown, due to the commercial sensitivity of portfolio information, some were not prepared to give specific details (see question examples above), but were happy to talk to parts two and three of the interview questions.

Company	Investor type	UK Holdings £m	FTSE100 (%)	FTSE 250 (%)	Aim (%)	Direct holdings (%)	Indirect holdings (%)
1	Investment house	10000-15000	50-60	20-30	0-10	90+	
2	Asset Management	15000-20000	Not wishing to disclose				
3	Pension fund	1000-5000	80-90		0-10	80-90	10-20
4	Investment trust	500-1000	60-70	30-40		90+	
5	Asset Management	10000-15000	90+		10	90+	
6	Investment trust	500-1000	Not wishing to disclose				
7	Other		Not wishing to disclose				
8	Other	Not wishing to disclose					

All respondents indicated that they had no other business relationship with their investment companies.

5. Results: What the investors said with regards to key governance factors:

5.1 Board composition and structure

With regards to board structure and composition all companies supported effective boards. Company 5 and 2 highlight the importance of this *"Good practice embodies the following key principles…an empowered and effective board and management team" [Company 5]* *"[Company 2] supports the combined code on board composition" [Company 2]* however, the prime focus that came out was the belief in the separation of the role of Chair and CEO. All companies regarded this separation as vital to the role of effective corporate governance. The existence of a non-executive chair was seen as one of the prime ways that enabled companies to engage and communicate at board level. One manager responded

> *"We like to see a group separate the roles of chairman and CEO, have committees for remuneration, nomination and audit, have a substantial percentage of its board as non-execs, have a diverse board of directors, including women, have an ethics committee, and report at least annually on its [Board/ Corporate Governance] practices" [Company 1].*

Another said:

> *"we will normally vote against the election of a director holding both positions unless a satisfactory explanation as to why these roles are combined and a time frame for their separation are provided and also we are not in favour of a chief executive going on to become chairman of the same company. However, if this does occur, we expect the company to consult major shareholders in advance and clearly set out its reasons in the next annual report" [Company 2].*

This implies that investors are tolerant of the 'comply or explain' notion, however lengthy and continual explanations of practices might be more frowned upon particularly if there is, in an investors eyes, no good reason. This reinforces views from previous literature.

5.2 Executive remuneration

All companies agreed that the remuneration committee provided a vital role for lobbying with regards to the setting of executive pay. Respondents believed in the importance of executive pay

> "*because it aligns the interests of directors and shareholders [Company 6*]", "if a company is performing well and value is returned to the investor, then a director's remuneration is justified in being higher" [Company 1].

another believed that

> *"It is right that the board should report each year in some detail its remuneration policy and how that policy was implemented over the year. We have for some time advocated that companies put the board's remuneration report to shareholders for a vote at the annual general meeting" [Company 8].*

However, when it came to the use of share options and any links to performance, responses were more mixed. All companies felt that giving out share options as part of pay packages was important, but linking pay to performance was more mixed. Two companies remained neutral about the real value of this and one was quite pragmatic in their view:

> *"If a company is performing well and value is returned to the investor, then a director's remuneration is justified in being higher. If not, then a director's pay should reflect this" [Company 1] "Good practice embodies the flowing principles…..remuneration policies that reward the creation of long-term shareholder value through the achievement of corporate objectives" [Company 5].*

Once company particularly stated that it felt value could be added by a dialogue with any remuneration consultants appointed on behalf of the Remuneration Committee. Literature thought shows limited actual instances of pay reduction, however recent activity has brought about discussions (often within the press) about levels and receipts of bonuses. Following such public pressure certain executives have chosen to forfeit their bonus awards.

5.3 Investor/company dialogue

All the respondents said that regular communication is highly important; however one company's only involvement was to receive communications and use their voting rights. Indeed the company only exercising voting rights never met management face to face, sent letters, or made telephone calls and generally use a proxy agency even though they believed regular communication to be important [Company 8]. As a company responsible for investment on behalf of others, this was quite surprising, as one would assume they would be more active in fully discharging their fiduciary responsibility to those that invested in them. Thus it is somewhat surprising that they are not overtly proactive when it comes to matters of engagement, waiting to vote at an AGM might be too late to correct or object to any governance issues.

Others were considerably more proactive with five respondents stating that they carry out communication with all levels of management; but only two respondents said that their communication was at board level, but this was with both executive and non executive directors. One investor stated *"we use a range of communication methods when engaging with companies that we hold. There is no fixed cycle…. we engage in dialogue with the company when [the] need arise"[Company 6].* In fact three companies considered they had rich levels of dialogue with face to face and telephone contract with their portfolio companies. The other four companies often used emails and letters.

With all companies believing open dialogue important, the question of how and how often this happens becomes very relevant. Respondents replied that they preferred to *"communicate through constructive dialogue" [Company 2], "engage directly" [Company 3]* or "*keep regular communication with the management of the company" [Company 7].* These comments relate to companies that have already been invested in, however one company takes action prior to investment.

> *"We visit every company (several times) before investing in it on behalf of our shareholders. We complete a corporate governance check on companies as part of our quality / value rating of companies; every company in which we invest must pass this first hurdle of financial strength, of which corporate governance is a part" [Company 1].*

The reasons given for regular communication was to enable them to gain an understanding on issues going on in the company and also to gain understanding of decisions made by management and also help shareholders on their voting policies. Furthermore, regular communication enabled board and management to disclose useful information on company strategies and other corporate information that will improve transparency from management and thus give greater understanding of the company's financial position

One company even stated that they are prepared to not just engage in dialogue but stated they *"seek to encourage best practice through regular dialogue with company management and by fully exercising voting rights across markets"[Company 5],* similarly they expanded on this *"we use a range of communication methods when engaging with companies that we hold. There is no fixed cycle, for example in 2007 we voted on 34889 proposals at 3279 companies" [Company 5]*. In addition to this, this company stated that they would *"endeavor to communicate why we vote against any resolution at an AGM or EGM" [Company 5]*.

This particular company was also open to the fact that they had also been proactive in working with regulators, industry bodies and other like minded investors to strengthen the regulatory environment and contribute towards the development of best practice.

The final questioning was with regards to issues that cause concern and how investors really deal with them. We were told that

> *"There aren't that many issues that come up requiring public criticism. Also, we usually hold fairly large positions in investee companies, so we see our role as trying to change an organization from the inside, rather than trying to embarrass / criticize it from the outside" [Company 1].*

6 Discussions, implications and conclusions

The financial crisis of 2008 -2009 shows that we still have gaps in our understanding (Ahrens *et al.*, 2011). This research thus provides a foundational starting point, is at the point of the emerging financial crisis, and later research by McCahery, Sautner and Starks (2016) suggest only 63% of investors have direct discussions, and 45% of their sample held private discussion, only one of this studies companies appeared to be less engaging. More importantly, contrary to other studies (McCahery *et al.*, 2016, Ram, 2017), investors do not see their relationship with their portfolios as an exercise in document inspection or proxy filings, albeit this might be their initial starting point. The above all gives rise to the concept of the 'invisibility' of real engagement, not merely in a fiduciary way, but in a stewardship way. All said they would avoid public criticism against their invested companies, but other more specific comments were harder to gain. The common practice was to address issues personally with face-to-face communications or telephone calls rather than perhaps more formally by writing. Again the concept here could be deemed active engagement, and something with more astute awareness of the broader investment/stock market perspective, particularly as there was no suggestion that the investors in this study would primarily engage in share selling ('visible disapproval') rather than use dialogue, a healthy response from the perspective of any other private shareholders. This has to be a positive step towards greater engagement over perhaps more remote objection, thus a true alignment with good governance standards. Similarly, overtly using the AGM to propose resolutions, contrary to practices in the mid 1980s and 1990s (Graves *et al.*, 2001, Logsdon and Harry, 2009), was not the chosen method, however all said they would use their votes to vote against items they disagreed with (again opening the invisible/visible debate).

The reality was that only two companies were really prepared to comment any further. One said

> *"we have contacted companies in the past concerning their poor governance practice, such as suspicion of fraud or refusal to take on better ESG [environmental, social and governance] practices" [Company 1]*, the other *"we consider all corporate governance issues to be important and will raise these with companies. This is in addition, to the financial and corporate strategy issues which the fund managers will raise with companies" [Company 2]*.

The implication of the above statements from the respondents is that, institutional investors are taking corporate governance of companies seriously. The research indicates that they are no longer a sleeping lion but are gaining more momentum and bite. However it would be remiss of this paper not to make reference to and try to rationalise the impact of the subsequent developments following the 2007-2008 financial crisis. Whilst much of this started in the sub-prime mortgage market, the ripple effects via subsequent quantitative easing cannot be ignored.

Whilst it might be argued that quantitative easing perhaps resulted in some rebalancing of institutional investors' portfolios (Breedon *et al.*, 2012, Joyce *et al.*, 2017), limited qualitative academic research prevails, giving us no real clues around anything more than those parts of the portfolio that might have been invested in corporate bonds. The lack of literature around this poses both weaknesses of this paper but more importantly a wealth of opportunities for further research. Firstly, regardless of the timeframe of the interviews, just prior to the financial crisis, the findings remain relevant, not necessary to assure that this might be the case ten years following the crisis, but to provide a unique starting premise. Three months after these interviews, the shares of the banking sector for example had been turned upside down by the financial crisis (Andrew and Kenny, 2012, Nurlan *et al.*, 2016). Whilst the investors held a broad portfolio, one cannot help but question whether higher or earlier levels of engagement as per Pergola and Verreault's (2009) discussions, might have in any form altered the way this particular event happened. One can be assured that subsequent to this, there has been a growing emphasis that institutional investors could, and should, be doing more to ensure companies are performing well and demonstrating good shareholder value and good corporate governance. Whether there are implications that prior to this they were not, is perhaps more sector specific and more deeply rooted in matter beyond the scope of this paper. Investors take their responsibility seriously, but still have the bounds of agency theory and the principal/agent debate to limit them.

To conclude, investors are well aware of the various options that are available to them to engage with and promote good corporate governance, however, what might still not be clear is still how proactive they are able to do this and that they are doing this well. Their dialogue point to clear engagement, and obviously they wish to cover their duties to those who entrust them to invest, but the balance of opportunity and cost to the investee companies may have subsequently changed. At the point of the study, the driving force was perhaps more industry based than policy driven. Subsequent to the study, the UK launched its UK Stewardship Code (Financial Reporting Council, 2010) and further revised this in 2012 (Financial Reporting Council, 2012a). All indicators are that this has been well received by the city asset managers and the proposition from the qualitative results could be that stewardship was high on investors' radar. However what is not known now is where this sits at this time. Have there been lessons learned that have encouraged the institutional investors to be even more pro-active in effectively discharging their fiduciary duty by ensuring companies? Only further research to provide comparators would be able to debate this and provide additional insights in the governance and agency debate.

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