Short-termism, ownership and implications for investor stewardship

Abstract: Institutional investors play a central role in corporate finance and ownership. But their direct role in corporate governance has received only limited attention, focused mainly on shareholder activism, with its focus on strategic change and rapid improvement in corporate performance. Following the financial crisis, however, policy has sought ways to counteract the perceived short-termism in equity markets. It has cast a spotlight on the role of investors, not least in the UK, with its Stewardship Code (introduced in 2010 and revised in 2012) and in related moves in a number of European countries and by the European Union. In the US too, policy has paid special attention to questions of proxy access and enhancing shareholder rights to voice. They share a concern to evoke the spirit of the 'universal owner', interested in both the long term and in the broad development of the economy as a whole. This paper examines developments in the policy against the backdrop of changing practices and structures, raising doubts about the premises of the policy direction and discussing the promises and drawbacks alternatives within other forms of ownership.

Key words: Investor engagement, ownership, stewardship, corporate governance

JEL classification: G2, G3, K2

1. Introduction

Institutional investors have long played a central role in corporate governance but no more so than since the financial crisis of 2007-09, when policymakers turned to them to act as if they were ‘owners’ with a stake in the long-term future of the companies in which they invest. The trend began in the UK with its Stewardship Code (FRC, 2010), followed by the Kay Review (2012) to counteract short-termism. France (Commission Europe, 2010; ORSE, 2011) and Germany (discussed in Roth, 2012), among other countries, took similar actions, while the European Union (European Commission, 2011, 2013) included investor engagement in its review of corporate governance.

In the US the Dodd-Frank Act (Library of Congress, 2010) gave shareholders new voting powers (e.g. say-on-pay) and made it easier to raise shareholder resolutions (i.e. proxy access). The European Union sought to amend its Shareholder Rights Directive to empower investors (European Commission, 2014). Some institutional investors that favour this approach now call themselves ‘shareowners’ rather than ‘shareholders’ (e.g. Butler and Wong, 2011). The thrust of each of these policy moves assumes that shareholders are able to prevent corporate excess and with certain incentives would want to. But the policy initiatives face obstacles arising from the changing structure and power balances in institutional investment, in particular the growth of foreign ownership, funds-of-funds, sovereign wealth, and even from a revival of shareholder activism, promulgated by activist hedge funds.

In his paper ‘After the corporation’, Davis (2013) provocatively argues that both scholarship on organisations and industrial policy are based on an outdated conceptualisation of the corporation. The disaggregation of production functions across industries makes the corporation of yore a relic of a previous industrial age. In the US at least, the old giants made up a large part of the social structure and services that has held society together. What happens to the structure of society ‘after the corporation’, he asks?

This paper turns that spotlight on investors. The policy push towards stewardship evokes a bygone era of family-owned enterprises and corporations controlled by grand financiers. But the patient capital of Warren Buffett is a model few follow, or could (Bushee, 2004). New money from end-investors increasing flows instead into funds-of-funds, detaching the end beneficiary even further from control.[1] Setting public policy to make finance serve the whole economy as envisaged in the ‘universal owner’ (Hawley and Williams, 2007; Urwin, 2011) - modelled on the large pension fund – seems a laudable goal. The economic interests of such investors, this theory argues, lie more in long-term advances of society as a whole than in short-term profits from share-trading.

But in view of the changes in investment, there is a danger such policy prescriptions are anachronistic and may even privilege a dying class of investor against other more vibrant ones. Moreover, they may legitimate shareholder primacy at a time when scholars and the rest of the policy framework question it (Armour *et al.*, 2003; Bainbridge, 2010; Stout, 2013). We – scholars, policymakers and practitioners alike – need to consider alternatives. Within the system of wealth creation and like the corporation, the traditional investor – including the universal owner – remains an important economic force. But institutional changes, working within the market system, will work as these investors decline as a social force?

This paper questions the efficacy and legitimacy of policy prescriptions that rely upon institutional investors acting as universal owners. It starts by depicting the tension between ownership in theory and practice. It then sketches of the extensive theoretical and policy-oriented debate over question of shareholder primacy and the assumption that underpins it of shareholder value maximisation as the driving force of corporate decision-making. This conceptualisation of corporate ‘ownership’ is then set against the backdrop of the investment landscape as it has developed over the past three decades.

Next, we will consider several examples of the policy attempts, including in detail the UK Stewardship Code, showing the gap between policy expectations and potential outcomes in practice, in particular in light of the recent emergence of hedge fund activism. We then discuss alternative approaches to achieve the policy aims, focusing on possibly remedies in institutionalising a preference for other ownership forms.

2. ‘Ownership’ in theory and practice

In the pre-industrial era, business ownership was simple. Unlimited liability and direct communication between capital, labour, suppliers and customers meant that markets exerted a strong and personal governing influence on business management even without the price mechanism. Reputation was an attribute of people, not brands. But the technical innovations that led to industrialisation required the aggregation of capital, which led to the limitation of owner liability in the joint stock company. As the process continued, it created what Berle and Means (1932/1991) famously called the ‘modern corporation’, where investors held small stakes in large enterprises and knowledgeable managers enjoyed positions of power over distant and fragmented owners. Ownership had become separated from control. Berle and Means described a US phenomenon, but it was one copied in many ways in Britain after the Second World War (Franks *et al.*, 2005) and emulated with variations as capital markets grew more international in the 1980s and 1990s.

The agency problem (Fama, 1980) came to dominate the emerging literature on corporate governance. Agency theory sees excess and avoidable costs arising from management shirking their responsibilities to owners or expropriating company assets for their personal use. The prescriptions of agency theory involve using equity-based incentives to align the interests of managers with shareholders and freeing up a market for corporate control as a disciplinary tool. In addition, agency theory has been cited as justification for policy requiring broader and deeper disclosure to reduce information asymmetries and stronger shareholder rights to enable monitoring, even though these may offer at best only partial solutions (e.g. Hermalin and Weisbach, 2012).

Such monitoring involves costs that some investors are unwilling to incur. But in the normative literature, and in particular among legal scholars of corporate governance, a theme developed suggesting that a category of investors had incentives to engage in monitoring, termed the ‘universal owner’. The term came into wide use building on the textbook written by Robert Monks and Nell Minow (1995), themselves activist investors with a long-term orientation. They argued that some investors, and in particular pension funds, invest across the whole economy and thus have interests to see the economy as a whole improve, not just particular stocks or sectors.

Moreover, in view of the long-term nature of their liabilities, proponents of this view argue that such investors have a fiduciary duty to take a long-term view of their assets (Hawley and Williams, 2000, 2007). In this view, such investors are likely to have duties and interests aligned with a public policy direction encouraging private investment in businesses with sustainable operations and profitability. Universal owners have little to gain from short-term trading profits, especially if trading encourages managers to take a short-term view of business opportunities. This sense of ownership is a particular one, however. It involves a long investment horizon, a wide breadth of actual investments (rather than just breadth of opportunities to invest), and a sense of commitment. As we examine next, another concept of ownership is in wide use in company law and practice.

2.1 'Ownership' in law and beyond

Legal scholars and practitioners alike consider ownership as a concept arising in property rights. Ownership involves a certain bundle of rights. Glackin (2014) traces this usage to John Lewis in 1888 in his *Treatise on the Law of Eminent Domain in the United States*, an idea developed further in the writings of Wesley Hohfeld (1920). This liberal and individualist view sees property ownership involving the freedom to dispose of property as the owner wishes, subject only to certain overriding constraints (e.g. eminent domain). Outright ownership of a business, in which the owner has unlimited personal liability, involves considerable rights.

The invention of limited liability and the creation of a legal personality for the company involved a change in the bundle. Owners of shares in the company have only limited rights. These vary by jurisdiction, but broadly they concern the right to elect directors, the right to vote on changes to the articles of association, and the right to approve certain material changes in the nature of the business, often to do with takeover bids and mergers (Siems, 2008). Shareholders have the right to receive a dividend, but the board of directors is under no obligation to pay one. Crucially, shareholders have no rights over the assets of the company and no right to withdraw their capital.

This sense of ownership is not only limited in terms of rights, it also represents a narrow view of what ownership means in common parlance. People feel a sense of ownership when they identify with something, when it becomes part of their personality. They do not possess the 'target' of ownership we see in the bundle of rights approach; they care about it, become one with it. This is a psychological – cognitive and emotional – investment, not just a material or financial one (Sikavica and Hillman, 2008). In the literature of organisation studies, such ownership appears in the case of employees (Pierce *et al.*, 2001) and is sometimes used by stakeholder theorists to justify that employees as well as shareholders have a residual risk in a company (Brink, 2010). McNulty and Nordberg (2015) argue that the care, identification and commitment in psychological ownership underpins some aspects of the policy attempts to promote stewardship.

2.2 Policy attempts to promote 'ownership'

In various papers and policy interventions, Monks uses a market-based rationale in advocating engaged share ownership. But his writings raise the spectre of a systemic failure (e.g. 'Capitalism without owners will fail,' Monks and Sykes, 2002), a view that, in the wake of the financial crisis of 2007-09, other polemicists saw as prophetic ('Capitalism without owners has failed,' Resta and Davies, 2011). In cases of market failure, the alternative voiced in the traditional dichotomy in political economy is state intervention. Policy moves in Europe since the crisis have relied more on 'nudge' tactics[2] and voluntary codes, rather than the brute force of law and regulation.

One such policy approach involves the concept of stewardship on the part of investors, that is, to encourage institutional investors to act in ways that promote better understanding of the forces affect long-term corporate performance, and with a sense of duty to the broader, long-term interests of their beneficiaries, that is, their end-investors. The concept of stewardship was promulgated in the United Kingdom, where the failures of corporate governance at UK banks identified in the Walker Review (2009) led to development of the UK Stewardship Code (FRC, 2010, 2012). In its revised version, it calls for institutional investors to engage with corporate management and boards in a constructive way across a range of issues:

> For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings (FRC, 2012, p. 1).

In this passage, ‘monitoring’ is a separate activity from ‘engaging’. The former includes carrying out meetings with the board chairman or other board members, attending the general meetings (Principle 3), or escalating their activities ‘as a method of protecting and enhancing shareholder value’ (Principle 4). The latter involves dialogue – listening as well as speaking – and specifically listening to explanations of why a company chooses not to follow the prescriptions of the UK Corporate Governance Code. This is, therefore, a recommendation seeking a relationship, not just an expression of rights.

The UK Stewardship Code draws a distinction between ‘asset managers’ and ‘asset owners’, with the latter identified broadly as ‘pension funds, insurance companies, investment trusts and other collective investment vehicles’ who ‘set the tone’ for stewardship (FRC, 2012, p. 1). Asset managers, by contrast, have day-to-day responsibility for managing investments; they generally work as agents for asset owners, their principals. Although the shareholder is in law the entity recorded on the share register, and therefore in the FRC’s terminology the asset manager, the emphasis of this code is that the principal’s interests are paramount, even if that is not what the law itself states. That is, it seeks to emphasise the agent’s duty to the principal as the basis for stewardship.

Through promulgating a discourse valorising ‘asset owners’, the Stewardship Code seeks to effect ‘behavioural changes that lead to better stewardship’ from asset managers and, by extension, investee companies (FRC, 2015, p. 1). As asset owners pledge support for the code, pressure should build on asset managers, with their more immediate, ‘day-to-day responsibility’(FRC, 2012, p. 1) to engage with companies. Similarly the code envisages that companies will therefore listen more to asset owners’ concerns. According to an assessment published in early 2015, the UK Stewardship Code has attracted about 300 signatories, providing ‘potential for a critical mass of oversight and engagement’, yet ‘despite these improvements, too many signatories fail to follow-through’ (FRC, 2015, p. 1).

The UK Stewardship Code spawned similar initiatives around the world, including ones in Germany (discussed in Roth, 2012) and France (Commission Europe, 2010; ORSE, 2011). Similar moves followed in countries including Italy, the Netherlands, Switzerland and latterly Japan. Like the UK Stewardship Code, these efforts encourage investor engagement without direct state intervention. That is, these are voluntary arrangements, encouraged by regulators but not required. Investors are not required to publish their voting records, let alone detail the timing and substance of their interventions with corporate management and boards.

The European Commission’s Green Paper on corporate governance (2011) also raised questions about the role of institutional investors promoting corporate decision-making focused on the long-term. Its follow-up Green Paper on long-term finance (European Commission, 2013) linked it to industrial policy initiatives with respect in particular to infrastructure and energy development, and the need to fund innovation for tasks including climate change. Green papers focus on idea generation more than policymaking, but these one served to reinforce a discourse of investor stewardship in policy discussions. The current debate over amending the EU Shareholder Rights Directive (European Commission, 2014) involves a variety of mechanisms to encourage engagement by institutional investors.

Both voluntary and regulative directions have detractors, supported by theoretical arguments and empirical information. But as we shall examine next, basing policy on the assumption that investors have the interests (economic) and interest (affective) in engaging is open to question. And developments in equity capital markets in the past 25 years suggest that those that might are a diminishing force. We illustrate this point with what is perhaps an extreme example – the UK – but an important one because of its centrality in the policy debate.

3. Practical impediments to 'ownership'

In developing their model of 'active ownership', McNulty and Nordberg (2015) highlight several ways that market mechanisms and institutional arrangements associated with public companies impede the development of the psychological commitment associated with stewardship. In addition, and while policy efforts to harmonise voting arrangements in Europe have had some effect, shareholders still face difficulties exercising the basic right to vote at annual meetings when it involves crossing national boundaries (European Commission, 2006). Well justified regulatory restrictions on shareholders acting in concert and thus disadvantaging other shareholders also paradoxically constrain shareholders' voice and reduce their ability to discipline corporate management (Santella *et al.*, 2012, pp. 279-281).

Moreover, aspects of the investment industry itself get in the way of stewardship. One is that mutual funds and other collective investments face particular performance pressures from the quarterly performance metrics that drive decisions of their own investors. Asset managers working on behalf of pension funds have similar issues on an annual basis. Popular opinion has highlighted the problem active fund managers – those that select individual investments – face in achieving good fund performance, that is, in beating the index. As a result, low-cost index-tracking funds now absorb the majority of funds under management in most places, and their low-cost business model leaves little room to pay for engagement.

And cost is not just an issue for index-trackers. Engagement with companies involves a present cost with a rather uncertain future benefit. Across a widely diversified portfolio, even low-key engagement, using less costly, non-decision-making staff, can cost millions of dollars/pounds/euros. Engaging in the 'purposeful dialogue' on matters of 'strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration' or giving 'careful' consideration of explanations of non-compliance with the corporate governance code envisaged in the UK Stewardship Code (FRC, 2012, pp. 6, 7) involves substantial resource commitment. Is it any wonder, then, that engagement tends to be restricted to cases of controversy, where the decisions at stake have substantial impact, or that routine engagement is often outsourced to agencies?

Moreover, benefits relating to the costs incurred by engaged investors in successful stewardship accrue to all investors, engaged or otherwise. Gilson and Gordon (2013) see investors as 'rationally reticent', unwilling to initiate interaction with companies while willing to respond to the interventions of others. They see this as a justification for the role of activist investors, such as some hedge funds, seeking specific changes where they see a tangible and likely benefit. Their campaigns then attract other investors. As we discuss in the next section, this form of engagement can clash with the policy direction towards 'purposeful dialogue' on strategy and other matters, or even the 'careful consideration' of explanations companies might give to not complying with codes of corporate governance. Edmans and Manso (2011) see a solution to this so-called 'free-rider' problem in using exit –

selling shares – rather than engagement through voice to express concern about corporate direction, another potential device to prod companies towards shorter-term considerations and against the policy flow.

These factors impede the participation of willing and economically interested would-be stewards in the investment industry. But the investment landscape in general shows a number of developments that suggest even larger hurdles to the policy push, what Cheffins (2010) has termed the Achilles' heel of a stewardship approach.

Investment practices have undergone dramatic changes in the quarter of a century since the Cadbury Code (1992) defined corporate governance in the UK and many other parts of the world. In the early 1960s, individuals still owned more than half the value of shares on the London Stock Exchange. By the early 1990s, their holdings represented barely more than fifth, and what we now call traditional institutional investors held the bulk of UK equities, with pension funds being the largest category, with almost a third (see Figure 1), as pension investors sought to diversify their holdings away from government bonds in search of better performance. The growth of pension funds' assets in equities began before the wave of privatisations that followed Margaret Thatcher election victory in 1979, but it accelerated thereafter.

Insert Figure 1 about here

The era of pension funds as universal owners was not particularly long lived, however. Data from the UK Office of National Statistics show that pension funds gave up this leading position in part to insurance funds but in particular to overseas investors. By 2012, these 'rest-of-the-world' investors owned more than 50% of UK equities (see Figure 2). Also growing were 'other financial institutions', from 0.4% in 1992 to 6.6% in 2012 (ONS, 2010, 2013). This category benefited by the expansion of UK-based hedge funds during the past decade and a half. They reached a peak of more than 12% in the data for 2010, before falling as foreign hedge funds replaced UK ones as buyers on the UK market. Meanwhile, pension funds – the archetype of 'universal owners'– in the UK now own less than 5% of shares in the UK equities market.

Insert Figure 2 about here

Indeed, the shifts in these ownership patterns were rather steady during the history of UK corporate governance codification. The four categories of 'traditional' institutions (pensions, insurance, unit trusts – or mutual funds – and investment trusts) peaked in their role at just over 60% of UK equities in 1992, just as the Cadbury Code was being drafted. Collectively they now own less than a quarter of the market.

That the majority of UK equities are now held by foreign investors has a number of explanations. Sovereign wealth funds grew rapidly during this period, in particular in China and among oil-producing states, modelled on the successes of the Norwegian state oil fund and the investment funds of Kuwait and Abu Dhabi. US institutional investors also expanded overseas during this period, seeking asset diversification. Moreover, the character of UK equities markets changed radically as well. Big names in UK equities left the stock market either by being acquired (e.g. Cadbury Schweppes) or by collapse (Marconi). They were replaced in part by large foreign companies, including many from developing economies in Asia, Latin America and the former Soviet Union. They listed their shares on the London Stock Exchange in search of outside investors wanting the assurance that came with the British legal and regulatory system and with UK corporate governance standards.

Meanwhile, private equity supplied capital to a growing number of growth companies, leading to a sharp decline in the number of companies listed.

Is it any wonder, then, that policy pronouncements for ‘stewardship’ by institutional investors fell on semi-deaf ears? Neither the investors nor the equities they were investing in bear particularly close relationship to the scope of interests represented in the UK Stewardship Code (Cf. Cheffins, 2010). Arguably sovereign wealth and some US-based pension funds share some characteristics of the universal owner, with their interests aimed at broad-based economic improvement over a long time. They should, therefore, favour a long-term approach to their investments. But their beneficiaries are not particularly interested in the long-term health of the UK economy but rather in the long-term appreciation of capital in the funds, irrespective of national boundaries. They accept that their assets must, therefore, fail to match their liabilities. In accepting that principle, their stewardship duties will not correspond to the wishes of policymakers for a long-term orientation to UK companies and the UK economy, but rather to the trading profits possible in a market for corporate control (Manne, 1965, 1984) and in identifying the opportunities for gains in other economies and markets.

These changes in investment practice suggest that the policy initiative is largely based on expectations of behaviour dating from an earlier point in history, at the start of the corporate movement when equity markets had a national character, rather than considering the current constellation of interests and motivations. Is it any wonder, then, that, Sir Winfried Bischoff, chairman of the Financial Reporting Council, should find that among the 300 funds that signed up to its Stewardship Code, ‘too many signatories fail to follow-through on their commitment’ (FRC, 2015, p. 1)? Is it any wonder that the version of ‘ownership’ involving psychological commitment or even interest in ‘purposeful dialogue’ is difficult to initiate let alone to achieve?

It is against this background that a new breed of activist shareholders, known with the moniker ‘activist hedge funds’, has moved to the centre of the corporate governance scene. Activist hedge funds appeared in the early 2000s when a number of hedge fund managers used their fund’s influence as minority shareholders to effect changes in the companies in which they invest. Hedge fund activism has emerged and flourished in the United States, and spread to other countries in Europe and Asia (for empirical evidence, see Katelouzou, 2015).

But even if activist hedge funds can qualify as ‘stewards’ by enhancing shareholder value, their allegedly short-term investment horizons may undermine their status as ‘owners’. A number of high-profile corporate actions where activist hedge funds were involved have invigorated a public debate about the perceived negative effects of hedge fund activism. Opponents of hedge fund activism have argued that they are often identified with a trading rather than an ownership mentality, and with vulture capitalism rather than the patient capital of the universal owner. For instance, activist hedge funds have allegedly sought to squeeze as much value as possible from the target company, forcing for dividend payouts, share buybacks, liquidation, buyouts or asset-stripping. Empirical evidence, however, suggests that activist hedge funds are in fact more long-term investors than the conventional wisdom might suggest, as the vast majority of activist hedge funds studied remained in the target for a period of more than one year, and with 39% of the total investments with an investment horizon of more than three years (Katelouzou, 2013). And previous empirical studies, however, refute the myopia theory and suggest that the activist hedge funds’ effect on their targets’ financial well-being is positive, although there are differing opinions as to whether the positive market reaction to hedge fund activism is simply due to a redistribution of wealth from creditors to shareholders (e.g. Klein and Zur, 2009).

4. Alternatives ownership forms

Policy may wish to promote dialogue and understanding alongside monitoring and control, but practice suggests that other conditions may prevail. Shifts in ownership patterns and the emergence of hedge fund activism raise questions about seeing the universal owner as a viable model for engaged investors. Shareholder empowerment seems to have stimulated confrontation more than dialogue. These disjunctions of policy and practice suggest a need to consider alternatives. How can policy help to break the cycle of performance and short-termism affecting both companies and their investors? Let us accept that the days of loyal, private shareholders investing carefully their life savings in tiny proportions of the shares of most companies are a thing of the past, assuming they existed at all.

The implication is that policy might be reset in ways to favour ownership forms that encourage long-term orientation of enterprises. In this section we consider alternative forms of ownership, other than the public listed company with a dispersed range of institutional investors. As the policy direction envisages a relational approach to ownership, let us consider, first, alternative forms of ownership, ones in which relationships play at least as strong a role as rights.

4.1 Favouring founders and families

Some current practices, especially in the UK, constrain the influence of founders and families in public companies, where differential voting rights are discouraged (a point we return to in the next section). In other countries, including the US, major institutional investors, including those that have long-term investment horizon and might qualify as universal owners see this as a policy objective. Yet family firms, including the family-led, *Mittelstand* companies in Germany and family controlled businesses elsewhere are often seen as paragons of a long-term orientation in decision making. As a result, we could consider policy alternatives that favour such companies, including preferential bidding rights for government business or tax incentives.

Empirical evidence is mixed, however. On the one hand, empirical evidence finding that family owned firms outperform their peers might support an alternative view of families as 'stewards'(e.g. Anderson and Reeb, 2003). On the other hand, however, in a study of US listed companies with family control, Miller *et al.* (2013) find that such control created little differentiation (a source of strategic advantage) and provided little protection from isomorphic pressures. Institutionalisation may lead to a strong sense of compliance with norms, but it can also persist ever after the circumstances in which they arose have changed (Meyer and Rowan, 1977). Moreover, a recent analysis (Cannella *et al.*, 2015) provides reasons for policy not to conflate founder-led and family-controlled firms. Its findings include that longer decision horizons are associated with the tenure of directors for family firms, suggesting that practice plays a role in success as well as structure.

In short, the evidence of successful long-term orientation is these types of firms is both nuanced and mixed. While a happy combination of founders' zeal and families' commitment can lead to successful outcomes, these conditions also bring risks. They seem to be neither necessary nor sufficient conditions to prevent malfeasance or ensure strategic success.

4.2 Favouring the state as owner

The financial crisis led to rescues and (for a time) partial or full nationalisation of some financial institutions in a wide range of the most liberal of market economies (e.g. UBS in Switzerland, RBS in the UK, AIG in the US), and even of some industrial companies

(General Motors). In addition, the rapid growth and commercial successes of Chinese state-controlled enterprises or ones with implicit state backing has led to fresh questions about the role of the state as owner. Moreover, the growth of sovereign wealth funds from resource-rich economies, often with small populations, has offered another model of state-led equity investment (Lyons, 2007; Ungureanu, 2014). What unites these three disparate types of state ownership is the perception that the state's interests lies in serving the long-term, strategic (economic and security) interests of the population as a whole. However, the dual role of the state as a shareholder-and-regulator remains understudied (Cf. Pargendler, 2012).

The state is in some ways the archetype of the universal investor, but experience of state control in electoral democracies has not been so favourable. Politicians driven by election cycles seem to lack a long-term perspective in much the same ways identified as the problem of short-term oriented capital markets. In addition state ownership limits personal incentives for entrepreneurship and creativity and often involves a high degree of bureaucracy that manifests in stated-owned enterprises. This is where recent Chinese experience is of interest, with the state providing an ownership platform even as it stands back from management while conveying competitive advantage, at least in domestic markets against foreign rivals.

4.3 Favouring collective ownership

Mutual or collective ownership is often seen as the means to diminish the effects of short-termism in capital markets. Colin Mayer (2013) argues the case for a return to an older form of management with concern for social welfare and more communitarian forms of ownership. In particular the success of the John Lewis Partnership, a UK-based retailer, has demonstrated that it is possible to combine a creative and strategic approach focused on long-term when ownership resides with the workforce and without hyper-aggressive incentives for top managers. Similarly traditional mutual organisations, owned by customers, have been held up as potential models for a return to a more communitarian approach, in particular for the financial sector. The John Lewis Partnership is an interesting model, but we wonder why it has seen so few imitators of its ownership structure. Perhaps it is because few companies have a founder uninterested in cashing out during his lifetime and who also has little desire to favour heirs over employees in inheritance.

Collectives have downsides, too. While the building societies of Britain have (with a few notable exceptions) disappeared under competitive pressure from banks, we see a certain nostalgia for them seen in press discussion after the financial crisis and in the advertising campaign of the most prominent remaining one (The Nationwide). Indeed, the Co-operative Bank, a mutual with a commercial focus broader than building societies, was seen as part of the solution to the crisis as the government encouraged its desire to purchase branches of Lloyds Banking Group during the restructuring that followed Lloyds' partial nationalisation. But its mutual status and collective governance did not prevent managerial excess that took a long time to discover (Myners, 2014). It had disastrous effects on the bank, leading it too to require a rescue, not this time by the state but instead through a capital injection from hedge funds, the supposed arch-enemy of long-term, patient capital.

In a series of essays written for the Co-operative Press, Mullineux (2014) argues good governance of co-operatives depends upon being (again) local, which helps to overcome the separation of ownership and control and thus the agency problem. Yet in a field like banking, with its extensive regulatory requirements and dependency on investments in technology, scale economies are significant sources of competitive advantage and militate against such localism. In the face of globalisation of many aspects of business and the need for network effects to increase the usefulness of many products and services, the localism associated with good governance of any commons has limitations as an alternative the corporate form.

4.4 Favouring networks

In considering the future of the corporate form, thinkers including Castells (2000) and many of the essays compiled in DiMaggio (2001) have argued that the speed of change, particularly in technology, and the resulting risk and uncertainty point towards structural reasons that favour the development of network relationships between firms. These go beyond mere supply-chain management in shared interdependence on other firms while retaining breaking down dependency relationships through the resilience that networks offer. Other scholars employ a different analogy drawn from the discourse of mobile telephony and computing – one of ecosystems – to describe how these constellations of companies operate, co-operate and co-evolve (Liu and Rong, 2015).

This approach sees the unit of economic analysis as existing above the level of the firm itself, providing nimbleness to offset scale diseconomies, and allowing for the admixture of different organisational forms within the economic unit, and also experimentation in organisational design and in design of governance approaches. There have been cases of malfeasance in such networks, of course, and the resilience they offer may prevent contagion. But likewise institutional pressures seem likely to constrain such freedoms of action. Mimetic isomorphism may lead to the copying successful examples that do not quite fit the circumstances of another firm in the network. The normative isomorphism required for standardisation can impede inventiveness. And coercive isomorphism comes into play when one actor in the network dominates (consider the case of Apple and its 'ecosystem' of suppliers and developers. Moves favouring the network form of organisation also risk the erosion of the social function of the corporation that Davis (2013) decries.

5. A research and policy agenda

The potential shortcomings in each of these alternative ownership forms suggests a need in scholarship and policy for a better understanding of the concept of ownership as well as about the details of the workings of interactions between investors and corporations. With the UK as its central focus, our analysis is both illuminating and limited. The rise of international investment and the advent of hedge fund activism have changed the landscape of investment and put into doubt whether policy that rests even implicitly on the idea of the universal owners can achieve the desired aims.

The alternative forms of ownership outlined above have benefits but also drawbacks. Collective ownership like the 'John Lewis' model has its advocates (Mayer, 2013), but collective ownership has also been known to result in poor monitoring and loss of control (Myners, 2014). Revisiting corporate law to make companies less like private property and more like a commons, i.e. 'a shared resource whose sustainability depends on the participation of multiple constituencies in its governance (not just shareholders, but employees, core suppliers and customers' (Deakin, 2012, p. 339), is worth exploring as an alternative to an investor-centric approach.

As the policy direction envisages a relational approach to ownership, future research needs to consider alternative forms of ownership, one in which relationships play at least as strong a role as rights. This paper has considered some of these alternative forms of ownership. Future research might assess the drawbacks of each and whether institutional changes, including ownership rights, might help overcome some of their shortcomings while retaining the advantages they have over the corporate form in encouraging a long-term orientation of enterprises. Might nimble small firms in resilient networks overcome the diseconomies of lack of scale and permit experimentation in ownership form within a functional economic unit?

6. Conclusions

Legal scholars have engaged in a sometimes heated debate over the value of enhancing shareholder rights (e.g. Bainbridge, 2013; Bebchuk, 2013). What we have examined here is something different, the possibilities arising from alternative ownership forms.

This paper shows that the current policy direction of encouraging corporate-investor dialogue – engagement, commitment and stewardship – faces formidable obstacles, given the current state of capital markets and configurations of share ownership. It also suggests that both the scholarly literature and current practice in a variety of countries has engaged in a search for alternative approaches.

What this paper does not do is advocate any of these, let alone all of them. Instead, fresh research into these alternatives and to encourage some experimentation may provide the ground for further research. Doing so will help us overcome the lack of evidence for policy and prepare us for the consequences when policy fails to keep pace with markets.

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1 Statistics on this development are not consistently reported, but the Investment Company Institute in the US says that investments in funds of funds reached nearly $1.7 trillion in 2014, nearly three times the 2007 (pre-financial crisis) level, and more than eight times the level a decade ago (source: http://www.ici.org/pdf/2015_factbook.pdf). Funds of funds provide even broader diversification for retail investors within a single transaction than mutual funds, which in modern portfolio theory makes them low-risk investments. But it means the beneficiary is at least one step further from investing directly in and engaging with the end-investment object.

2 The concept of policy ‘nudges’ became popular in policy circles around the world through the writings of behavioural economists Thaler and Sunstein (2009) and Sunstein’s subsequent work with the Obama administration in Washington. In outline, it draws on prospect theory (Kahneman and Tversky, 1979) to urge policy paths that influence choice by setting default options in policy-friendly directions, rather than imposing those directions.

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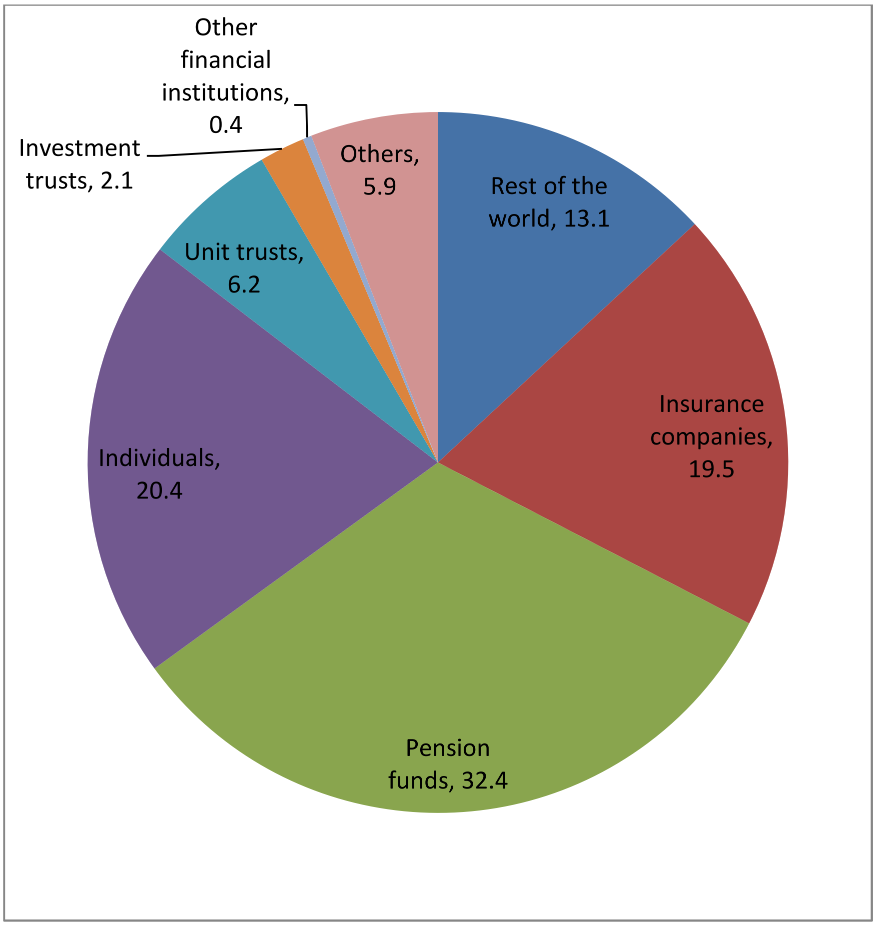

Figure 1 - UK share ownership, 1992 (in percentage); source ONS

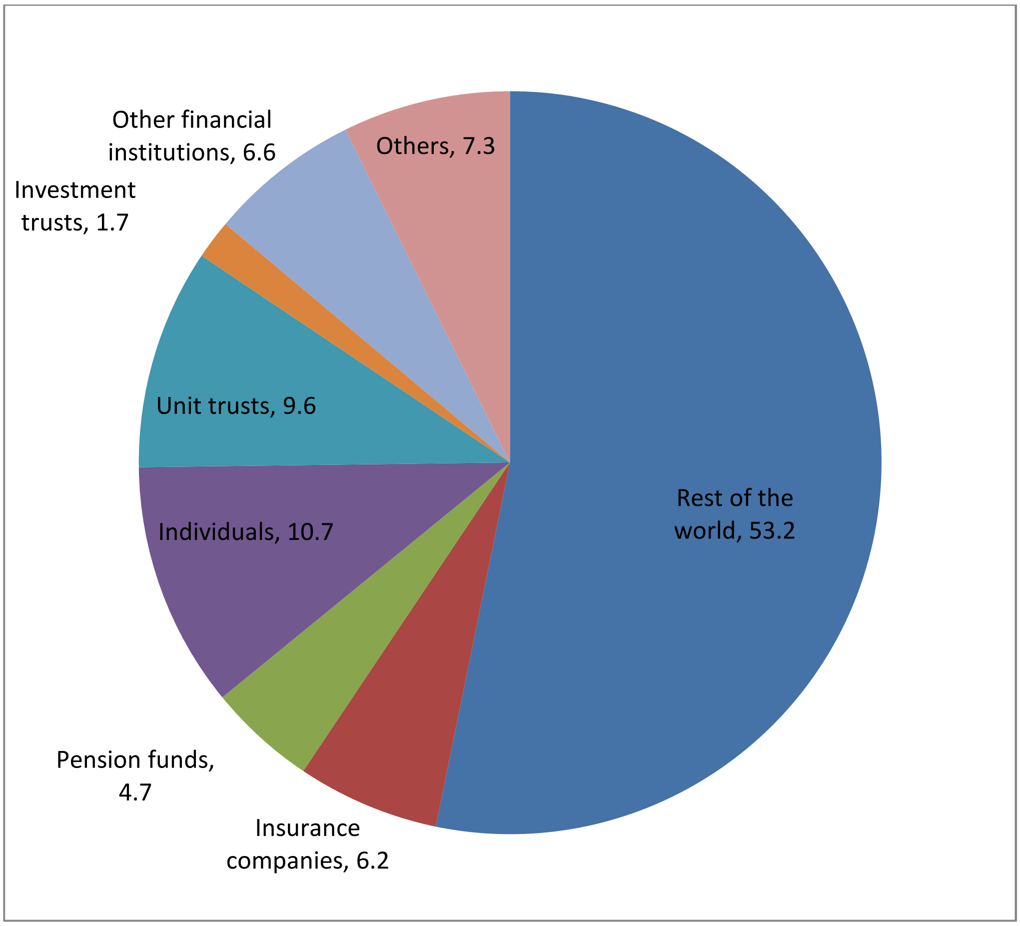

Figure 2 - UK share ownership, 2012 (in percentage); source: ONS