

Aligning with the interests of Shareholders

The Treasury Select Committee in the UK has published its third report on the collapse of financial institutions, "Banking Crisis: reforming corporate governance and pay in the city." The report hit out at many areas of governance which the committee considered had become ineffective including the remuneration of failed executives, uninterested non-executive directors and inaccessible auditing and reporting. Bonuses once again hit the headlines.

Given less attention by the media were the two external factors cited by the committee as contributory to the banking crisis. These were the media's reporting of the crisis and the failure of shareholders to scrutinise their investments properly.

The latter is particularly interesting as it concerns how banks have communicated with their shareholders historically. The report states that the interests of the banks were, "not aligned with the interests of shareholders", and institutional investors', "engagement with the banks prior to the crisis was often too weak or non-existent." The challenge for policymakers, the report says, is to focus now on "how we can promote more effective shareholder engagement."

We are also seeing more and more examples of shareholders flexing their muscles over, what they

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feel, is unfair remuneration for executives who were intrinsic to the failure of these institutions. Shell and RBS are two high-profile examples in which previously mild and meek shareholders have shown considerable dissent recently. Although shareholders votes aren't always necessarily legally binding, the publicity they bring is a considerable dent in the reputation of any organisation.

Whilst there will inevitably be some structure for shareholder communications and reporting imposed by the regulators, the best outcome for banks and shareholders alike will be to avoid costly and onerous reporting frameworks or a rebirth of the 'Operating and Financial Review (OFR)'. There are three things that the banks can do to minimise the impact of regulation:

1. Banks must re-centre the culture of their operations around their shareholders

It is shareholders that allow industries to thrive through their financial investment. It is also the voices and votes of shareholders' that defend the city against regulation and laws which could limit the operations of commercial entities. Shareholders allow pharmaceutical companies to develop life-saving diagnostics and treatments, energy and extractives companies to invest in difficult projects and, in this case, banks to take the investment risks which underpin entire economies.

2. Engage don't just report

Banks must feel a greater responsibility to actively engage with shareholders and potential shareholders. By listening to those that invest in them, banks can develop their business in a way that will encourage investors to continue to hold their stake in them. Active engagement also builds up 'goodwill' capital. This is nothing more complex than the positive association shareholders make with their investments. It can go a long way to offset any ill feeling that might develop in times of crisis.

3. The definition of shareholders must be thought of in its broadest possible sense

Banks must communicate with more audiences than the markets and the traders who buy and sell their shares. The vast swathes of the population that have an investment in them through private investments or pensions and savings are also the people, whose views can drive government policy and popular opinion, making them an important stakeholder too.

One good thing to have come of the crisis is that the population generally is gaining a better understanding of the language banks and the city use. Tools such as the 'UK Financial Services Authority (FSA)' Financial Capability package are helping to improve this yet further.

But this can no longer be a barrier; banks must adapt their communications – from the fine print on mortgages to quotes from CEO's in the Times newspapers' city pages – to be more open and inclusive. By putting shareholders at the centre of their business, banks will also be putting customers, regulators and other industries at their core too.

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