Promoting Long-Term Sustainable Company Growth Through Section 172 Reporting and Loyalty-Driven Benefits

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Abstract

An excessive short-term focus can undermine the creation of long-term value; in contrast, a long-term oriented alignment can help companies to function towards the objective of promoting long-term sustainable economic growth. These concerns are central to this paper, committed to exploring this topic and potential ways forward. The analysis set forth considers two ways of encouraging companies to operate with the objective of promoting long-term company growth. Pursued correctly, these can play a crucial role in mitigating the sources of short-termism whilst promoting longer-horizon thinking and behaviour in financial markets. First, the paper discusses the reinforcement of long-term sustainable performance, achieved through the new section 172 reporting and considers the duty's effectiveness in light of recent data. In addition, the paper examines the role of the loyalty rewards scheme in limiting short-termism. Loyalty benefits are a popular corporate governance tool; yet still, they are a complete novelty to companies and shareholders based in the UK. Their popularity has put competitive pressure on the UK's financial regulator to ease the one share, one vote principle in order to safeguard the prominence of the UK equities market. A scheme to be encouraged, it has the potential to reshape company goals by focusing on long-term and sustainable value.

Introduction:

Recent corporate collapses have created a challenging environment for companies across the globe. Pressures placed due to the global pandemic, the high street crisis and other social challenges, have served as a constant reminder of the importance of resilient, strong and robust institutions, with healthy long-term objectives in place. As resilience and success relies heavily on a company's long-term relationships with its stakeholders, corporate governance must work on reinforcing long-term company value. An excessive short-term focus can undermine the creation of long-term value; in contrast, a long-term oriented alignment in financial markets can help companies to function towards the objective of promoting long-term sustainable economic growth. These concerns are central to this article, committed to exploring this topic and potential ways forward. The analysis set forth considers two ways of encouraging companies to operate with the objective of promoting long-term sustainable economic growth. These include, first, the focus on long-term sustainable performance, achieved via section 172 reporting and second, the encouragement of long-term investing with loyalty-driven benefits. Pursued correctly, these can play a crucial role in mitigating the sources of short-termism whilst promoting longer-horizon thinking and behaviour in financial markets.

There is an increasing awareness by companies and legislators that firms' responsibilities are much wider than merely serving the interest of their shareholders; deviating from a maxim of profit maximization can often make sense. As a result, there has been a lot of deliberation on ways to promote a company's long-term sustainable economic growth and align its purpose to long-term corporate strategy. Central to this, enhanced communication and engagement with stakeholders can result in increasingly active shareholders and improved dialogue with companies on long-term strategic issues (rather than mere notions of short-term profits). Corporate reporting under section 172 of the Companies Act 2006 provides an opportunity to attain these aims. Section 172 of the Companies Act 2006 has been in force for over a decade; it concerns the duty imposed on directors to run the company for the benefit of its shareholders as a whole and in doing so, to take into account the long-term impact of any decision, the preservation of the company's relationship with its stakeholders, the external impact of its activities and the maintaining of a reputation for high standards of business conduct.[1] In light of a number of well-publicised corporate insolvencies, questions were raised around whether and how directors comply with the duty. All companies qualifying as large are now required to disclose in their strategic report a 'section 172(1) statement' that explains how directors have had regard to the matters set out in sections 172(1)(a)-(f) of the Companies Act 2006 when performing their duty under the section. This 'update' is a result of the rising pressure to modify directors' duties in an era where the impact of businesses on wider stakeholder groups and the environment is gaining prominence. A healthy development, part of a reporting movement where companies are required to highlight their corporate governance content in their annual reports and demonstrate in their disclosures how directors have met the section 172 duty. Nonetheless, there remain important reservations on the effectiveness of the revisions. The paper critically considers the new reporting requirements in light of the most recent data, and examines whether the section 172 duty constitutes a solid step towards the promotion of long-term sustainable company growth.

[1] For an insightful discussion on the role of stakeholders in corporate governance, see Paddy Ireland, 'Corporate Governance, Stakeholding and the Company: Towards a Less Degenerate Capitalism?' (1996) 23 Journal of Law and Society 287.

Further, investors and other market participants are gradually recognising the importance of encouraging a longer-horizon thinking and behaviour in financial markets. The promotion of loyalty by shareholders is one solid tool in reducing the predisposition of directors toward short-termism, one of the main instigates of economic, social, and environmental unsustainability.[2] Therefore, the paper next explores the potential use of loyalty benefits by companies as a means of encouraging a base of long-term shareholders. A closer link between companies and their long-term owners can encourage more sustainable capitalism and long-term value creation; loyalty benefits have the potential to achieve this connection. At present, it is permissible as a matter of English law for an English company to grant additional or weighted voting rights in its constitution to certain shares. But more explicit incentives can be provided to stimulate loyalty and engagement by shareholders. Loyalty benefits, or loyalty rewards can be granted, such as enhanced dividends, enhanced voting rights and fees for good stewardship, to shareholders holding their shares for a specified period of time. Unequal voting rights arrangements under dual class share structures are gradually becoming popular by firms around the world, particularly technology firms, as a way to maintain a level of control over the firm. Still, the democratic values of corporate law (on both sides of the Atlantic) are revealed through the general meetings of shareholders, highlighted by the 'one share, one vote' principle. Will loyalty rewards be endorsed in the UK, considering this? Such changes have already taken place elsewhere, such as France, Italy, and the US: loyalty shares have a long tradition in France and have also been recently introduced in Italy. Loyalty shares with 'tenure voting' or 'time-phased voting' are also found in the United States. Certainly, the popularity of the loyalty incentives structure has put competitive pressure on the UK's financial regulator to ease the one share, one vote principle in the premium listing regime of the London Stock Exchange in order to safeguard the prominence of the UK equities market worldwide. A scheme to be encouraged, it has the potential to reshape company goals by focusing on long-term and sustainable value. The findings from key studies conducted thus far suggest this is a widely held view, despite the challenges faced in terms of implementation.

1. Long-Term Sustainable Performance Through Section 172 Reporting:

Recently, reporting requirements have received a makeover as a result of The Companies (Miscellaneous Reporting) Regulations 2018. Company management teams within large UK companies have to comply with the new disclosure statement when preparing their new annual reports.[3] The revised reporting requirements,[4] which came into effect on 1 January 2019, concern the directors' duty to promote the success of the company, as prescribed in section 172.[5] The suite of regulations relate to two key issues: first, directors' engagement with employees, and management's engagement with suppliers and other stakeholders that have a relationship with the company; second, and perhaps most crucially, the impact this engagement has had on directors' decision making. At present, the section 172 duty (of the Companies Act 2006) requires directors to run the company for the benefit of its shareholders as a whole and

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[2] This is supported by the financial literature that followed the financial crisis of 2007-08.

[3] This includes public and private UK companies, including subsidiary companies, which qualify as 'large companies' under the Companies Act 2006.

[4] Section 172 reporting (s414CZA)

1) A strategic report for a financial year of a company must include a statement (a "section 172(1) statement") which describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172.

2) Subsection (1) does not apply if the company qualifies as medium-sized in relation to that financial year (see sections 465 to 467).

[5] The revised UK Corporate Governance Code ('the 2018 Code') also encompasses this reporting requirement.

in doing so, the board should take into account the long-term impact of any decision, the preservation of the company's relationships with its stakeholders, the external impact of its activities and the maintenance of a reputation for high standards of business conduct (section 172(1)(a) to (f)).[6] Directors were not previously required to disclose how they had considered stakeholders and other important factors (such as the company's regard for the environment) in their decision-making process. Now, the new 'section 172 report' within the annual report tells directors to explain how they have had regard to their duties under section 172 over the course of the reporting year. This means that directors not only have to comply with the mandatory information already required in the strategic and directors' reports, but are also expected to include a separate, clearly identifiable section 172(1) statement which describes how they have had regard to the matters set out in section 172(1)(a) to (f) in the performance of their duties.

The Financial Reporting Council, which has statutory powers to investigate whether a company's aforementioned statement complies with the Act, has given specific direction on the content of the section 172 statement. According to the Guidance for the Strategic Report[7], the statement must identify the issues, factors, and stakeholders that have been considered relevant. It must also describe how the directors have understood the aforementioned issues (for example by stakeholder engagement) and explain how these have affected their principal decisions.[8] In identifying the relevant stakeholders, the FRC guidance encourages companies to look beyond the list prescribed by section 172: directors should consider all relevant stakeholders, such as pensioners and the workforce, including those without a contract of employment. Long-term factors are likely to impact heavily upon the setting of a company's dividend and distribution policy, and accordingly, the statement must specify how the company's distribution policy has allowed sufficient resources to support its long-term aims. As explained by the FRC's guidance, companies are to publish information on some or all of the following: the issues, factors and stakeholders that directors deemed relevant in fulfilling section 172(1) (a) to (f); how they have formed that opinion; the principal approaches used by the directors to engage with stakeholders and consider the matters at hand; and finally, the impact on the company's decisions and strategies during the financial year. Although there is already legislation in place that tells directors to report to members on how they have performed their duty under section 172,[9] the new regulations expand the required content of the strategic report and the directors' report. Under the new directors' report requirements, company reports comprise of information about key aspects of the section 172(1) duty even where the directors do not regard the information to be of adequate strategic importance to be incorporated in the strategic report that year. It is also relevant to note that there are consequences in the event of

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[6] Section 172 of the Act contains the duty to promote the success of the company. According to the section, a director is required to act in the way he or she considers, in good faith, will be most likely to promote the success of the company for the benefit of its members (the shareholders) as a whole. In carrying out this duty directors must have regard (amongst other matters) to the following factors: the likely consequences of any decision in the long term; the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly as between members of the company.

[7] Financial Reporting Council, 'Strategic Report: Section 172 Reporting Requirements' (*Financial Reporting* Council, 2018) <https://www.frc.org.uk/getattachment/3a35133f-47a0-4145-a041-a60c66e633e5/Amendments-cover-May-2020.pdf> accessed 13 March 2022.

[8] Typically, statements may be built around other parts of the strategic report, such as strategy, business model, culture, and governance. In addition, it is crucial for companies to assess the quality and relevance of the existing disclosures.

[9] Section 414C of Strategic Report and Directors' Report Regulations 2013, 414C of Companies Act 2006.

a failure to comply with the requirements under the Companies Act 2006. If an approved strategic report fails to comply with the section 172 statement, every director who knew of this failure (or was reckless as to whether the company complied) and failed to take reasonable steps to secure compliance or prevent the report from being approved, commits an offence. In addition, every officer of the company commits an offence if the statement is not published on the company website.

The aforementioned changes were intended to give more power to stakeholders. The relationship between companies, their employees and external stakeholders has long taken centre stage in the corporate governance reform debate. Yet still, the importance of this issue has depreciated in worth, as of late. In this regard, the remodelling of section 172 is encouraging. Regulated firms might already be under robust corporate governance requirements, but the new reporting requirements push compliance with the section 172 duty to a different level. Currently there is no systematic and reliable way of assessing how companies are meeting their section 172 duty. Bearing in mind the strong support across business, investor groups and civil society for strengthening stakeholder voice at board level, this 'remodelling' is promising. Simply saying that the matters within the section have been considered, is not enough: the company must also explain how directors have carried out their duties. Since the main focus of reporting is the annual report, the statement in the Strategic Report gives a fair indication to shareholders on how directors have had regard to the matters set out in section 172(1).[10] Considering the section's indistinct wording, requiring boards to report on their behaviours is a step in the right direction.

Yet still, whether the new reforms will prove successful in practice, remains unclear. Will they be an effective tool in promoting a long-term company mindset? That all depends. The changes could have a transformative effect on directors' duties, corporate governance as well as the economy at large. This is because they accentuate and encourage corporate transparency and corporate disclosure, which in turn can lead to better information through the 'feedback loop' and better decision making. By and large, stakeholders want to know how their interests have been taken into account. The statement obliges companies to make and record board decisions: by requiring disclosures, it is hoped that boards will make decisions that benefit companies in the long run whilst taking into consideration their key and most valuable stakeholders. The reforms do not seek to minimise a company's commercial objectives; rather, their goal is to oblige company boards to enrich strategy through a clear statement on how they have had regard to their duties under section 172 over the course of the reporting year. They provide a strong platform to boards to explain and rationalise their decisions, thereby incentivising a deeper level of engagement with employees and other stakeholders. They are not about increasing stakeholder rights at the expense of shareholder rights; these interests are not conflicting but as noted, they are inter-linked.[11] The changes ask boards to be more structured and systematic about their approach to section 172. And in a broader way, they target the wider discussion about the goals and aspirations of companies, their values and impact, and the effect of their operations upon socially responsible and beneficial activities. While this secondary legislation does not alter directors' legal expectations, it places key stakeholders at the forefront by pushing companies into thinking more long-term whilst motivating directors to think beyond the financial aspects of companies. This can help elevate the degree of trust between

[10] Strategic Reports must include a 'section 172' statement for periods commencing on or after 1 January 2019.
[11] Alex Chisholm, 'Stewardship and Governance' (*Department for Business, Energy & Industrial Strategy*, 22 November 2018) <www.gov.uk/government/speeches/stewardship-and-governance> accessed 18 June 2022. As Chisholm suggests, this is recognised 'in the rich range of responses to the green paper from UK investors'.

the board and stakeholders.[12] A move to be encouraged; engaging effectively with key stakeholders, such as customers, suppliers and employees helps companies become more sustainable and competitive in the long run.

So far, the data suggests that section 172 is an effective development in ensuring that the reporting duty is taken seriously. According to the annual review of corporate reporting practices in the FTSE 350, conducted by Price Waterhouse Coopers, 82% of FTSE 350 companies referred to stakeholder engagement in their reporting and a significant number (22%) referred explicitly to section 172 (although, as noted, many companies will have felt they were addressing section 172 concepts in their wider stakeholder reporting). In terms of the format and placement of the companies that referred to section 172, 87% included the reference to section 172 in the governance report. Regarding the content of the report, 37% provided more than just a reference to the regulations and gave insight into the preparations, while 75% referenced stakeholders and/or stakeholder engagement in connection with s.172. Finally, 17% referenced the long-term consequences of decisions and 31% referenced the impact on community and environment.[13] Some disclosures also explained how section 172 is built into board processes and how directors have been given training on this area. In addition, research conducted by the Financial Reporting Council indicates that the new regulatory requirements of the section 172 statement[14] have driven companies to increase reporting on their stakeholders. Investors, the research concludes, are ultimately interested in understanding how a company is progressing towards accomplishing its purpose and attaining long-term success; in that regard, information on stakeholders and information on decisions helps with that understanding. Since the consideration of stakeholders and the consequences of decisions form part of the section 172 duty, the new 172 statement constitutes a helpful bridge between the two types of information.[15]

Further observations can be drawn, from a survey of a sample of 25 annual reports published by UK listed companies with December 2019 year-ends (of these companies, 18 are in the FTSE 100 and the rest are FTSE 250).[16] Regarding the matters covered in the statement, the majority of companies described or provided examples of how they had measured the impact of the company's material decisions on community, environment and other stakeholders, and also explained the matters that may influence company performance over the longer term. In addition, they have considered critically the trade-offs between different stakeholders over the longer term, evaluating the impact of their decisions. Some companies emphasised the two levels where stakeholder engagement can materialise, that is operational and board, and have provided examples of good practice, for instance where stakeholder engagement executed at

[12] ICSA, 'The Stakeholder voice in Board Decision Making: Strengthening the Business, Promoting Long-Term Success' (*The Governance Institute, The Investment Association*, September 2017) <www.cgi.org.uk/assets/files/free-guidance-notes/the-stakeholder-voice-in-Board-Decision-Making-09-2017.pdf> accessed 17 June 2022.

[13] PricewaterhouseCoopers LLP, 'Navigating the Stakeholder Agenda: Reporting on Section 172' (*PWC,* 2019) <https://www.pwc.co.uk/audit-assurance/assets/pdf/navigating-stakeholder-agenda.pdf> accessed 22 July 2022. Interestingly, 82% of companies reported on aspects of it in the last round of annual reports (2018/19), prior to the new requirements becoming mandatory.

[14] As well as changes to the UK Corporate Governance Code and the Guidance on the Strategic Report.

[15] The Financial Reporting Council, 'Reporting on Stakeholders, Decisions and Section 172' (*FRC,* July 2021) <https://www.frc.org.uk/getattachment/d0470ab4-f134-4584-9f54-a48a8bfdc62d/FRC-LAB-Stakeholders-Report-s172.pdf> accessed 22 July 2022.

[16] Deloitte LLP, 'The New Section 172(1) Statement – Observations from First Reporters' (*Deloitte LLP*, April 2020) <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-audit-section-172-observations-from-first-reporters-april-2020.pdf> accessed 19 May 2022.

an operational level was considered in the boardroom. In addition, just over two-thirds of companies included clear examples of major issues that can impact their stakeholders by making references to one or more concerns raised by them. As shown, 18 out of 25 companies included examples of matters that influence decision-making and as well as examples or case-studies of key board decisions taken during the year as a direct result of stakeholders' concerns.[17] In terms of the structure of the statement, this latter survey indicates that in most annual reports the statement was presented as a summary with cross- references to other relevant information, thereby avoiding repeating information included elsewhere in the report. As noted, it is reassuring that cross-references were precise and effective, and that companies made the effort to point to useful, additional information.

In evaluating the evidence in relation to corporate reporting, it appears the section 172 duty is taken seriously by companies. Given the profile of the debate around the stakeholder agenda, this is rather unsurprising. The various studies indicate that the section 172 reporting is not treated as a mere box-ticking exercise: quite the opposite, in fact**.** Still, some misgivings can be observed from the given evidence. To begin with, a relatively decent number (17%) referenced the long-term consequences of decisions (as shown by the annual review of corporate reporting practices in the FTSE 350), such as the long-term impact of decisions or the effect of decisions on their reputation.[18] However, given the growing recognition of the need to stimulate a long-term oriented alignment in financial markets, things can improve in this regard. Companies need to be more focused on strategies for long-term value creation, and more open about them in their engagement with investors, particularly in relation to environmental, societal, and governance issues. This indicates stability. Long-term strategies suggest a secure environment, and this improves confidence in the markets whilst boosting morale amongst employees. Essentially, this is a solid way to heighten productivity and long-term returns and will ultimately be of value to the economy as a whole as it will create more sustainable growth, more employment in the market and better returns for savers. Reporting on long-term goals motivates companies to improve shareholder engagement as well as their long-term relationship with stakeholders. That is precisely why the FRC guidance encourages companies to look beyond the list prescribed by section 172 and report on long-term factors that are likely to influence the setting of a company's dividend and distribution policy; the statement, the guidance stresses, must stipulate how the distribution policy has allowed sufficient resources to support the company's long-term aims.

Further observations can be noted. Directors are required to explain the reasons the adopted tools were suitable and how these tools actually swayed their decision-making process. The expectation is that companies will attain a sense of duty to identify and seek the views of key stakeholders. However, little guidance is provided on what this could mean in practice. Additionally, there is no set structure on what should be included in the statement and as a result, it is unclear how compliance with the Companies Act can actually materialise (although according to The Department for Business Energy and Industrial Strategy it should be included as a 'separately identifiable statement').[19] Also, more direction is needed on how directors can

[17] Deloitte LLP, 'The New Section 172(1) Statement – Observations from First Reporters' (*Deloitte LLP*, April 2020) <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-audit-section-172-observations-from-first-reporters-april-2020.pdf> accessed 19 May 2022.

[18] Ernst & Young LLP, 'Section 172(1) Reporting: Emerging Observations from December 2019 Reporters' (*Ernst & Young*, April 2020) <https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/topics/assurance/section-172-publication.pdf> accessed 15 April 2022.

[19] Department for Business, Energy & industrial Strategy, *Corporate Governance Reform, The Government Response to the Green Paper Consultation* (August 2017) para 2.36.

guarantee effective engagement with this duty. At the very least, a number of key issues should be clarified; importantly, that statements must not duplicate information found elsewhere in the annual report; rather, they should provide meaningful, substantive observations on the compliance with the section 172 duty than a mere standardised text on the engagement process. Significantly, the overall narrative needs to be thoroughly integrated; assimilation into the report is the key matter here. Companies should report outcomes on the reporting period in question. What is more, simply saying that companies engage with particular stakeholders can not suffice: companies must report on what they have done with that engagement (for example, 'we have taken a number of steps to tackle the concerns expressed by our suppliers'). However, according to research, this is not the current practice.[20]

To secure the statement's successful implementation, companies can take a number of further steps, particularly private companies that do not have as many formalities in place. For a start, the avoidance of generalisations: the statement must not be a generalised or broad statement that introduces vague points but rather, it should reflect the company's specific circumstances in terms of strategy, future direction and key stakeholders. Also, it should reflect how it chooses to engage with those key stakeholders. Boards must demonstrate how they have chosen to tackle the identified issues and how they have addressed the impact of their approach upon the key stakeholders. The statement must explain why the board identified specific stakeholders as the key stakeholders and in addition, how they choose to engage and communicate with those key stakeholders. Companies should avoid engaging with stakeholders for the sake of it; rather, engagement must address material and quantifiable issues; furthermore, how the company complied with the identified requirements, what is significant to it and, where applicable, what the board and management propose to do in future. Essentially, the statement should reflect not just the how but also the why: how each of the factors of section 172 has been taken into account, and why particular decisions were taken in relation to the company's engagement with its key stakeholders.[21]

Training could also help secure the proper compliance with the new statutory requirements. Keeping up to date with weighty requirements whilst carrying out their day-to-day responsibilities can prove challenging for directors. Induction training that focuses on the effective engagement with key stakeholders can help in this regard. Training should take place not only at board level but should also involve the training of other key members, such as those with delegated responsibilities and those who provide information to the board and company committees. The induction should focus on the substance of the section 172 duty, and tackle matters such as: who the key stakeholders of the company are; what policies and processes are in place to guarantee that stakeholder considerations are included in the decision-making process; what principal decisions are likely to be made by the directors. Identification at this stage is key: ascertaining who the company's main stakeholders are, and, in addition, demonstrating a level of understanding towards their views, is imperative. In that regard, allocating the responsibility for ESG and section 172 reporting to a specific director can help safeguard effective compliance. In addition, it would help if any issues relating to the new statement were reserved as returning items on the agenda so that they can be properly inserted into the board's decision-making process; also, revision courses should take place at least

[20] ICAEW Insights, 'Ensuring the Section 172 Statement is Actually Used' (*ICAEW*, 06 Dec 2021) <www.icaew.com/insights/viewpoints-on-the-news/2021/dec-2021/ensuring-the-section-172-statement-is-actually-used> accessed 13 May 2022.

[21] Financial Reporting Council, 'Strategic Report: Section 172 Reporting Requirements' (*Financial Reporting* Council, 2018) <https://www.frc.org.uk/getattachment/3a35133f-47a0-4145-a041-a60c66e633e5/Amendments-cover-May-2020.pdf> accessed 13 March 2022.

annually to ensure that directors keep up with their duties on a continuous basis. Finally, it should be remembered that private companies differ from public companies – as a survey shows, some private companies were perplexed by their first section 172(1) statement because of its unfamiliarity and the time needed to identify the key information.[22] This is in contrast with public companies where more formal structures are in place; for instance, public companies typically retain a record of how decisions are made and which fundamentals were actually considered - this means that each year reflects the business decisions of that specific year. It may therefore be good practice for private companies to consider ways to record central decisions in board meetings and document the engagement process of a specific year so that the key components for next years' statement are firmly in place.

The new reporting requirements will prove challenging for boards navigating through them for the first time, especially boards of private companies. Still, there seems to be willingness to embrace the new disclosure requirements to their full, original intent. The alternative, and less desirable scenario, would see them being treated as a mere box-ticking exercise, performed mechanically and with resignation, thereby serving a bureaucratic expediency than a means of accomplishing the revisions' original intentions. So far, the surveys do not indicate this, and this is encouraging. Nonetheless, companies can do more to report on their strategies for long-term value creation; this will improve shareholder engagement as well as companies' long-term relationships with stakeholders.

2. The Promotion of Long-Term Investing Through Loyalty-Driven Benefits

The UK share ownership model favours exit over voice.[23] This means that shareholders are primarily characterised by a focus on short-term results (such as quarterly earnings) at the expense of long-term strategies and long-term value creation. That is why the majority of investors choose a short-term oriented investment model without engagement - they prefer to sell shares rather than exercise active ownership.[24] As Kay explains, 'the structure of the industry favours exit over voice and gives minimal incentives to analysis and engagement.' He further notes that equity markets promote the sale of shares over the exchange of views with the company as a means of engagement, substituting the interested investor with the anonymous trader.[25] Also, widely dispersed short-term shareholders are unlikely to know better than managers and boards — and a governance system that relies on them to keep companies above board, is faulty to say the least. In addition, most institutional investors lack the time or inclination to get involved. Big investors have diversified portfolios and do not care to participate in the governance of the numerous institutions in which they own shares. In fact, it is common for professional money managers to engage the services of intermediaries for

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[22] Stephanie Henshaw, 'Preparing a Section 172(1) Statement: Tips for Private Companies' (*Financial Reporting Faculty, ICAEW,* 06 December 2021) <www.pkf-francisclark.co.uk/preparing-a-section-1721-statement-tips-for-private-companies> accessed 15 June 2022.

[23] John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report (July 2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> accessed 1 February 2018.

[24] For a general discussion, see C. Fernando: *Business Ethics and Corporate Governance* (2nd edn, Pearson 2010); Justin Fox, *The Myth of the Rational Market A History of Risk, Reward, and Delusion on Wall Street* (1st edn, Harperbusiness 2009).

[25] John Kay, The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report (July 2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> accessed 1 February 2018. Also see Patrick Bolton, Frederic Samama, 'L-Shares: Rewarding Long-term Investors' (2012) 25(3) Journal of Applied Corporate Finance 86.

guidance on how to vote. Supervising and disciplining management also comes at a cost: opportunity costs minimise incentives to collect information, as the benefits that can potentially be gained by closer monitoring of managerial performance can easily outweigh the costs of such a policy.[26] Nonetheless, in our fixation with shareholder democracy, we must not lose sight of reality. Active participation by investors is not only a familiar proposition but a politically correct one too. No one would, after all, support irresponsible ownership; rather, *responsible ownership* is actively encouraged. Although managers, regulators, and politicians have long been unhappy about the apparent short-term pressures exerted by the stock market on listed companies, the UK Stewardship Code is not the answer. The Code is intended to encourage voice over exit by providing a set of principles and guidelines designed to boost the level and quality of engagement between institutional investors and companies. It provides the standards for what is expected of investors in their stewardship activities and sets a number of obligations on investors to involve themselves in active engagement as good practice. The premise is that investors have an obligation to implement effective ownership and governance whilst being accountable to their company boards.[27] However, there exist significant gaps between rhetoric and reality in so far as the UK Stewardship Code is concerned. As well-intentioned as it is, the idea underpinning the Code is seriously flawed.[28] The problem lies with shareholders themselves. Stewardship is not foremost in the minds of investors; expecting them to oversee and discipline management is therefore destined for disappointment. Most shareholders hold their shares for a relatively short period of time and are consequently focused on the maximization of their short-term share price. They are not interested in becoming company guardians nor do they care to promote the long-term interests of the investee company. Meanwhile, those who intent to remain shareholders for a longer period of time *do* care about the long-term prosperity of the company.

There are more proportionate and practical means of encouraging loyalty and stewardship.[29] In the financial literature that emerged following the financial crisis of 2008, loyal shareholders appeared as a a likely mechanism to alleviate the rising trend toward short-termism by directors of publicly listed companies, whose decisions tended to follow a short-term approach, with an undue attention on quarterly earnings and share prices (and proving highly damaging in the process). In this regard, the allowance of two types of shareholder ownership based on the investors' philosophy on ownership can provide an effective way forward: that is, the passive investor who chooses not to engage with company management, opting to abstain from exercising any kind of ownership rights and, on the other hand, the loyal investor who chooses

[26] Demetra Arsalidou, *Rethinking Corporate Governance in Financial Institutions* (Routledge 2015), chapter 3; Demetra Arsalidou, 'Shareholders and Corporate Scrutiny: The Role of the UK Stewardship Code' (2012) 9(3) European Company and Financial Law Review 342. For an insightful discussion on the granting of a voice to institutional investors, see also BS Black, 'Agents Watching Agents: The Promise of Institutional Investor Voice' (1992) 39 University of California at Los Angeles Law Review 811.

[27] Generally, see Daniel Cash, Robert Goddard: *Investor Stewardship and the UK Stewardship Code: The Role of Institutional Investors in Corporate Governance* (1st edn, Palgrave Macmillan 2021); Iris Chiu, 'The Interface between Financial Regulation and Corporate Governance' (2012) 33 Company Lawyer 65, 66.

[28] See CIMA Global Academic Research Programme, 'Is the Stewardship Code Fit for Purpose? A Field Study of Engagement by Asset Management Firms' (2019) 15(1) <https://www.cimaglobal.com/Documents/Thought_leadership_docs/Academic-research/4841-stewardship-code-research-report.pdf> accessed 18 May 2022.

[29] David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities – Final Recommendations,* 26 November 2009, London, available at http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf accessed 10 May 2011, 79.

to do the opposite.[30] The latter type would have an incentive to be a loyal steward because the activity of engagement would have the potential to improve their long-term return.[31] All in all, parting long-term investors from the rest gives a stronger presence to those shareholders most likely to have something to contribute through the interface between them and boards. Yet still, such investors would need incentives to engage with companies in a loyal manner. These will be explored in the next part.

2.1 The Benefits of the Loyalty Rewards Scheme:

When contemplating the positive traits of a healthy large company, strong and reliable stewardship is a prerequisite. In this regard, the values, expertise, alignment and investment duration of the steward in question, matter greatly. In addition, the share structure matters; for that reason, those concerned with increasing the sustainability and long-term survival of capital markets will appreciate the potential of loyalty benefits or loyalty shares.[32] The expression loyalty shares or loyalty benefits is used to describe all kinds of benefits, such as financial benefits and other incentives granted to shareholders who remain in the company for a specific period of time. Typically, they are given by a company to reward a particular type of shareholder: the one who remains a shareholder for a long period of time and who actively promotes a company's long-term interests in order to gain the benefit of these rewards. In this regard, investment duration is the most immediate measure of a shareholder's loyalty.[33] Loyalty benefits can be structured in several ways, such as enhanced voting rights, fees for good stewardship, richer distribution of dividends or increased dividends that are neutral in terms of the capital structure viewpoint of a company and that simply require a company's articles of association to include an opt-in clause permitting a surplus in the distribution of dividends to shareholders who retain their shares for a specified period.[34] Also, the term includes the option to purchase more shares at a favourable price[35] and equity warrants or loyalty shares, the latter referring to shares that carry a special right, as long as they are held for a certain period of time - in other words, they are allotted as a benefit to long-term investors.

Loyalty benefits are a popular corporate governance tool; yet still, they are a complete novelty to companies and shareholders based in the UK. This is in direct contrast to countries like France, the Netherlands, Italy and Belgium that have either introduced or revised the regulation of loyalty shares.[36] As noted, Italy and France have gone beyond what was prophesied by the

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[30] Demetra Arsalidou, 'Shareholders and Corporate Scrutiny: The Role of the UK Stewardship Code' (2012) 9(3) European Company and Financial Law Review 342.
[31] European Commission, 'Green Paper – The EU Corporate Governance Framework', COM (2011) 164 final, 5 April 2011, 11 - 12.
[32] Pablo Berrutti, 'Loyalty Shares can Promote Better Long-Term Stewardship' *Financial Times*, (London, 25 September, 2019) 7.
[33] Chiara Mosca, 'Should Shareholders Be Rewarded for Loyalty? European Experiments on the Wedge Between Tenured Voting and Takeover Law' (2019) 8(2) Michigan Business & Entrepreneurial Law Review 244, 247.
[34] Chiara Mosca, 'Should Shareholders Be Rewarded for Loyalty? European Experiments on the Wedge Between Tenured Voting and Takeover Law' (2019) 8(2) Michigan Business & Entrepreneurial Law Review 244, 247.
[35] Patrick Bolton, Frederic Samama, 'L-Shares: Rewarding Long-term Investors' (2012) 25(3) Journal of Applied Corporate Finance 86.
[36] Jose Engrácia Antunes et all, 'Report of the Reflection Group on the Future of EU Company Law' (2011) <https://ssrn.com/abstract=1851654> accessed 11 April 2022, 46.

various proposals at the EU level, with Belgium following suit.[37] France and Italy have mechanisms allowing more loyal shareholders to increase their voting power. Investors who own shares for longer periods (such as two years) receive more voting power than those who choose to sell their shares quickly. Voting power increases with the length of ownership under this type of share scheme. [38] Italy, France and the Netherlands also allow companies to reward long-term shareholders with higher dividends. France and Sweden have a type of two-tier ownership system, and in France[39] long-term shareholders can cast twice as many votes than other shareholders. In terms of evaluating outcomes, this can be left to shareholders themselves, who can decide on the most suitable approach to adopt in the articles of association. For instance, they can set certain limits, as is the case in France where the extra dividend is capped to a maximum of 10 per cent more than that received by short-term shareholders.[40] Also, in Italy new laws allow voting shares to turn into loyalty shares, through the passing of an extraordinary general meeting resolution that awards 'loyal' shareholders an extra vote per share. Interestingly, according to an empirical study, in the period between 2015-2018 forty-five Italian listed firms, that is, around one-fifth of all firms listed on the main segment of Borsa Italiana, introduced this system.

According to UK Company Law, companies can allow certain shares to enjoy weighted voting rights in their constitution (for example, by attaching additional votes to certain shares under particular circumstances).[41] However, loyalty shares and dual class shares are almost non-existent amongst listed companies in the UK. Therefore, the question is whether the UK, a leading financial centre worldwide, should reconsider its current stance. From a competitive perspective this would make sense: loyalty privileges can strengthen shareholders' motivation to keep their shares for a longer period of time. Those who show loyalty can obtain financial advantages and as well as more power within the company (such as enhanced voting rights). Indeed, the long-term stewardship mindset and the investment importance of long-term sustainability positioning is gradually gaining prominence. Loyalty benefits combat the promotion of long-term engagement by shareholders *and* the deterrence of short-termism in capital markets. This is encouraging; short-term pressures can result in short-term bonuses,

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[37] Chiara Mosca, 'Should Shareholders Be Rewarded for Loyalty? European Experiments on the Wedge Between Tenured Voting and Takeover Law' (2019) 8(2) Michigan Business & Entrepreneurial Law Review 244, 252.

[38] Patrick Bolton, Frederic Samama, 'L-Shares: Rewarding Long-term Investors' (2012) 25(3) Journal of Applied Corporate Finance 86.

[39] In France the introduction of loyalty shares took place as early as 1966 and in 2014, the Loi Florange made them the default choice for listed companies: Francois Belot, Edith Ginglinger and Laura T. Starks, 'Encouraging Long-Term Shareholders: The Effects of Loyalty Shares with Double Voting Rights' (2019) Université Paris-Dauphine Research Paper No. 3475429 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3475429> accessed 27 June 2022.; Thomas Bourveau, Francois Brochet and Alexandre Garel, 'The Capital Market Consequences of Tenure-Based Voting Rights: Evidence from the Florange Act' (2019) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3324237> accessed 27 July 2022; Marco Becht, Yuliya Kamisarenka and Anete Pajuste, 'Loyalty Shares with Tenure Voting - A Coasian Bargain? Evidence from the Loi Florange Experiment' (2018) Law Working Paper No 398/2018 <https://ecgi.global/sites/default/files/working_papers/documents/finalbechtkamisarenkapajuste.pdf> accessed 23 June 2022.

[40] Jose Engrácia Antunes et all, 'Report of the Reflection Group on the Future of EU Company Law' (2011) <https://ssrn.com/abstract=1851654> accessed 11 April 2022, 46.

[41] For a general discussion on the historical, doctrinal and theoretical bases of shareholder rights in British company law, see RC Nolan, 'Shareholder Rights in Britain' (2006) 7 European Business Organisation Law Review 549. Nolan, at 567, explains that British company law allows shareholders to exercise residual and ultimate control in companies, a choice that implies that companies, as far as their shareholders are concerned, are voluntary associations.

reckless balance sheet gearing and highly questionable accounting practices (that are designed to bring forward profits but also value-destroying share buyback schemes).[42]

All in all, loyalty rewards give a greater voice to those shareholders most likely to have something to contribute, grant a stronger role to long-term investors and play a crucial role in the reduction of short-termism.[43] They empower those shareholders least absorbed with the day-to-day share price and quarter-to-quarter earnings changes and more absorbed with long-term value creation. They grant such shareholders the incentive to care more about their companies. A concept to be encouraged, it has the potential to reshape company goals by focusing on long-term, sustainable value. As Lord Myners suggests,[44] short-term investors should have reduced rights as owners because 'companies are too important' for big investors to trade in and out.[45] When shareholders are widely dispersed, it is wrong to expect them to keep managers in check; therefore, divorcing long-term investors from the rest could facilitate more engagement and communication between them and boards.[46] In addition, this mechanism can help motivate foreign investors: although they constitute a substantial part of the UK market, foreign investors do not tend to take an active stance in quoted companies. However, should they desire to be the recipients of the aforementioned loyalty benefits (such as financial incentives, enhanced dividends and long-term tax benefits for good stewards) they will choose engagement.[47] By and large, the long-term vision is the best vision, and loyalty rewards are a solid way to encourage sustainable investment by shareholders.

2.2. Trials and Tribulations of the Loyalty Rewards Structure:

Although the short-termism debate has highlighted serious glitches in the corporate governance system, the projected solutions have, so far, been weak. Yet still, whether loyalty rewards form an effective tool in stimulating long-term engagement by shareholder is debatable. There remain practical difficulties associated with the operation of such a structure. Essentially, it oversimplifies the benefits attached to loyalty rewards. As argued, it ignores the need for managers to buy or sell shares based on external factors,[48] and additionally, it runs counter to the one share, one vote principle.[49] It can also serve as a self-benefit device for controlling shareholders or boards: as noted by the Reflection Group's report on the future of EU company law, such arrangements can exacerbate issues linked with dominant shareholders, allowing

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[42] David Gait, 'Dual Shares Class Blundering' (*Steward Investors Sustainable Funds Group*, Fourth Quarter 2014) <www.stewartinvestors.com/content/dam/stewartinvestors/pdf/global/SFG-DualShareclass.pdf> accessed 12 June 2022.

[43] Min Yan, 'Permitting Dual Class Shares in the UK Premium Listing Regime – A Path to Enhance Rather Than Compromise Investor Protection' (2022) 42(2) Legal Studies 335.

[44] Who, in 2008, became the UK's Financial Services Secretary.

[45] As noted in Jane Croft, Kate Burgess, 'Opposition Grows to 'Two-Tier' Share Plan' Financial Times (London, 2 August 2009) 5.

[46] Justin Fox, Jay W. Lorsch, 'What Good Are Shareholders?' (2012) Harvard Business Review <https://hbr.org/2012/07/what-good-are-shareholders> accessed 12 May 2022.

[47] Arad Reisberg, 'The Notion of Stewardship from a Company Law Perspective: Re-defined and Re-assessed in Light of the Recent Financial Crisis?' (2011) 18 Journal of Financial Crime 126, 138.

[48] That is, according to David Paterson, Head of Corporate Governance at the National Association of Pension Funds: Jane Croft and Kate Burgess, 'Opposition Grows to 'Two-Tier' Share Plan' *Financial Times* (London, 2 August 2009) 5.

[49] Jane Croft, Kate Burgess, 'Opposition Grows to 'Two-Tier' Share Plan' *Financial Times* (London, 2 August 2009) 5.

strong controlling shareholders to have too much power over the weaker, minority owners.[50] Loyalty shares can be exploited by controlling shareholders to further insulate themselves from market pressures and weaken minority investors. They can thereby be counterintuitive, in that they can act against the one-share one-vote principle, seen as the 'stepstone' of many corporate governance codes around the world.[51] Indeed, departures from this principle have been found to have detrimental effects on shareholder value.[52] According to Bajo et al, this can create a disparity: the benefits of encouraging long-term investment can be overshadowed by the costs associated by the increased separation between ownership and control. By reinforcing the position of controlling shareholders and strengthening their command on the firm, loyalty shares can incite the extraction of private benefits at the expense of minority investors. Since loyalty shares benefit both majority and minority shareholders equally, minority shareholders might thereby choose to be rationally apathetic as they will lack the motivation to become engrossed with company matters.[53] The influence of majority shareholders within the company will, consequently, greatly increase.

Critics also argue that loyalty shares are less transparent than other control-enhancing mechanisms, such as dual-class shares.[54] Companies with dual-class shares have two types of shares, with one class having more voting rights than the other. Such shares are granted before a company goes public and therefore the exploitation risk is lower.[55] They allow certain groups of shareholders, normally the founders of the company, to have greater control over board decisions even as shares in the company are widely dispersed. The key distinction between loyalty shares and traditional dual-class structures is that additional rights cannot be traded but can only be earned. Should the controlling shareholders sell their shares, the loss of loyalty shares results in the new shareholder only having the voting rights attached to their economic interest. That means that the benefits of loyalty shares are not perpetual and expire upon a sale. Further, loyalty shares constitute a single class of shares, available to all shareholders; therefore, the additional votes granted through this scheme depend on the holding period of the individual shareholder as well as the holding period of other shareholders.[56]

What transpires is that there are positives (antidote view) and negatives (poison view) to the ability of loyalty benefits to combat short-termism and encourage shareholder engagement.

[50] Jose Engrácia Antunes et all, 'Report of the Reflection Group on the Future of EU Company Law' (2011) <https://ssrn.com/abstract=1851654> accessed 11 April 2022, 46. The report also argues such structure can also diminish liquidity.

[51] Emanuele Bajo, Massimiliano Barbi, Marco Bigelli and Ettore Croci, 'Bolstering Family Control: Evidence from Loyalty Shares' (*Oxford Business Law Blog*, 27 September 2019) <www.law.ox.ac.uk/business-law-blog/blog/2019/09/bolstering-family-control-evidence-loyalty-shares> accessed 17 April 2022.

[52] Lucian Arye Bebchuk, Reinier Kraakman and George G. Triantis, 'Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in Randall K. Morck (ed), *Concentrated Corporate Ownership* (University of Chicago Press 2000); Adams and Ferreira, 2008 article https://academic.oup.com/rof/article/12/1/51/1583700

[53] Emanuele Bajo, Massimiliano Barbi, Marco Bigelli and Ettore Croci, 'Bolstering Family Control: Evidence from Loyalty Shares' (*Oxford Business Law Blog*, 27 September 2019) <www.law.ox.ac.uk/business-law-blog/blog/2019/09/bolstering-family-control-evidence-loyalty-shares> accessed 17 April 2022.

[54] The most high-profile company with a dual class structure in the UK is Deliveroo Plc.

[55] ECGI, 'Loyalty Shares: Limited Use Structure or Corporate Game Changer?' (*European Corporate Governance Institute*, 28 February 2019) <https://ecgi.global/news/loyalty-shares-limited-use-structure-or-corporate-game-changer> accessed 15 March 2022.

[56] ECGI, 'Loyalty Shares: Limited Use Structure or Corporate Game Changer?' (*European Corporate Governance Institute*, 28 February 2019) <https://ecgi.global/news/loyalty-shares-limited-use-structure-or-corporate-game-changer> accessed 15 March 2022.

The jury is still out on this matter and the empirical evidence on this question is negligible. Yet still, a study that considered the effectiveness of loyalty shares through a hand-collected database of Italian firms, illustrates that loyalty shares can serve as a strong remedy against short-termism.[57] In response to the many arguments raised (both positive and negative) regarding the effectiveness of loyalty benefits, there are some ways to boost this scheme. Crucially, if public companies choose to adopt loyalty shares, they can stipulate that the adoption of these shares must happen before the company goes public. As Martinez puts it, this will prevent controllers from opportunistically adopting their loyalty shares, thereby exploiting 'the greater level of dispersion, asymmetries of information and rationally apathy existing among public investors.' The adoption of loyalty shares before going public can be a suitable way to safeguard the position of public investors while offering more adaptability by permitting public companies to use shares with multiple voting rights.[58] And while loyalty shares could weaken the principle of equality of shareholders (rooted deeply into UK corporate governance), on balance, loyalty rewards can work. Whereas the 'one share, one vote' principle makes sense, corporate laws must not be too fixated with it. Certainly, there is great support in literature in the principle and generally, the overriding view is that it should be encouraged. As Bebchuck et all[59] suggest, concentrated control in the hands of a few causes agency and entrenchment problems, and these can take the form of distortions in investment decisions. Further, monopolies may be formed as well as inadequacies in the market for corporate control.[60] However, law, economics and finance literature suggests that the one-share-one-vote principle does not necessarily promote shareholder democracy or shareholder empowerment. Indeed, although the principle is politically attractive, it is suboptimal in terms of its economic efficiency.[61]As argued, 'while, in the political landscape, the "one person, one vote" standard is absolute dogma and weighting votes according to people's preferences and interests has never proved feasible, in the corporate scenario the one share, one vote principle is constantly challenged by the incentives of companies and their shareholders to shape corporate rights according to specific needs.'[62] Indeed, other countries that have traditionally had the 'one share one vote' structure as the default structure, have replaced it with the loyalty shares structure. For instance, in France, since 2016 shareholders are given double voting rights if they have held their shares continuously for at least two years.[63]

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[57] Chiara Mio, Elise Soerger Zaro and Marco Fasan, 'Are Loyalty Shares an Effective Antidote Against Short-Termism? Empirical Evidence from Italy' (2020) 29(4) Business Strategy and the Environment 1785.

[58] Aurelio Gurrea Martínez, 'The Case Against the Implementation of Loyalty Shares in Spain' (Oxford Business Law Blog, 09 July 2019) <www.law.ox.ac.uk/business-law-blog/blog/2019/07/case-against-implementation-loyalty-shares-spain> accessed 10 May 2022.

[59] Lucian Arye Bebchuk, Reinier Kraakman and George G. Triantis, Stock Pyramids, 'Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in Randall K. Morck (ed), Concentrated Corporate Ownership (University of Chicago Press 2000).

[60] Sandford Grossman, Oliver Hart, 'One Share - One Vote and the Market for Corporate Control' (1988) 20(1-2) Journal of Financial Economics 175; Milton Harris, Artur Raviv, 'Corporate Control Contests and Capital Structure' (1988) 20 Journal of Financial Economics 55, Tarun Khanna, Yishay Yafeh, Business Groups in Emerging Markets: Paragons or Parasites' (2007) 45(2) Journal of Economic Literature 331.

[61] Arman, Khachaturyan, 'The One-Share-One-Vote Controversy in the EU' (2006). ECMI Research Paper No. 1 <https://ssrn.com/abstract=2005054 or http://dx.doi.org/10.2139/ssrn.2005054> accessed 15 April 2022.

[62] Chiara Mosca, 'Should Shareholders Be Rewarded for Loyalty? European Experiments on the Wedge Between Tenured Voting and Takeover Law' (2019) 8(2) Michigan Business & Entrepreneurial Law Review 244, 245.

[63] ECGI, 'Loyalty Shares: Limited Use Structure or Corporate Game Changer?' (*European Corporate Governance Institute*, 28 February 2019) <https://ecgi.global/news/loyalty-shares-limited-use-structure-or-corporate-game-changer> accessed 15 March 2022.

Loyalty by investors can only work if long-term shareholders are rewarded for their commitment and good stewardship; this, in turn, can help eliminate short-termism pressures on companies and discourage excessive trading.[64] Most shareholders do not want to spend their valuable time pushing for long-term realisations; their main goal is to make a quick profit. On the other hand, those there for the long run, want to see the company succeeding long-term. But such investors must be convinced they will stand to benefit from constructive engagement with boards; this, in turn, will bind them more closely into the type of long-term active share ownership that they would have agreed to in advance.[65] Hence, any reform must grant incentives to those willing to accept the onerous responsibility of stewardship.[66] Otherwise, corporate governance will be seen as turning a blind eye to the problem of the passive 'free-riders' who enjoy the engagement efforts of the more energetic investors. This would be wrong. Shareholders are not the gatekeepers of the commercial world; rather, they are characterised by inertia, egoism and short-term thinking. Turning them into company guardians without providing them with proper incentives, financial or otherwise, is not only irrational but also precarious. Legislators and regulators cannot not simply hope that shareholders will be interested in promoting long-term wealth. Tools that empower and stimulate the activism of long-term shareholders and that confer on them benefits (should they agree to promote long-term visions), can prove effective.[67] In the absence of concrete changes in the shareholder benefits framework, stewardship expectations will simply not work.

Conclusions:

Corporate governance must promote healthy, innovative and sustainable companies over the long-term. A solid corporate environment must find a maintainable balance between the various interests of stakeholders, including shareholders and the controlling owners of companies, whilst promoting a company's long-term ambitions. And while shareholders matter greatly, their interests lie in symmetry with the long-term interests of the company itself and society as a whole.[68] The numerous recent corporate failures (caused by the global pandemic, high street crises and other social challenges) have emphasised the huge weight that must be placed on long-term strategies that support economic growth and improved engagement between companies and their long-term stakeholders. Lessening many of the sources of short-termism whilst stimulating a long-term oriented alignment in financial markets, is the keystone to this objective.

The paper considered two means of encouraging companies to function with the objective of promoting long-term sustainable economic growth: the focus on long-term sustainable performance, achieved via section 172 reporting and the use of long-term investing with loyalty-driven benefits. To begin with, the new reporting requirements form a step towards the

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[64] Andreas Kokkinis, 'Shareholders Short-Termism in the UK: The Kay Review and the Potential Role of Corporate Law' (2014) 11(3) Corporate Ownership & Control 166, 171.

[65] Andrew Hill, 'Preacher Myners is Right to Raise Hell with Investors' Financial Times (London, 21 April 2009) 4.

[66] David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities – Final Recommendations,* 26 November 2009, London, available at http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf accessed 10 May 2011, 70.

[67] AS Ginevri, 'The Rise of the Long-Term Minority Shareholders' Rights in Publicly Held Corporations and Its Effect on Corporate Governance' (2011) 12 European Business Organisation Law Review 587, 604.

[68] Paige Morrow, Andrew Johnston, 'Commentary on the OECD Principles of Corporate Governance' (2015) Sustainable Companies University of Oslo <https://www.oecd.org/daf/ca/FrankBold2015CGP.pdf> accessed 25 June 2022.

long-term sustainability for companies.[69] These regulations require all companies of a significant size to include a separate statement in their strategic report that describes how directors have considered the 'enlightened shareholder value' requirements of section 172; in addition, stakeholders will have to be informed on how directors comply with the legislative requirement to take into account employee and other stakeholder interests. In evaluating the evidence in relation to corporate reporting, the data suggests that the section 172 duty is taken seriously by companies; there is an eagerness to embrace the new disclosure requirements to their full, original intent than view them as a mere bureaucratic expediency. Although there is scope for improvement, this is a good step towards the promotion of long-term sustainable company growth. In addition, a stronger relationship between companies and their long-term stakeholders can provide considerable benefits to companies and while some are willing to take a more long-term perspective, they are generally not rewarded for their loyalty. Since their engagement is advantageous to the company, long-term shareholders need to receive rewards, financial or otherwise, that incentivise them to engage.[70] Loyalty rewards, such as enhanced dividends, enhanced voting rights and fees for good stewardship, give a greater voice to those shareholders most likely to have something to say and play a vital role in the reduction of short-termism.[71] Tools that fuel the activism of long-term shareholders and that confer on them benefits should be encouraged. Due to the consequences of the pandemic on companies and the wider economy such sweeping changes will prove fundamental to a company's survival, with far-reaching implications for the UK corporate governance system as a whole.[72]

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[69] ICSA, 'The Stakeholder voice in Board Decision Making: Strengthening the Business, Promoting Long-Term Success' (*The Governance Institute, The Investment Association*, September 2017) <www.cgi.org.uk/assets/files/free-guidance-notes/the-stakeholder-voice-in-Board-Decision-Making-09-2017.pdf> accessed 17 June 2022, 8.

[70] Patrick Bolton, Frederic Samama, 'L-Shares: Rewarding Long-term Investors' (2012) 25(3) Journal of Applied Corporate Finance 86.

[71] Min Yan, 'Permitting Dual Class Shares in the UK Premium Listing Regime – A Path to Enhance Rather Than Compromise Investor Protection' (2022) 42(2) Legal Studies 335.

[72] Nina Boeger, Charlotte Villiers, *Shaping the Corporate Landscape: Corporate Reform and Enterprise Diversity* (Hart Publishing, 2018).