

# Private companies with public shareholdings

*A handy guide for pension fund trustees*





# Private companies with public shareholdings?

## The nature of the beast

Increasingly prominent in the London market are companies whose activities are entirely based abroad, and whose only important connection with the UK is their listing.

The typical such company is large, with a market capitalisation courtesy of their commodity base that propels them straight into the FTSE 100 and a necessary holding in tracker funds. They are best described as **private companies with a public listing**: most of their shares are held by the founders or a small group of partners, and characterised by a relatively small free float of perhaps 20% to 30%.

There will usually be three categories of non-executive director, of which the most conspicuous will be the founders or their representatives. Then there will be some, usually from the company's country of origin, whose precise status and role may be somewhat unclear. Finally, with the ostensible role of providing corporate governance comfort to the London market comes a small band of City luminaries – the officially designated Independent Directors.

What all these companies have in common is that, in practice, control remains with the former owners and outside shareholders are invited to come **along for the ride**. As this type of company takes up an increasing proportion of the index, pension funds and especially tracker funds will feel they have no choice but to pay for their ticket and hope for the best as they jump on for the ride.

## Ticket to ride

But pension fund trustees can expect the ride to be bumpy; often distant assets, international management and a minority of UK directors mean that investor access to meaningful and comprehensible information is likely to be low. And the company's approach to comply or explain and to a principles-based governance regime may not be what investors expect.

While the share price is rising, investor ignorance is likely to correlate very positively with bliss, contentment – and an unquestioning attitude. However, the honeymoon is likely to come to an abrupt end if things turn rocky, and investors' trust, or at any rate their willingness to take things on trust, is likely to evaporate. Does this matter?

As a few high profile cases (such as ENRC in the summer of 2011) showed, the answer is yes. The **"governance discount"** can amount to the billions, as the market marks down a company's shares relative to the index.

This discount is bad news all round. For shareholders, their holdings lose significant value. For the company, the ability to raise finance becomes impaired. For management, who become demotivated as the value of their share-based LTIPs sink ever deeper.

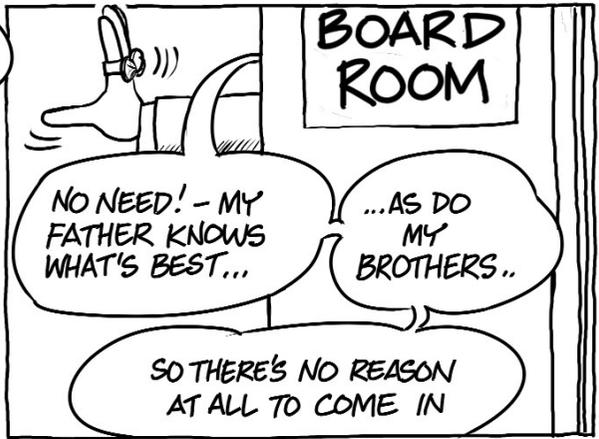
What can investors do to minimise the risks? Lots of things, of course, but this guide concentrates on just one. And that's to do with avoiding the governance discount – a real risk, even though it's one that is difficult to assess, and even more difficult to hedge.

## What next?

So when you and your fund manager make the buy decision on a “private-company-with-public-shareholding-type” holding you need to take the risk of a governance discount into account in your valuation. And when you set out to fulfil your responsibilities under the **Stewardship Code** you need to be mindful that the Independent Directors in this sort of company are going to be more than usually in need of back-up from minority public shareholders.

The rest of this guide sets out some questions that will help you to explore seven of the distinctive risks that go with being a public shareholder in a private listed company. If you can't ask the directors directly, then you can **warn your investment managers** these questions will be coming their way, and that in due course you'd like answers which demonstrate critical thought and constructive, effectual communication with the company, rather than breezy optimism or dedicated box-ticking.

Enjoy the ride.



# Things for pension fund trustees to think about (and ask)

## 1 Probing probity

- has the company kept to agreements and undertakings given at the time of the IPO?
- how does the board monitor undertakings, and does it clearly report on these?
- has the company met its commitments on board composition?

## 2 Form over substance

- what are the explanations for non-compliance with the Code and do they really stack up?
- what are the implications, and have your concerns been communicated to the Chairman and SID?
- are the safeguards to protect the interests of minorities clearly set out?
- what mechanisms exist to ensure that the independent directors actually have any ability to protect minorities?

### **3 Dysfunctional dynamics**

- how independent is the Board Chairman from the influence of the controlling shareholders?
- how much of the time devoted to shareholder dialogue is attributable to the controlling group and to others?
- what are the relationships like between the Chairman of the Board, the Committee Chairs and the SID?

### **4 Feeble stewardship**

- how independent are the Independent Directors and what relationships – commercial or familial – did they have prior to joining the Board?
- is the board willing to face a regular independent evaluation and will they explain what they have learned from it?

### **5 Unfettered self-interest**

- how do the Independent Directors know that they see and understand all related party transactions?
- how does the Audit Committee get assurance that all related party transactions are fully disclosed?
- does internal or external audit look at discretionary overheads, including executive expenses, and report to the Audit Committee?

## 6 Tame tickers

- how do the auditor's fees earned from audit and non-audit work compare with the FTSE peer group?
- do the auditors earn a significant amount in fees from the founders' other business interests?
- how has the Board ensured the genuine independence of internal audit, especially if it is connected with the controlling shareholder?

## 7 Impotent subsidiary

- how do the company and its board demonstrate their independence from undue parental or shareholder control?
- if a government is a shareholder or represented on the board, how can investors be confident that shareholder value won't be trumped by political considerations?

# How we can help

## At Independent Audit, we are experts in governance

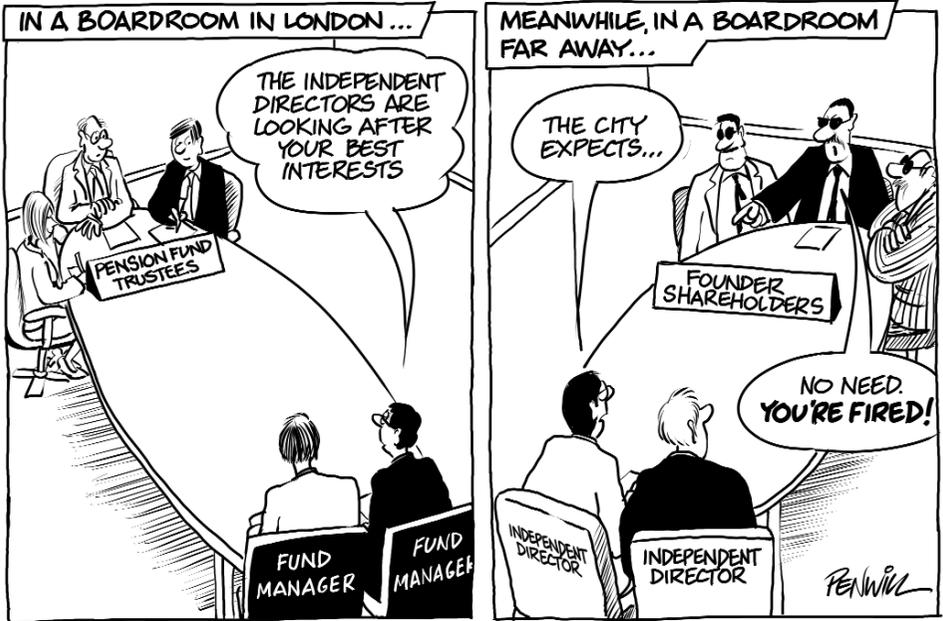
We provide **advice and assurance to Trustees Boards** over the quality of their governance. As well as the Board and Committee reviews for which we're well known, we've also helped many of our clients – large and small, across a variety of sectors – ensure their risk, compliance and audit functions provide a solid foundation for effective governance.

Our reviews of Trustee Boards take a variety of forms. We undertake **full reviews**, focused on interviews with trustees and those others with a key role to play. We review the information that the trustees receive and, if appropriate, may observe a meeting of the trustees. We then report back to the Board how they are doing and what they could do more effectively.

We can also help undertake **externally-facilitated self-assessments**. We use our web-based self-assessment service, *Thinking Board* – an easy-to-use questionnaire platform that includes a specialist module for assessing the effectiveness of pension fund Trustee Boards. We help you work out the right questions to ask, analyse the responses and feed back to the Board of Trustees with practical suggestions for improvement.

Alternatively, you can use *Thinking Board* as a **stand-alone self-assessment tool**, with no outside involvement, which lets you stay in control whilst still getting the benefits of an external perspective. Perfect for those assessments between external reviews, examining specific themes and for tracking progress.





## Contact

For more information about our work with pension fund trustees in the areas of governance, board effectiveness, risk and audit, please contact **Jonathan Hayward** on +44 (0)20 7220 6582 or at [jonathan.hayward@independentaudit.com](mailto:jonathan.hayward@independentaudit.com).

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