**Divorce between ownership and control**

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**Ownership and control**

* The owners of a private sector company normally elect a **board of directors** to control the business’s resources for them.
* However, when the owner sells shares, or takes out a loan or bond to raise finance, they may **sacrifice some of their control.** Other [shareholders](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/shareholders/) can exercise their **voting rights**, and providers of loans often have some control (security) over the assets of the business
* This may lead to conflict between them as these **different stakeholders** may have different objectives. The flow chart below attempts to show the divorce between ownership and control.



**The Principal Agent Problem**

How do the owners of a large business know that the managers they have employed operate with the aim of maximising [shareholder](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/shareholder/) value in both the short term and the long run? This lack of information is known as the **principal-agent problem** or “**agency problem**”.

* The **principal agent problem** revolves around a simple issue - how best to get your employees to act in your interests rather than their own?
* Shareholders tend to want good returns in the form of dividend payments and a rising share price.
* Managers may have different objectives such as power, bonuses, large expense accounts, prestige and status. The problem is the many shareholders - have no day-to-day control over managers. Pension fund managers cannot dictate what CEOs and CFOs of businesses decide to do and senior executives may have little knowledge of what their managers are doing.
* Many investors in a business **are 'passive'**. The biggest investors in UK listed companies tend to be large **institutional shareholders** such as **pension funds** and **insurance companies**.

Examples of the principal-agent problem that have hit the headlines recently in the UK include the mis-management of financial assets on behalf of investors (e.g. [Equitable Life](http://news.bbc.co.uk/1/hi/business/3547441.stm).) The classic case in the United States was the [Enron](http://www.bbc.co.uk/radio4/today/reports/archive/international/enron.shtml) fraud and debacle.

The **credit crunch** focused attention on the failure of shareholders in the major banks to understand the complex and risky behaviour that was being undertaken by bank employees involved in the sub-prime mortgage boom and the growth of securitised lending.

In the banking crisis it became clear that senior management at many of the world's biggest banks simply did not understand the complexity of what their traders were doing. Traders stood to earn huge bonuses if their risky loans worked, but faced little sanction or loss if they went bad. This skewed their incentives and created a problem of **moral hazard**. This term originated in insurance, recognising the idea that people with insurance may be careless – for example, paying for secure off-street parking looks less attractive if your car is insured.

A separation of ownership and control in banks and insurance companies contributed to the sub-prime crisis and the result has been a **collapse in shareholder value** as the stock market prices of banks and insurance companies has fallen sharply.

**Employee Share Ownership Schemes**

There are various strategies available for coping with the principle- agent problem. One is the expansion of employee **share-ownership schemes**.  But the use and occasional misuse of share options schemes has been controversial for several years. A recent example involved the [US computer giant Apple](http://news.bbc.co.uk/1/hi/business/5131990.stm).

**The growth of "shareholder activism"**

* Increasingly we are seeing [shareholders](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/shareholders/) who are more **proactive** in putting executive management under pressure - these are known as **activist shareholders**. In 2012 some commentators pointed to the emergence of a “shareholder spring” prompted by investor anger over huge remuneration packages alongside poor financial performance
* At the forefront of this change has been the expansion of **hedge funds** and a number of wealthy private investors. Latterly, the **sovereign wealth funds** have appeared on the scene.
* An activist [shareholder](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/shareholder/) uses an **equity stake** in a corporation to put pressure on its existing management.
* The **goals of activist shareholders** range from **financial** (e.g. increase of shareholder value through changes in dividend decisions, plans for cost cutting or investment projects etc.) to **non-financial** (e.g. dis-investment from particular countries with a poor human rights record, or pressuring a business to speed up the adoption of environmentally friendly policies and build a better reputation for ethical behaviour, etc.).
* Activist shareholders do not have to hold large stakes in a business to make an impact. Even those with relatively small stakes or 3 or 4 per cent can launch publicity campaigns and make direct contact with the senior management. **Private equity / hedge funds** have been among those most involved in the rise of shareholder activism. They tend to focus on **under-performing businesses**

Is this new breed of shareholder activists an important voice and counter-balance to the power of entrenched management and willing to stand up to corporate corruption and highlight poor management?

Can they help to overcome the **principle-agent problem**? Or are they aggressive corporate raiders seeking short-term corporate change merely for their own personal gain?

[Environmental groups](http://www.foe.org/international/shareholder/index.html) such as Friends of the Earth have also latched onto the potential for shareholder activism to impact on businesses especially in the areas of the environmental impact of their business activities.

It remains the case that ownership and control within British industry is dispersed. Typically the largest shareholder in any large business listed on the stock market is likely to own a minority of the shares. Majority ownership by a single shareholder is unusual.

[**Corporate Social Responsibility**](http://www.csr.gov.uk/) **(CRS) and Business Ethics**

* **Business ethics** is concerned with the **social responsibility of management** towards the firm’s stakeholders, the environment and society in general.
* There is a growing belief that ethical and ‘green’ business are linked to improved business performance because of increased public concern for human rights and the environment.
* For example, many businesses are now trumpeting their progress in making their activities carbon neutral by offsetting the impact of their production activities on their environment through offset activities. Businesses such as [Carbon Clear](http://www.carbon-clear.com) provide a means by which organisations can find ways to offset their carbon [emissions](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/emissions/).
* Business ethics extends to treating [stakeholders](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/stakeholders/) ‘fairly’; hence the growing emphasis on health and safety issues, good working practices and the like in business decision-making.
* According to the Ethical Investment Research Service (EIRIS) £6.7 billion is invested in ethical and environmental investment funds in the UK (and rising)

For more reading on this try this link to the [Institute for Business Ethics](http://www.ibe.org.uk/faq.htm). The Times 100 Case Studies includes one on [Cadbury’s and corporate social responsibility](http://www.thetimes100.co.uk/case_study.php?cID=15&csID=107).  [Click here for BBC news articles](http://search.bbc.co.uk/cgi-bin/search/results.pl?tab=ns&q=carbon%20neutral&recipe=all&scope=all&edition=d) on carbon neutrality.

**Examples of private benefits from corporate social responsibility projects**

* **Marks & Spencer Plan A** to cut carbon emissions: Estimate of £50m extra profit (20% cut in packaging costs; 19% increase in energy efficiency) – their aim is to be the world’s most sustainable retailer
* **GE (Ecomagination):** $70bn of extra revenue in first 5 years (new products for the green economy)
* **Unilever (Project Shakti):** $100m extra sales by selling to rural Indian communities – their Sustainable Living Plan aims to double sales & halve environmental impact of its products by 2020. 15 years of sustainability projects = CO2 from energy down 41%; water use down 65%; total waste down 73%
* **British Telecom**: BT’s commitment to its sustainability agenda has helped it win £2.2bn worth of business in the financial year 2007-2008, up from £1.8bn the year before.
* **Sony**: A vision of being a zero carbon emission firm by 2050 with staged targets along the way
* **Dow Jones**: A.T. Kearney looked at 99 companies who have a strong commitment to sustainability (as defined by the Dow Jones Sustainability Index) and compared their performance with industry averages. They found that In 16 out of the 18 industries studied, companies committed to sustainability outperformed industry averages by 15%

Multinationals are increasingly seeing CSR as a **key driver of product innovation** - CSR has grown in strategic importance during a period of uncertain / weak economic growth