# City and industry

*The **Governor** discusses[1] some of the issues arising in the relationship between industry and the financial sector in an increasingly innovative and competitive financial environment. He looks, in particular, at the question of contested takeovers and argues that:*

- *Boards cannot necessarily expect protection from unwelcome predators, which would lead to less efficient management and more expensive financing.*
- *Nevertheless, there have been some cases recently where opportunistic predators have sought to unsettle the management of a well-run company to secure a favourable short-term impact on the share price, partly or primarily at the expense of the future: and this must be a matter of great concern.*
- *Approaches of this kind give rise to temptation to engage in tactics that are immensely damaging to the interests of shareholders and the reputations of the companies and advisers involved. Those in the City who act in these cases must accept full responsibility for the transactions that result and should exercise the most careful judgement from the outset with respect to the clients for whom they act and the activities contemplated.*
- *Companies can act to protect themselves against speculative disruption by fostering good relations with shareholders, in particular by improved disclosure of information on their longer-term aims and plans for research, development and investment.*

I am most grateful to the Confederation of British Industry for inviting me here this evening, and it is a particular pleasure to share a platform with David Nickson. The last person from the Bank of England to face a CBI audience was my colleague David Walker, who—armed only with impeccable logic—ventured to speak at last year's Conference Debate on the City and Industry. It was by all accounts a lively occasion and many of the themes discussed there have remained contentious: so it will not surprise you that I propose to address some of them again tonight. It is right that we should keep under very close scrutiny the relationship between the financial sector and industry, and I very much welcomed David Nickson's timely initiative, late last year, in creating a high-level task force to study City/Industry relations. I hope and believe that this group will be able to produce constructive ideas that will command general support. Certainly in the City there is a readiness to question old practices and to welcome new ideas.

It is an especial pleasure to come to Sheffield, a great centre of industry with long and proud traditions. I know only too well how difficult industrialists have found these last few years of restructuring. For a while the Bank of England was directly involved in some aspects of it; and we have always prided ourselves on and devoted considerable resources to keeping in close touch with industry in this as in other regions. We greatly value the work undertaken by our Agents around the country in providing a continuously up-to-date picture of the problems facing industrialists—and indeed of their impressions of us in the financial community.

It must be very tempting to look south and reflect that somehow the City of London lies in another world, divided from the industrial centres and sheltered from their problems. But I have to tell you that your problems in industry would find an echo in many a City board room. Financial firms are by no means immune from the pressures of competition and cost, from difficult capital investment decisions, from management weakness or from skill shortages. Competition, indeed, is as fierce in the City as in any part of our commercial life, and it is made still more intense by the increasing inter-connectedness of the main world markets and the homogeneity of the products traded in them—as well as by the almost complete openness of the City to competition from powerful international firms.

## Change in the City and its impact on industry

Recent changes in the City—graphically labelled 'Big Bang'—came about precisely because of the intensity of

(1) In a speech to the Yorkshire and Humberside Regional CBI in Sheffield, on 11 March.

international competition. Our domestic securities industry faced, in effect, the kind of choice between parochial decline on the one hand and international orientation on the other that faces many manufacturing industries. The measures taken over the past few years, culminating in the 'Big Bang' itself last October, demonstrate that it was the competitive, international option that was chosen—with all that implies in terms of risk as well as potential reward. Fixed commissions have been replaced by negotiated commissions; barriers to entry to the Stock Exchange have been removed; powerful new enterprises have been formed; and modern technology has allowed a transformation in the openness and efficiency of the market. In thus transforming themselves, members of the Stock Exchange have responded to and embraced international competition—just as any business has to, whether providing goods or services. Prices have been cut, new technology acquired, and human and financial capital redeployed.

This is all to the good, for the City's earnings contribute massively to our economy. But how, you may ask, do all these changes benefit industry? The impression is sometimes given—and is compounded by television pictures of frenzied young men in immense trading rooms—that securities dealing, and activity in related but more esoteric markets like futures and options, is an end in itself. But this is a misleading impression. Trading in a secondary market is an essential source of liquidity, without which shareholders would be less ready to invest—or to allow companies to retain profits rather than distribute them. More generally, competitive trading provides the market background against which new financings and product development take place. The competition in the dealing rooms brings direct benefits in terms of lower costs and a greater variety of products—new ways of raising money, of sharing and spreading risk and of providing investment products. The changes introduced by the Big Bang have already lowered dealing costs and increased the liquidity of the markets in many shares: and this is likely to be favourably reflected in the market for new finance for companies of all types.

While there are great opportunities here for the industrialist, I do not wish to suggest that the changes have made life easier for him or for his finance director. If companies are to make the best use of all the new financing and risk management techniques now available, considerable sophistication and constant up-dating are required—as well as a degree of caution. The choices of financing instrument have multiplied: so too has the number of intermediaries. It is much easier than in the past to shop around, to obtain competing quotes for particular funding or other transactions or types of advice. The pendulum has swung a long way since a company put all of its deposit, borrowing and payments business through a single bank, and relied on a single issuing house for its access to capital markets. While the relationship between a company and its professional advisers, be it legal, taxation or financial, remains extremely important, that type of 'relationship' banking is now supplemented and indeed sometimes replaced by 'transaction' banking, whereby a range of intermediaries may be involved with a company, some just for one piece of business. For some company treasurers this is an entirely sensible way to approach the City: many are, after all, at least as sophisticated as the bankers with whom they deal. But in other cases the abandonment or dilution of the relationship with a lead bank or corporate finance adviser can be a source of subsequent regret. Often when trading conditions become more difficult the new transaction-based intermediaries prove fair-weather friends: in such times well-informed, stable and supportive banking relationships can be of immense value, and the fact that they may cost slightly more will then be of little relevance.

## Relations with shareholders

But the City cannot always be a comfortable place for company boards—it would be wrong if it were. It does after all provide the market in which the shares of public companies are bought and sold: and this means that it is a market in which the proprietorship of the company resides and may change hands. Like all markets, it sends messages, sometimes disagreeable ones.

If proprietorship of a company is to mean anything, it must include the right to vote and the right to sell; and boards cannot escape the fact that shareholders may sometimes vote or sell all at once. It is therefore highly desirable that boards should pay very close attention to what their shareholders are telling them—either directly, or indirectly through the market. And it is correspondingly incumbent upon shareholders, particularly substantial or influential ones, to exercise the rights attaching to their ownership with all due responsibility.

It is much easier for institutional shareholders than for individuals to keep themselves informed about a company and in touch with its management. We in the Bank have devoted considerable attention over the past fifteen years or more to promoting a closer relationship between the major institutional shareholders and the companies in which they invest: encouraging them to intervene, collectively if necessary, if they feel matters to be going adrift. This will involve, in particular, a close interest in the composition of the Board. In times of dissatisfaction or concern, the relationship is likely to be a difficult one, and it will always be bound by constraints on both sides, not least because price-sensitive information has to be kept confidential until it is made public; but it is worth persevering with—if only because the alternatives are so unpalatable. If a substantial shareholder feels frustrated and unable to get his views across, his only recourse may be to sell his shares. But for a holding of any size this can be difficult; so that in practice the institution may often feel locked in—and all too ready to listen to or even accept overtures from a potential predator.

## Takeovers and predators

I am only too well aware of the expense, disruption and sometimes even damage that can be inflicted on a company by a contested takeover. But that alone is no reason to condemn all such bids. Boards cannot expect protection from unwelcome predators, for that is but a short step from saying that they should be protected from their own shareholders—who are, after all, the proprietors of the company. Protection of the kind that some have advocated would in my view lead to less efficient management, and by limiting investors' rights it would make them less ready to take up new equity, with the result that raising finance would become more difficult and more expensive.

Takeovers and mergers have an important role to play in our system. They can lead to economies of scale, to beneficial integration, and to more efficient market penetration. This is particularly important at a time when real competition for many firms comes from larger foreign enterprises. They can also lead to better company management. They do not always do so: shareholders can be wrong, and so may be the management of bidder companies. But the degree of success or failure has not in my experience depended on whether or not the takeover was contested.

Some of you may nevertheless feel that in some respects the process has gone too far: that market mechanisms that ordinarily play an essential role in protecting the interests of shareholders have sometimes in recent years come to be abused. Some takeover bids appear to have been launched not so much in response to evidence that a company's management is not up to the task, or in the belief that its business would do better in different hands, but in order to reap a once-for-all capital advantage. And there have been situations recently where opportunistic predators have sought to use the considerable platform and influence of a minority shareholding to unsettle the management of a well-run company. The expression 'putting a company into play' is as unpleasant as the idea behind it. The aim is to pressurise a company's management into action dedicated solely to a favourable impact on the share price in the short term, partly or even primarily at the expense of the future. The consequence is often a protracted period of unfocused uncertainty which inflicts quite unnecessary damage, weakening a company's management and distracting them from longer-term objectives, sapping the morale of its workforce, and making employees feel individually insecure to the point of leaving.

This must be a matter of great concern to the City. Approaches of the kind that I have described often depend for their success on creating a highly-charged and artificial situation in the share market, and give rise to temptations—on both sides of the battle—to engage in aggressive, even manipulative, tactics that are immensely damaging to the interests of shareholders and to the reputation of the companies and advisers involved. Those in the City who act for companies or individuals in these cases must, I suggest, be ready to accept a full measure of responsibility—even if it entails opprobrium—for the transactions that may result, and should exercise the most careful judgement at the outset with respect to the clients for whom they act and the activities contemplated. Those who sow the wind cannot expect the whirlwind to visit elsewhere. History—including quite recent history—well illustrates the need for City houses to be properly jealous of their reputations and those of their clients.

What can companies themselves do by way of self-protection against speculative disruption? I have already mentioned the importance of forging good relations with shareholders, especially institutional investors. Markets are not generally myopic—they are usually capable of assessing quite accurately the information they receive. But they do need information if they are to give the right signals. Company reports are sometimes alarmingly bland and uninformative. Boards often complain about the short-term views taken by their shareholders—but do not give them anything on which to base a longer view. We all know that good training programmes, soundly-based research and development and campaigns to break into new markets, as well as major investment programmes, are costly and their short-term impact on the profit and loss account cannot be disguised. Yet these are the lights that brighten a company's future. Why hide them under a bushel? Why not, in a word, give a clear presentation that the company has made its dispositions and knows where it intends to be four or five years from now? Under the pressure of a takeover, companies are quick enough to reveal information beneficial to the share price. Shareholders' scepticism in such circumstances is hardly surprising—so why not anticipate, within commercially prudent limits?

We have in this country one of the most efficient financial markets in the world. Industry should benefit from this, not labour under a sense of disadvantage and resentment. It is nothing less than madness for there to be divisions between the City and industry. In partnership, they can achieve all that the nation expects from its commercial system. I want that partnership to flourish.