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TAKING SHAREOWNER STEWARDSHIP TO THE NEXT LEVEL:

CAN DEDICATED ‘ACTIVIST’ FUNDS ADD VALUE?

“Repeated failures to link [shareowner] activism to performance are often blamed on three elements: inadequate monitoring due to free riding, legal and institutional obstacles, and incentive problems among institutional investors....”

Quoted from “Returns to Shareholder Activism”
London Business School, April 2008

Peter Drucker’s ‘Pension Fund Socialism’: Implications

Last month’s *Letter* noted that Peter Drucker had foreseen the ‘pension funds socialism’ challenge as early as 1976. He predicted that pension funds would increasingly become the owners of the free world’s capital “not because they want to be...but because they have no choice.” This reality, according to Drucker, would force pension funds into having to decide what kind of owners they would become. Would they become ‘patsies’, continually pushed around by politicians, union leaders, and corporate executives? Or would they become truly ‘arms-length’ organizations with the legitimacy to act in the best interest of millions of workers and pensioners?

Today, the implications of that, at-the-time, radical Drucker insight are finally going ‘mainstream’. The recent Global Financial Crisis drove home the reality that 21st Century capitalism needs responsible, knowledgeable owners, and that pension funds fit the bill to play that role better than any other class of shareowners. Last month’s *Letter* described the evolution towards effective shareowner stewardship by pension funds as still a “work-in-progress”. For example, a recent UN-sponsored survey found that lack of time and resources in the pension fund sector are still major barriers to the implementation of effective individual and collective shareowner strategies.

The *Letter* concluded by suggesting that adopting the uniform global code of shareowner stewardship recently proposed by the UK’s Walker Review would act as a solid platform from which to take shareowner stewardship to the next level. The *Letter* also illustrated the power of well-orchestrated national collective action initiatives by showing how a handful of strategies devised by the Canadian Coalition for Good Governance improved the governance scores of Canada’s corporate sector materially in just six years. This sequel *Letter* examines the effectiveness of other forms of shareowner activism. Specifically, we look in some detail at the effectiveness of strategies devised by dedicated ‘activist’ funds such as the Hermes UK Focus Fund, and see what can be learned from the experience.

The Hermes UK Focus Fund

In the research study “Returns to Shareholder Activism” cited at the top of the page, authors Brecht, Franks, Mayer, and Rossi note that earlier studies on shareowner activism have generally concluded that “activism can prompt small changes in target firms’ governance structures, but has negligible impact on share values and earnings.” This seems to be due to three reasons:

1. Individual investment funds generally hold small stakes in listed companies.
2. Many institutional investors (e.g., mutual funds, corporate pension funds) face conflicts