

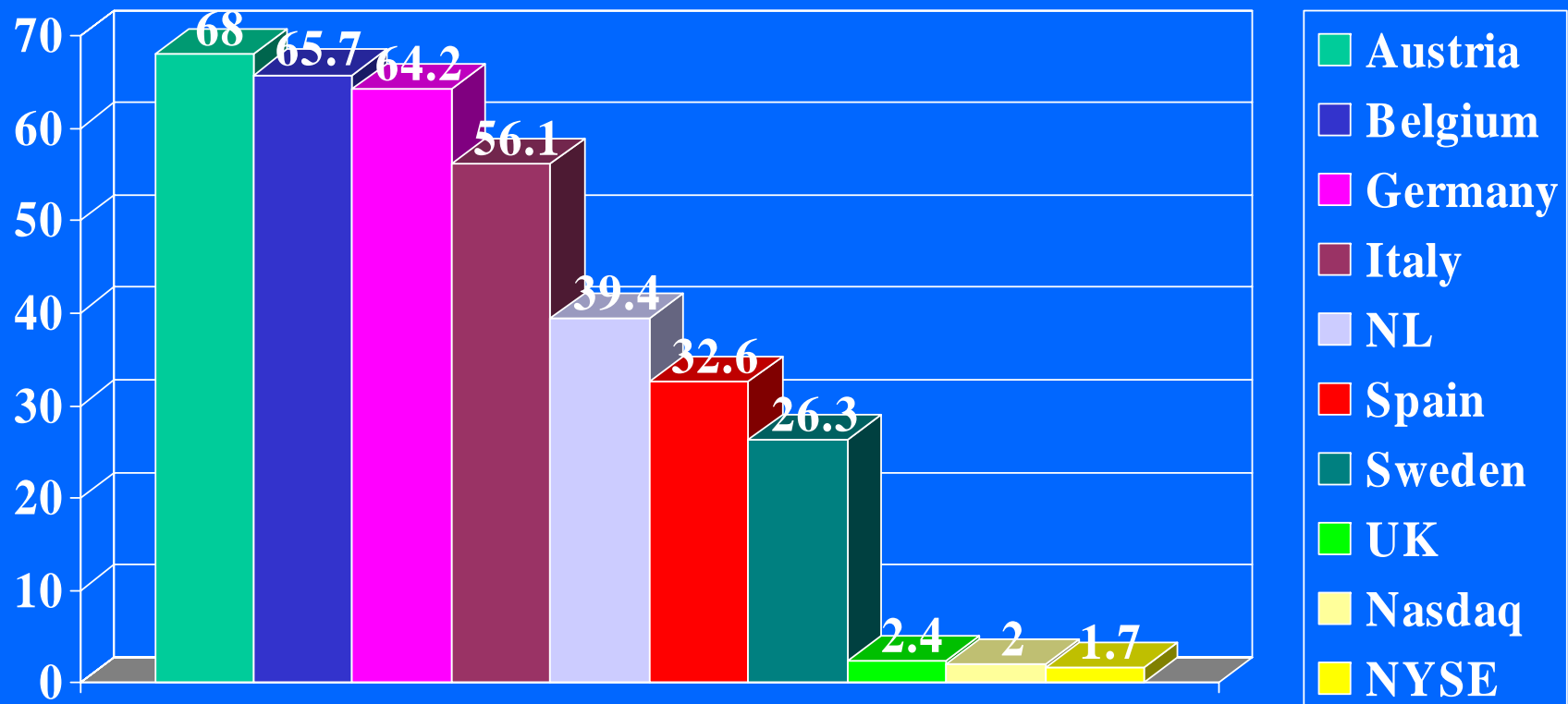
Pensions Funds and Corporate Governance

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“Trust is good; control is better” - Lenin

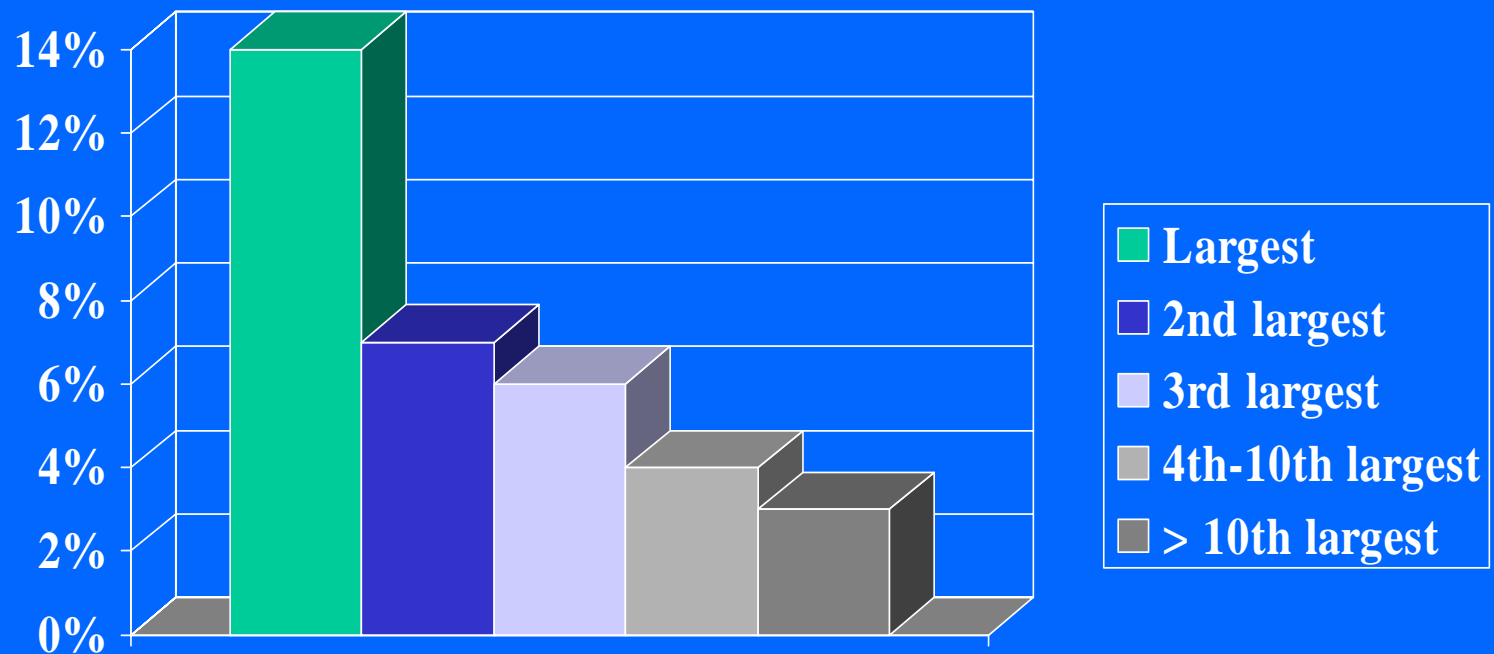
- Have pension funds been active?
- Is shareholder activism on the increase?
- Is it beneficial?
- Should we legislate for greater activism?

The Problem: In Most Countries Ownership Is Concentrated



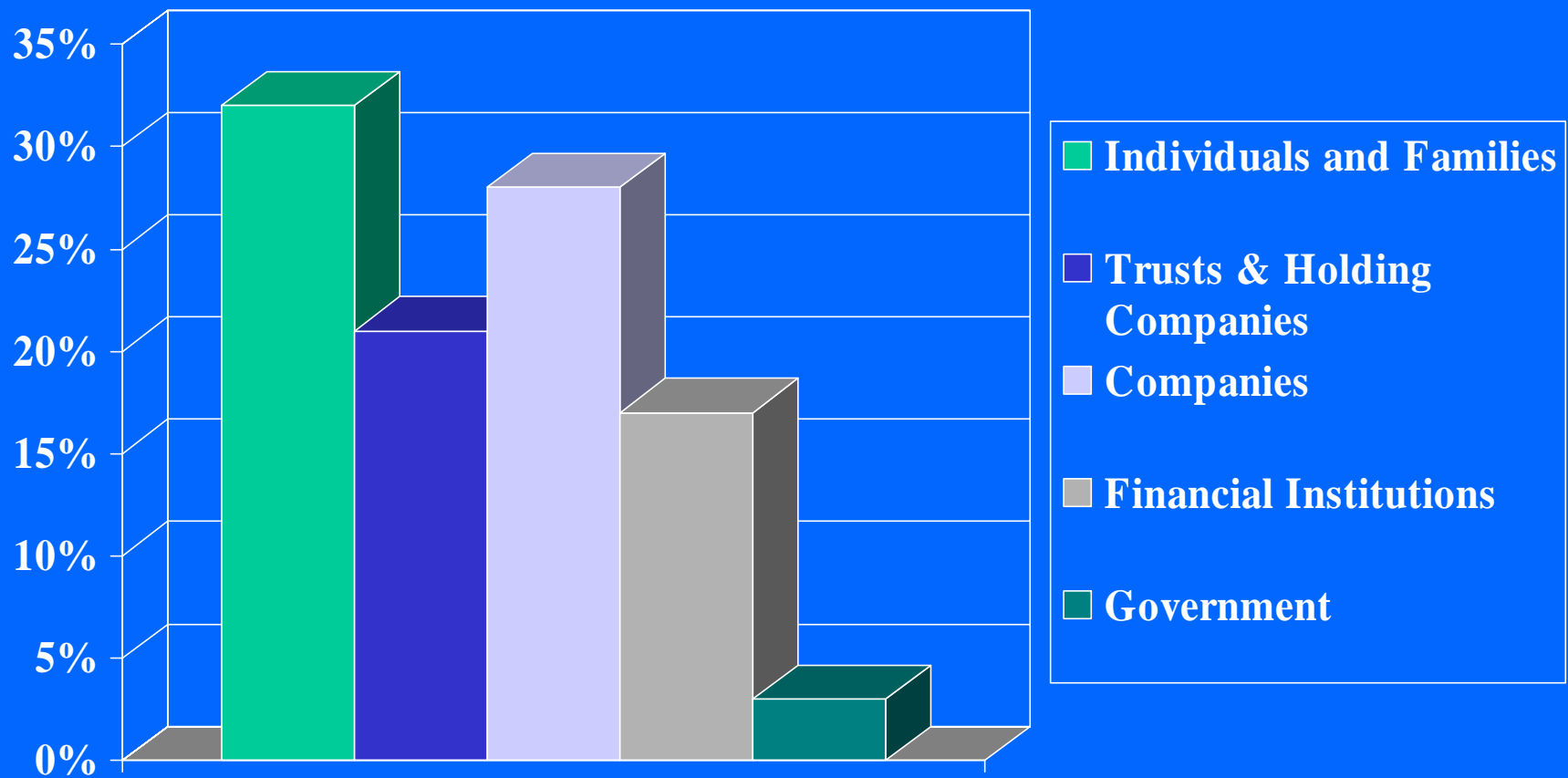
Source : country chapters in Barca and Becht (2001)

In Britain It Is Not

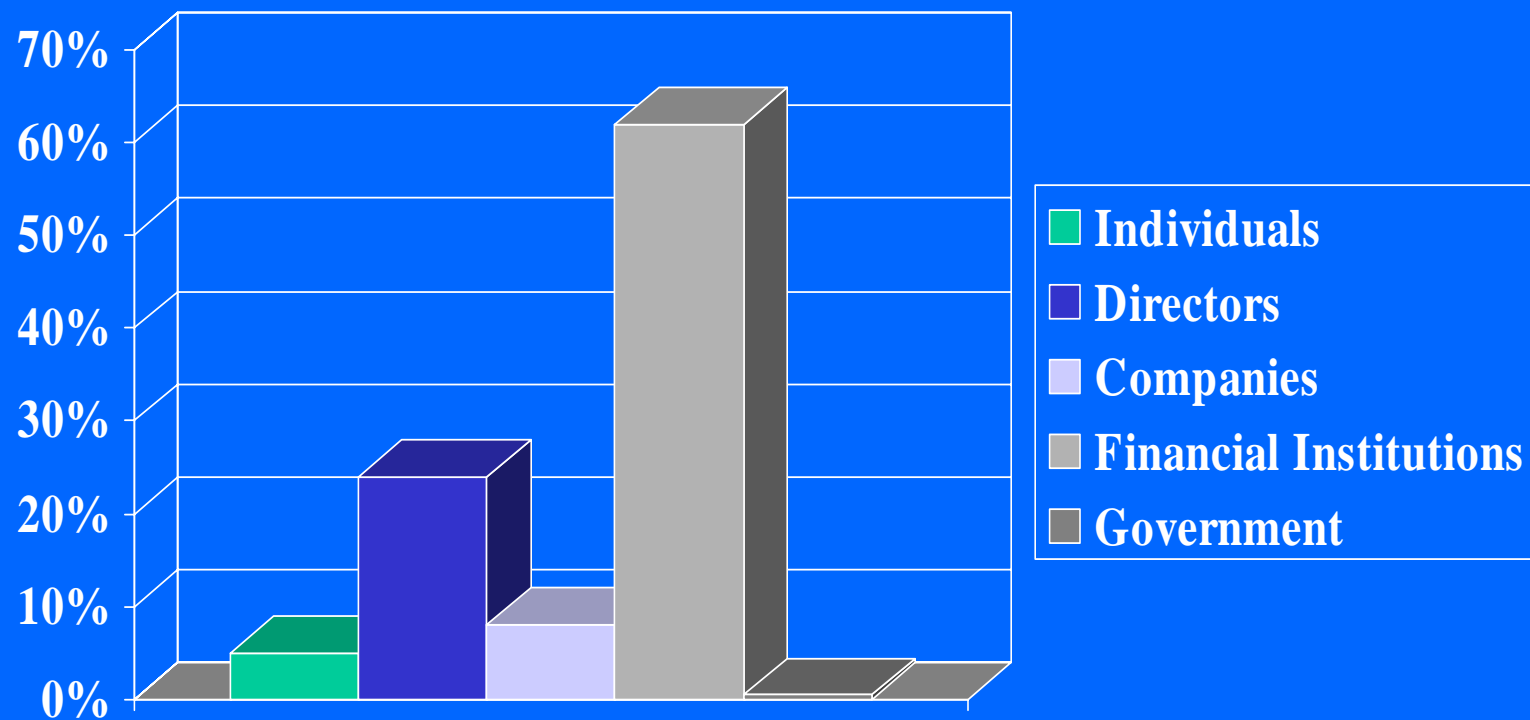


Source: M. Goergen and L. Renneboog: "Strong Managers and Passive Institutional Investors in the UK", ECGNIPProject

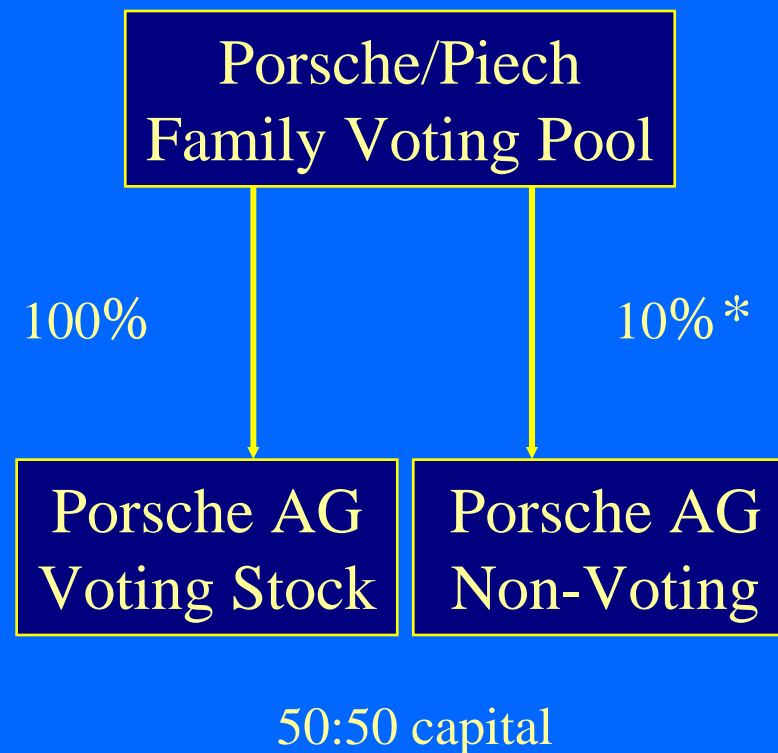
In Most Countries Family Ownership Is Widespread: Germany



In Britain It Is Not



In Most Countries, Dual Class Shares Are Commonplace



In Britain They Are Not

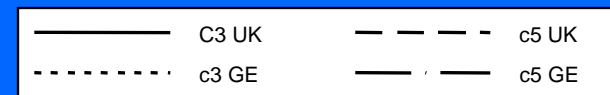
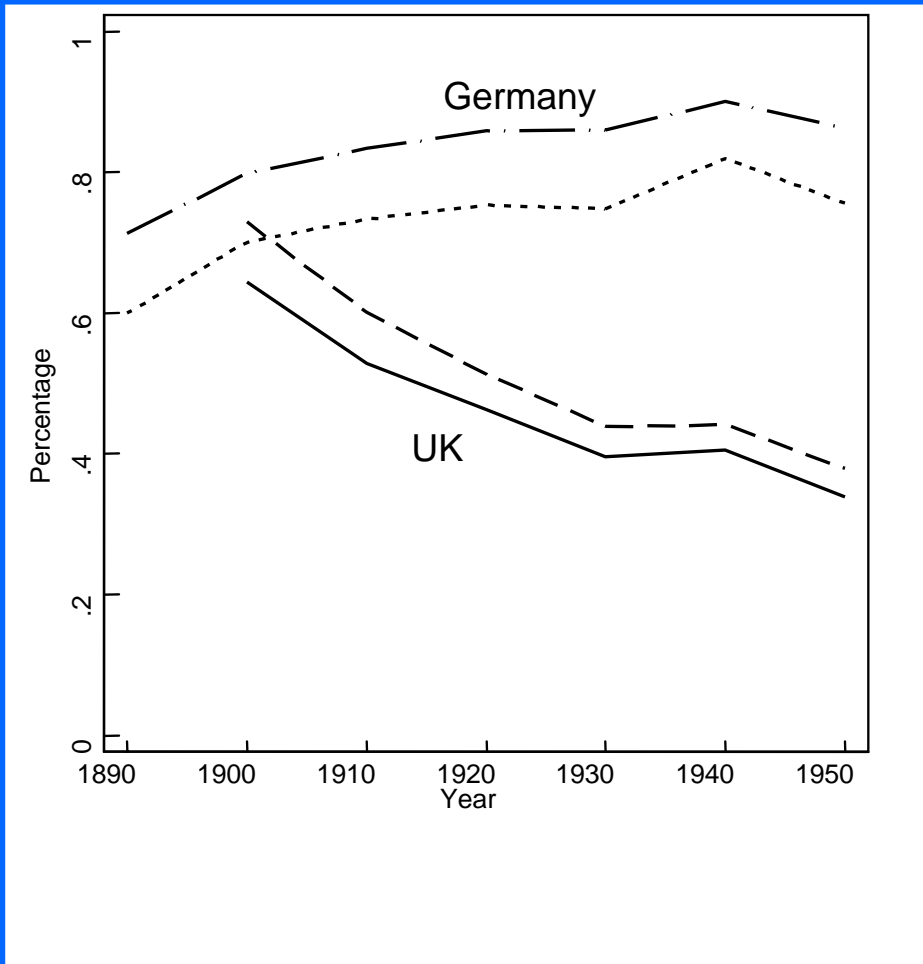
Britain Is Odd Not Just By European Standards

	Dominant Owners Today
Canada	Family pyramids
Germany	Family pyramids Corporate
Japan	Corporate
UK	Widely held Institutions
US	Widely held

Even A Hundred Years Ago It Was Odd

	1900-1910	1910-1920	1920-1930
Canada	Family pyramids		Growing dispersion
Germany	Families		Growing dispersion
Japan	Family pyramids		Growing dispersion
UK	Growing dispersion		
US	Families	Growing dispersion	

But What Really Marks Out The UK Is The Speed With Which Concentration Declined



As A Consequence Families Disappeared In Britain

Year	No. of Shareholders Required for 25% Shares	No. of Companies Where Families Holdings > 25%	No. of Companies Where Institution Largest Shareholder
1900	2	18	0
1920	11	15	0
1940	18	8	4
1960	26	5	8
1980	58	1	8
2000	48	0	17

And Were Replaced By Institutions

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1900	2	18	0
1920	11	15	0
1940	18	8	4
1960	26	5	8
1980	58	1	8
2000	48	0	17

As a Consequence Shareownership Became Dispersed

- Institutions hold 60% of shares
- Somewhat lower in the US
- Dispersed amongst several institutions so no one institution has a large holding

But Not Entirely So

- Five largest shareholders command 30% of shares
- Similar in US: five largest shareholders can command 25% of shares
- Possible for institutions to form coalitions

Do Institutions Form Coalitions?

- Difficult to get precise data because most interventions not publicly observed
- “Whenever possible, the institutions prefer to operate in the shadows. The prevailing view, even among activist managers, is that “secrecy and trust are essential”” (Black (1994)).
- Alternative approach is to look for evidence of interventions when firms perform poorly

Do Institutions Discipline Poorly Performing Companies?

- What is the relationship between board turnover and poor corporate performance?
- What is the influence of the size of shareholdings?
- Are institutions more active when they have significant blocks of shares?

Board Restructuring and Corporate Performance

	Worst Decile	Decile 5	Best Decile
	%	%	%
Total board turnover	15.5	6.8	6.4
Executive Directors	21.1	8.1	6.9
Non-Executive	7.4	4.2	4.8
CEO	28.8	11.6	10.4
Chairman	15.8	7.2	5.9
Sample	24	23	23

Who Owns The Firms and Who Disciplines Management?

	Worst Decile	Decile 5	Best Decile
	%	%	%
Largest shareholding	16.9	11.0	17.1
Sum of all large shareholders	42.4	30.5	45.9
Institutions (all)	17.9	17.2	17.4
Industrial companies	5.8	4.8	6.2
Families	3.5	0.9	4.7
All Directors	15.3	6.8	17.6

Forms of Shareholder Activism in the US

- Formal activism at shareholder meetings: recommendations of proxy advisers, filings of shareholder proposals and voting at annual meetings
- Public pressure outside of shareholder meetings in conferences, press meetings, articles, league tables etc.
- Private communications and negotiations

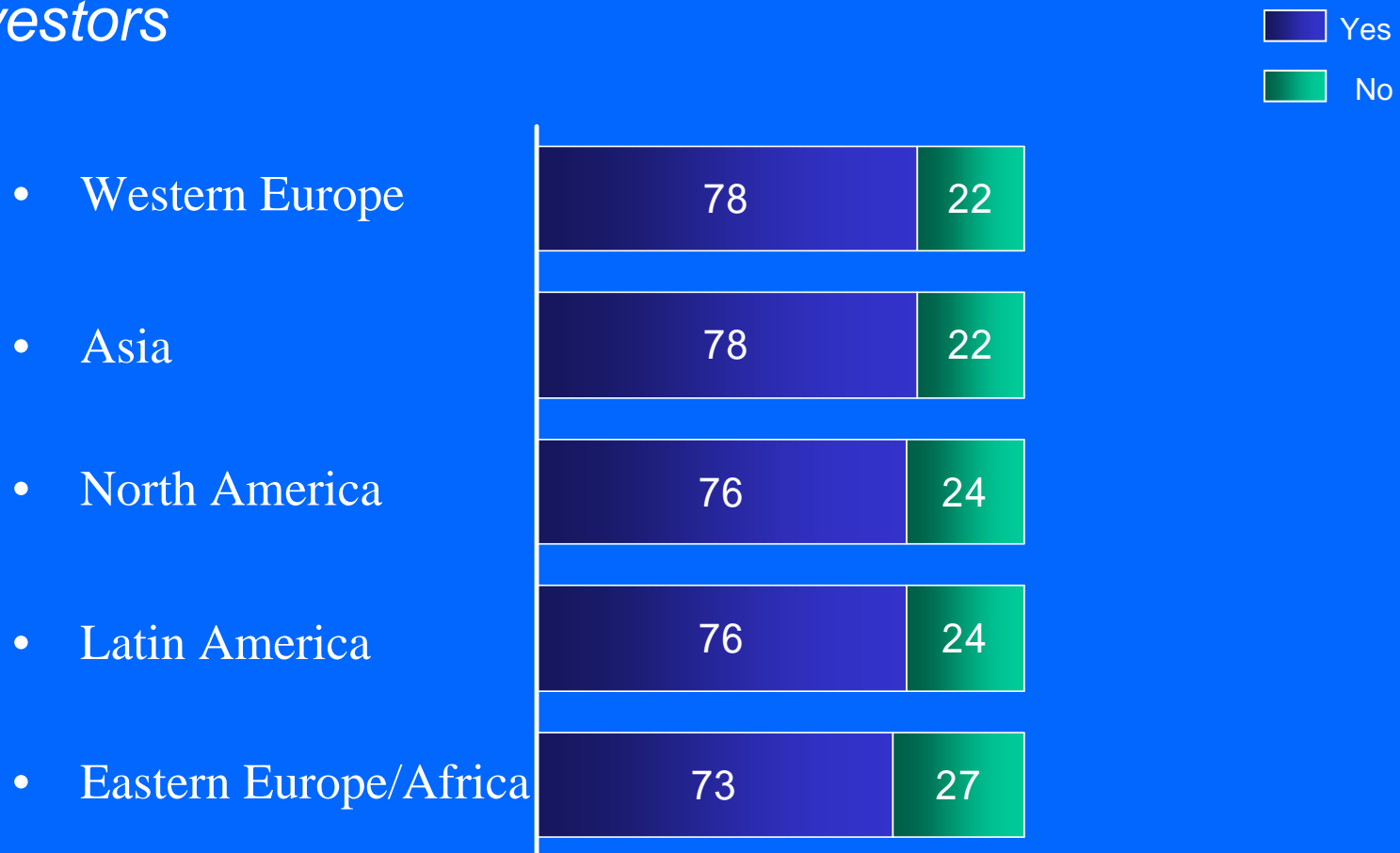
Evidence

“The empirical literature provides little evidence that shareholder proposals create value” (Karpoff (1998))

“A small number of American institutional investors, mostly public pension plans, spend a trivial amount of money on overt activism efforts. They don’t conduct proxy fights, and rarely try to elect their own candidates to the board of directors. The current available evidence, taken as a whole, is consistent with the proposition that the institutions achieve the effects on firm performance that one might expect from this level of effort - namely, not much” (Black)

But Investors Are Willing to Pay a Premium for Good Corporate Governance

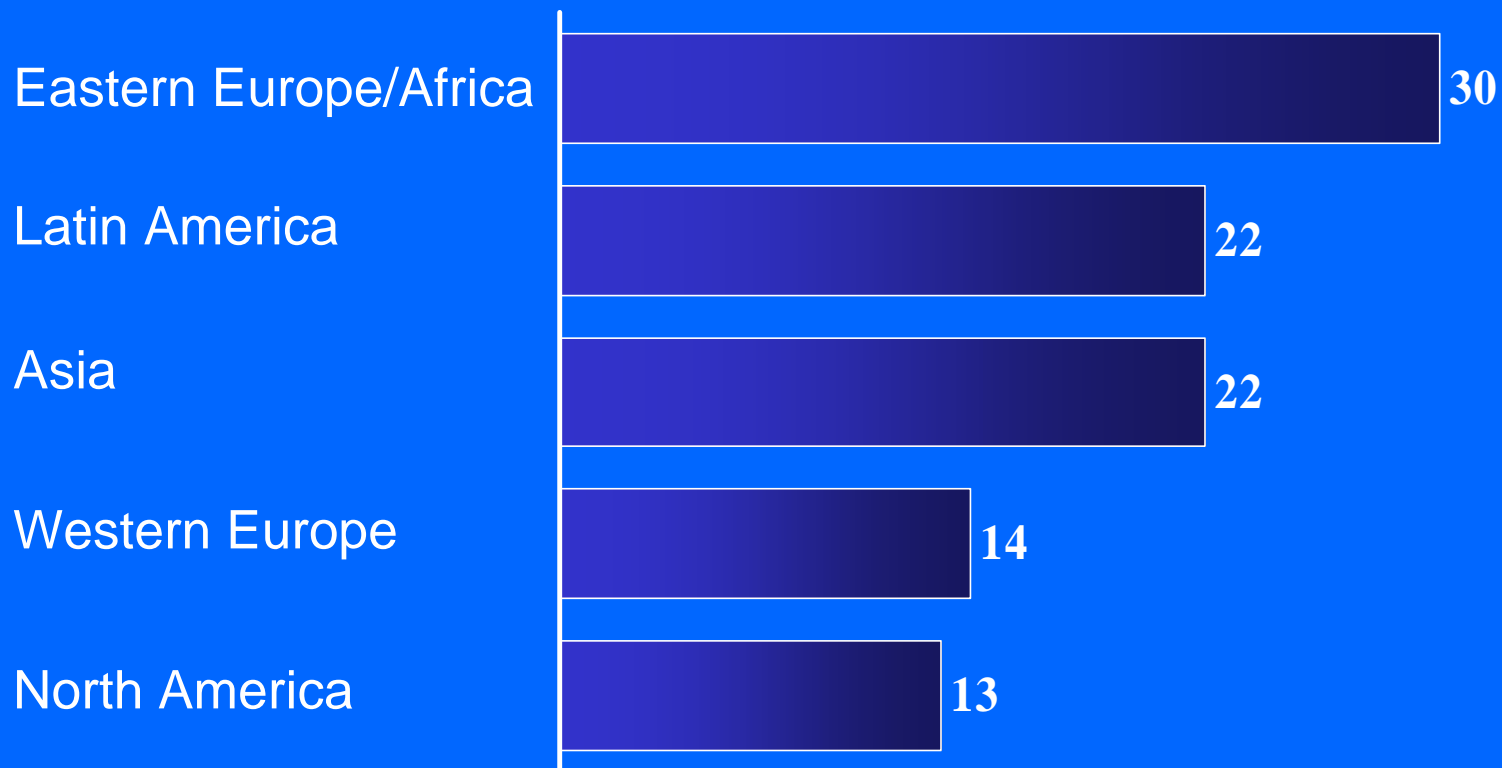
% of investors



Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

And The Premium is Substantial

Premium in 2002



Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

Why The Difference?

- Free-rider problem
- Exit over voice
- Under-weighting and relative performance
- Insider and party in control problem

Is Activism Increasing?

- More active funds: CalPERS in the US, Hermes in the UK
- More coalition formation amongst funds
- More active shareholders meetings
- More opposition to shareholder remuneration: Glaxo, Marconi, Prudential, Vodafone, Wellcome
- More involvement in board elections: ITV, Sainsbury

Is It Successful?

- Smith (1996) examines 51 firms targeted by CalPERS
- On average impact on share prices is zero
- But, shareholder wealth increases with successful targeting (+1.4%). Unsuccessful activism results in losses (-1.6%)
- Performance of UK focus fund is about 28.6% compared with -4.6% for FTSE All Share index over same period

Can There Be Too Much Intervention?

- Rift between institutional and investors creating need for “peace talks between Britain’s captains of industry and top fund managers” (Financial Times, 30 March 2004)
- Repeated concerns about effects of hostile takeovers on short-termism

When Is There Little Intervention?

Interest Cover > 2

	Worst Decile	Decile 5	Best Decile
Total board turnover	9.3	6.2	6.5
Executive Director	8.1	7.3	7.0
Non-Executive Director	6.7	4.4	4.9
CEO	10.0	6.5	11.7
Chairman	0.0	4.3	6.7

When Is There a Lot of Intervention?

Interest Cover < 2

	Worst Decile	Decile 5	Best Decile
Total board turnover	16.5	8.1	6
Executive Director	22.7	9.7	6.4
Non-Executive Director	7.7	3.9	3.6
CEO	30.6	8.3	0.0
Chairman	18.4	13.0	0.0

Who Intervenes in Financial Distress?

- 19 of 34 cases there were new equity issues
- 5% of rights issues between 1989 and 1998 were distressed issues (Franks and Sanzhar)
- Distressed issues frequently associated with change in management – provision of finance made conditional on management changes
- Prudential latest example
- Link to debate about pre-emption rights (Myners Committee)

Is Germany Very Different?

- Much higher levels of concentration of ownership
- Similar relation of board turnover and performance
- Also associated with extremes of bad performance e.g. earnings losses
- And again no relation with concentration or type of owner, including banks

Conclusions

- Weak evidence of institutional activism
- Some cases of well focused intervention being successful
- In general impediments to activism
- Can create serious tension between investors and firms
- Most commonly associated with onset of financial distress
- Is this appropriate?

Policy Implications

- What can be done to improve corporate governance by institutions?
- Legislation regarding, for example, voting
- Legislation regarding corporate governance, e.g. Sarbanes-Oxley
- Greater disclosure of corporate governance systems in companies and shareholder activism by institutions