Understanding Pension Fund Corporate Engagement in a Global Arena:

A Response

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The opinions are those of the author.

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The Four Stages of Capitalism

Clark & Hebb in their paper for this conference analyse the changes occurring in pension fund corporate engagement in terms of the evolutionary model of capitalism with its four stages of effective control:

(i) the first stage where owners controlled the business;
(ii) the second stage where management controlled the business;
(iii) the third stage where asset portfolio managers controlled the business;
(iv) the fourth stage where pension funds controlled the business.

Clark & Hebb argue that the fourth stage has or is emerging currently and that corporate engagement as currently practised is the method for influencing the strategic management of enterprises.

Whilst this model may be applicable to institutions that portfolio managers and pension funds might invest in, it ignores the overall business structure of capitalist economies around the world, and is at best a model of large US corporate controls.

I would also argue that even within the US it is too simplistic, and it leads to a misunderstanding of what has happened and therefore possibly prescribes a model that will result in inappropriate influences on pension funds.

My view is that all of these stages currently operate in most capitalist economies and they are not evolutionary but simply a function of corporate size and economic cycles.

The Evolution of Capitalism: Another view

I would argue that the appropriate model to analyse corporate influences is to acknowledge there are in any corporation various stakeholders:

(i) investors (both equity and debt);
(ii) management(ie employees capable of influencing corporate positions);
(iii) employees (non management);
(iv) customers;
(v) suppliers;
(vi) regulators;
(vii) politicians(government).

and that all of these influence the corporate response to events but in varying degrees depending upon the size of the business, the economic cycle, and the degree of competition .

In my view there is no evolution of enterprise control, but varying influences related to these factors with business size being predominate.

I would divide enterprises into small, medium and large, and would illustrate the operation of the four stages of capitalism within a single time period by considering the following characteristics of businesses:

(i) *Small Businesses*: ownership is still the major driver of corporate responses, although this can be reduced or modified through regulation and political intervention. External investors rarely have any influence;

(ii) *Medium Businesses*: whilst ownership is still influential, it is weakening due to the introduction of external investors (both debt and equity) and the desire by external investors to introduce professional management for shareholder value enhancement and debt provider protection to simply widen the resources available to the enterprise that are appropriate for this level. At this stage management is important but not sufficiently strong to provide themselves with disproportionate benefits to other stakeholders. Employees are also becoming more important in terms of value to the enterprise due to skill specialisations creeping into the business management, and they are able to influence their share of the value being created through unions and similar structures.

(iii) *Large Businesses*: here ownership, especially if it is widely held through some stock exchange mechanism, is seeing reduced influence in the enterprise, and management are then in a position to influence corporate decisions as there is little effective opposition, but you also find at this level there is greater regulatory interest, and greater employee interest.

The influences in an enterprise are not static, and economic or business cycles will affect the extent to which there might appear to be a change in the influence of the corporate strategy, and these are more likely to affect the larger businesses.

In particular, the recent phenomena of what is now regarded as excessive remuneration packages for executives can be seen as nothing more than the result of a cycle of extraordinary profit growth(maybe artificially constructed in some cases) that allowed management to write these terms for themselves, and with very little opposition from shareholders until profits declined.

To consider this attempt to reign in the excesses of the past decade as being some new evolution to pension fund control is naïve. Pension funds held shares and debt in these corporations when the management wrote themselves the excessive remuneration packages and very little, if anything was done about it.

My view is that there has been no evolution of capitalism, with businesses of varying sizes and control mechanisms existing continually with market cycles appearing to create the evolutions.

Political Drivers, a Possible Explanation?

Politics is the art of influencing decisions more proportionately than economically justified. Capitalism and politics are irrefutably linked as stakeholders in the capitalist system jostle for a greater share of the economic cake in a highly unstable system that is continually seeking equilibrium.

With the growth of the importance of pension funds in providing retirement security for employees, and the decline of the state role, the managers of the pension funds have found themselves with a situation where they have a significant increase in the ownership of the larger businesses of the world, and also a position where politically they need to join the jostling to optimise (or just be seen to be Attempting to head in this direction) the share of the economic cake going to their members.

This is the same phenomena that asset managers faced last decade when they also found themselves with significantly increasing assets to manage with the commercial consequence that they needed to agitate for a greater share of the economic pie to enhance their position with investors. This evolution(which I would argue is temporal and not fundamental) is driven b y secular greed, and has nothing to do with the evolution of management control of enterprises.

The activism of asset portfolio managers and pension fund managers can then be explained in terms of market cycles offering a situation that needs changes, and a commercial reality that dictates greater corporate engagement.

The Implications of the Wrong Model

If you accept the Clark & Hebb four stages of capitalist evolution then you are faced with the situation that the major influences on the value of enterprises in the future will be through pension funds and therefore to maximise wealth generation, governments should concentrate on ensuring pension funds get involved in the management strategy of their investments. It should also follow that in terms of social balance, it is the pension funds that should be used to encourage this and the use of industrial courts or processes to manage employee benefits should be discouraged or at least reduced. Undoubtedly the development of the concept of socially responsible investments is behind this concept.

It would also follow from this model that regulation should be aimed at forcing pension funds to take on corporate engagement and that other forms of regulation to manage corporates should be reduced.

Whilst this model may have desirable short term results, it is going to break down once the world returns to a high growth cycle when, based on historical evidence, business owners loose interest in corporate engagement, and the excesses are able to evolve until market cycles dictate they be reigned in.

The appropriate model is one that recognises that you are going to have multi staged businesses at all times, with varying influences, overridden in the case of larger businesses by market cycles. This model would then indicate that government should be continuing to identify where the economy does not create equal balance between competing parties and manage the process to rebalance to the equilibrium.

The appropriate regulatory environment is then one that recognises the simultaneous existence of the four pillars of capitalism, and continues to value all mechanisms equally.

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