

Giving Stakeholders an Investor Voice

Gerard Hertig (ETH Zurich)

December 2014

While changes in investor activism and compensation policies have reduced the shareholder-manager conflict of interests, the benefits of strategies of shareholder profit maximization have been increasingly questioned over the past decade. This debate has generated a number of stakeholder oriented corporate governance initiatives and put institutional investors under pressure to better take into account the overall interests of their constituencies. As a result, institutional investors have gathered and disclosed more information about the social value of their investments. This has been criticized as too small a departure from the shareholder profit maximization approach.

The point is well taken, but does not sufficiently take into account institutional investor diversity. It is not obvious why business angels, venture capitalists, private equity firms or mutual funds should be required to take into account stakeholder interests. By contrast, it makes sense to give pension fund beneficiaries a voice regarding stakeholder investments. More specifically, in jurisdictions or pension plans where asset allocation is fully delegated to pension fund managers, beneficiaries would be given three options. The default option would preserve the status quo, i.e. complete reliance upon pension fund manager discretion. Beneficiaries would be given two distinct opt-out opportunities. One would be to have 20% of 'their' capital fully invested in those of the pension fund's assets that are more stakeholder value oriented. The other would be to devote said 20% to the pension fund's more shareholder value oriented assets.

This setup has several advantages. First, it provides a choice that allows beneficiaries to express their risk and/or policy preferences without fundamentally jeopardizing their retiree income. Second, it preserves pension fund managers' investment discretion; in particular, the opt-out opportunities do not require them to invest in assets they are not familiar with nor does it increase their monitoring costs. Third, it allows for regular rebalancing or change of beneficiary choices. Admittedly, implementation may prove problematic in situations where it is not easy to distinguish between stakeholder value and shareholder value oriented investments. This may, in particular, be the case when investments that were considered stakeholder value oriented when added to the pension fund portfolio (e.g. 'green' or 'social' investments) end up being more profitable than investments originally considered shareholder value oriented. One solution could be to ignore short-term performance and simply rely on regular pension fund portfolio adjustments. Another solution could be to consider this evolution when doing the yearly rebalancing of the 20% options.