

# The New Global Investors

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**Bob Monks is an almost legendary figure in the field of corporate governance - a campaigner for improved corporate accountability for over twenty-five years.**

During the Reagan Administration he served in the Department of Labor as Administrator of the Office of Pension and Welfare Benefit Programs, and was largely instrumental in requiring US pension funds to utilise their shareholder voting rights. Monks has been a partner in a Boston law firm, and served as vice president of Gardner Associates, an investment management company. He also served as a board member and chairman of the board of the Boston Safe Deposit & Trust Company and the Boston Company.

Bob Monks was the founder of Institutional Shareholder Services (ISS), serving as its president from 1985-1990. ISS is now the leading US corporate governance consulting firm, advising shareholders with assets in excess of \$1 trillion on how to vote their shares. In 1992 he launched Lens Inc, an investment fund which pioneered the concept of taking stakes in under-performing companies and using shareholder activism to press for change. Over its life Lens has consistently achieved returns in excess of the Standard & Poor's 500 average, the main US equity benchmark. In 1998, he founded Hermes LENS Asset Management Company in partnership with the BT Pension Scheme to promote the same investment principles in the UK.

He has now written a new book called *The New Global Investors* (Capstone 2001), which argues that institutional investors should use their ownership rights to enforce more responsible behaviour by large corporations. I called on Bob Monks to discuss his work and the new book. At first sight he hardly looks an obvious candidate to upset the corporate apple cart, being a scion of an old-established New England family, a graduate of Harvard College, and of Harvard Law School. He is also at an age when many people would be enjoying a quiet retirement. I asked him what drove him on:

'Well, I've been working in this area for twenty-five years and have now written five books on the subject. The key point is that we have inadvertently created a monster called the limited company. What we need to do now, and I see this more and more clearly as time goes on, is to integrate the normative values of society with the economic efficiency provided by the capitalist system. Company are complex adaptive systems, and increasingly they are driving the economic system for their own ends rather than for the public good.'

Bob Monks has also played a major role in developing thinking on corporate governance, concurrent with his shareholder activism work. In 1995, together with Nell Minow, he wrote *Corporate Governance* - in my opinion one of the best books ever written on this subject (Blackwell). The book is an exhaustive 550 page tome setting out the crucial importance and key issues of corporate governance. In recent years he has broadened the scope of his inquiries, moving beyond the relatively specialised field of corporate governance to address broader

questions of corporate social responsibility. This was first tackled in the book *The Emperor's Nightingale - Restoring the Integrity of the Corporation* (Capstone 1998). In that book Monks gave a strong warning that:

'The key advantages of the corporate form - limited liability and a vastly extended capacity for raising capital - have in turn led to the development of a corporate culture far removed from the greater concerns of individual owners, with a resultant focus on near-term growth and profitability. The tendency of large corporations to organise themselves around short-term interests is increasingly a matter of public concern...the corporation is an entity so powerful that it quickly outstripped the limitations of accountability and became something of an externalising machine, in the same way that a shark is a killing machine - no malevolence, no intentional harm, just something designed with sublime efficiency for self preservation, which it accomplishes without any capacity to factor in the consequences to others....these externalities range from the costs of training, medical and disability expenses arising from work, to unemployment, and impact on the environment.'

His new book continues the shift in emphasis in Monks' work away from technical corporate governance issues to wider societal and ethical considerations. For many years socially responsible investors (SRI) have used the ownership rights attached to their shareholdings to press for better corporate behaviour in areas like environmental pollution and respect for human rights. (This is more true in the US, where ICCR has run thousands of socially responsible shareholder action campaigns over the last thirty years, than it is in the UK.) It is striking that Bob Monks sees a growing overlap between corporate governance and SRI. I asked him about this shift towards ethics in his work.

'It's true that this is a relatively new area for me in the context of my writing. In fact it was Peter Drucker who convinced me just a couple of years ago that corporate governance was essentially just one aspect of investment. However, questions of business ethics have always concerned me. Years ago I took over as Chief Executive of a small coal mining firm. After a couple of months a miner died, and I was informed that the industry statistics suggested that a man would die in our mines every three months. I got out of that business as quickly as I could.'

*The New Global Investors* expands upon the concerns expressed in Monk's previous book. An early chapter entitled 'the problem' argues that many of the problems of modern life such as environmental pollution, unsustainable levels of debt, workplace injuries and the collapse of local communities, can be attributed to the insatiable desire of large corporations to make ever-higher profits. Companies do not deliberately intend to bring about such evils, but the book asserts that they are an inevitable side-effect of the corporate drive for profit-maximisation resulting in as many costs as possible being 'externalised' on to society, i.e. onto the rest of us. Nor is government regulation much use; for large, powerful companies the rewards for breaking the law may well significantly exceed the costs of any likely penalty for doing so.

The author is genuinely worried that such behaviour, and in particular the egregious levels of executive pay, are leading to a 'crisis of corporate legitimacy' that could ultimately lead to adverse societal and political restrictions on modern business, reducing its undoubted potential to

generate real wealth. I asked Monks whether his practical shareholder activism work had helped develop his thinking on corporate governance:

' Absolutely yes, I would never have got there without it. Look, the real "smoking gun" that tells you that something is seriously wrong is the question of executive pay. In the 1990s the average American Chief Executive saw his pay rise six-fold, far more than the growth in profits. The ratio of the average CEO salary to that of the average factory worker is approaching 500 times - something that is obscene.

Such greed is siphoning off a lot of the benefits to society of increased productivity into a relatively few hands. It is also leading to growing "anti-capitalist" resentment that threatens our existing free-market system; we certainly don't want this to result in a return to heavy government regulation of the economy. In a free society, institutions rest upon the popular belief in their legitimacy. I'm worried that discontent with business is growing among ordinary people. The agitators who demonstrated in Seattle, Davos, Gothenburg may have been just the tip of the iceberg.'

The 'solution' put forward in *The New Global Investors* is that the large pension funds, 'Global Investors', who increasingly possess material stakes in the world's largest companies should recognise that they alone have the effective power to make global business work in a responsible way. The book calls for a broader interpretation of the traditional 'fiduciary duty' which governs the running of such funds duty to include issues of social responsibility. This is already starting to happen as a result of pension fund SRI regulations adopted in the UK, and subsequently copied in Sweden and Germany. In particular, such funds could appoint their own independent representatives to boards to ensure that companies are indeed run on behalf of all shareholders. This is textbook economic theory, but a model that does not seem to be followed in practice. Monks is scathing about this, complaining that in the UK and the US the plain fiduciary duty of pension fund trustees and their specialist advisers to act solely in the interests of their beneficiaries has been 'watered down' to 'the point of inaction'. I suggested that the need for independent, expert advice was particularly true in the case of executive compensation plans, most of which were so complicated that it was difficult for outsiders to understand them:

' Too right - the point is that the complexity is deliberate, so people don't realise how much money these guys are making. People say that executive pay is a free market, but it is a rigged market - essentially the board, led by the Chief Executive, appoints and pays the consultants who determine executive pay. No wonder that this has soared in recent years. The only way out I see for institutional investors to assert their rights of ownership, and appoint an independent remuneration expert reporting directly to them. That way you would get an independent assessment.'

*The New Global Investors* advocates five basic principles of corporate governance, based upon those agreed by the OECD in June 1999. They are the following:

1. **The corporate governance framework should protect shareholders' rights**, i.e. they should receive timely and accurate information about a company where they are investors, and they should also have the right to participate in major decisions.

2. **The corporate governance framework should ensure the equitable treatment of all shareholders, including minorities and foreign shareholders,** i.e. in particular, members of the board and executives should disclose any material interests in transactions.
3. **The corporate governance framework should recognise the rights of stakeholders in corporate governance,** i.e. there should be co-operation between corporations and stakeholders on issues like jobs, the local communities, suppliers, and the environment.
4. **The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation.** This includes ownership and governance as well as financial disclosure, and information material should be audited.
5. **The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.** This clause really reflects older corporate governance principles that the board should act as an independent 'watchdog' over senior management, and carefully protect the interests of shareholders. (See the UK 1948 Companies Act for example. It is clear this Act never envisaged that the complexity of modern business would lead to the existence of powerful chief executives who could dominate the board of their company as they saw fit.)

The last section of *The New Global Investors* describes the final piece of the jigsaw needed to reassert corporate social responsibility - better accounting and auditing practices that force companies to accurately disclose the 'externalities' that they are currently loading on to the rest of us. The book describes the growth of the Global Reporting Initiative (GRI) that since 1997 has attempted to develop detailed sustainable accounting guidelines covering social, financial, and environmental factors - often described as 'triple bottom line' reporting. Critics of social reporting (and social investing) often argue that you cannot measure 'soft factors' like social welfare. However, the same thing was said about environmental accounting ten years ago. As I write proud names in the US construction and chemical industry are filing for Chapter Eleven bankruptcy protection on account of asbestos litigation going back over thirty years. It is becoming increasingly obvious that it is negligent not to disclose potential environmental liabilities, and the same will surely be true for social factors like health and safety, working conditions for overseas suppliers etc.

Bob Monks is surely right to suggest a combination of his suggested measures would move us a long way to solving the problem of increasing unease about corporate legitimacy. To sum up these include: a broader interpretation of pension fund fiduciary responsibility; a more developed interpretation of corporate governance, as described above, and accurate triple bottom line reporting. I have made similar suggestions myself, particularly that large institutional investors, who cannot easily sell all their shares in most companies in any case, should agree to dealing limitations similar to those imposed on senior executives, in return for appointing an independent 'relational investor' representative on to the board. Such suggestions have normally been dismissed on the grounds that this would lead to major problems of conflict of interests between the duty owed to the company and that owed to shareholders. I put this point to Bob Monks:

'People have often made this objection to me - it's just horse manure! What about the conflicts of interest between the investment banks, hired by the company, when they give estimates of 'fair value' for transactions involving the management, or compensation consultants, also hired by the company, on setting executive pay. But there is a real issue here which does need addressing - that is the potential conflict of interest within the asset management business, where investment management firms often have a number of commercial relationships with companies.'

Interesting man, interesting book.

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**For further information please see Bob Monks' website:**

[http://www.ragm.com/library/topics/global\\_investors.html](http://www.ragm.com/library/topics/global_investors.html)