The Economist

Asset managers get involved in the companies they own

Index-tracking funds take a more hands-on approach to corporate governance

EXECUTIVES have grown used to being nagged about their company's strategy and governance by all and sundry. Activist hedge funds targeted 524 companies worldwide between January and June, compared with 570 in the whole of 2013 and 805 in 2017, according to Activist Insight, a research firm. Last year two big index-makers, S&P Dow Jones and FTSE Russell, excluded firms with multiple share classes from their flagship indices. On August 22nd Glass Lewis, a firm of "proxy advisers" which advises shareholders on how to vote, gainsaid the management of Sports Direct by urging the British retailer's owners to evict its founder, Mike Ashley, from the board. Now hitherto quiescent big asset managers are sticking their oars in as well.

Institutional investors, which own the largest stakes in most listed firms, have conventionally deferred to proxy advisers in matters of corporate governance. A positive recommendation from Glass Lewis or Institutional Shareholder Services (ISS), the two giants of the shareholder-advice industry, can raise the vote in favour of a motion on board appointments, executive pay and the like by up to 20 percentage points, according to a recent analysis by academics at Stanford University.

But big funds do not always blindly follow proxy advisers' suggestions. BlackRock, the world's biggest fund manager, overseeing more than $6trn of assets, is putting more emphasis on "stewardship": active engagement with firms it co-owns (and, in the case of index-tracking funds, from which it cannot divest). It employs only 35 people to liaise with firms' management and decide how its passive funds should vote, but that number is likely to double in the next three years. State Street Global Advisors, another big asset manager, boasts that last year it managed to shame a number of companies without a woman on their boards to hire some.

As well as their separate efforts to become more involved in the companies they own, asset managers are also banding together. Focusing Capital on the Long Term, an organisation founded in 2016, wants to reduce short-termism in investment, for instance by abolishing quarterly guidance. Its members include asset managers and pension funds, as well as companies like Dow Chemical, an American firm, and Tata, an Indian conglomerate. In 2017 a group of 50 investors, among them BlackRock, State Street, Vanguard and Elliott, a prominent activist fund, as well as the state pension funds of states like Illinois and California, launched a stewardship "code" for America, the last big advanced economy to lack one.

Institutional investors in British-listed firms have gone a step further. In 2014 a group of them founded a body called the Investor Forum to allow them to approach specific firms while avoiding legal restrictions on shareholders acting "in concert". Its 40 members include British fund-management firms such as Legal & General and Schroders, and foreign giants like Capital Group and GIC, a Singaporean sovereign-wealth fund.

Since 2015 the Forum has looked at 34 problem cases and spoken directly with the board in 22 of them. It intervened at Rio Tinto when the miner was picking a new chairman, and at BT, a telecoms firm, about poor capital allocation.When TCI, a strident hedge fund, alleged that the chief executive of the London Stock Exchange had been ousted against his will, the Forum helped investors obtain the information they needed to decide whether to support the board's position.

The Forum does not forbid members from acting independently. Rather, explains Andy Griffiths, its head, it serves as an "escalation mechanism" when firms ignore individual investors or exhibit problems that worry many shareholders. Executives can expect to receive more such earfuls from investors, whether they are acting solo or in a chorus.

This article appeared in the Business section of the print edition under the headline"Passive, aggressive"