futureperspectives

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There is a need to challenge conventional ways of thinking, especially withinthis sector. Are we creating platforms for these types of conversations? Are we sharing knowledge and information to help shape the future? What actions can be taken? These are hard but necessary questions.

Jon Duncan
Responsible investment at Old Mutual

How we invest today has a bearing on the quality of our future.

Jon has been able to bring a perspective of what is happening on the ground within businesses in South Africa, and has encouraged an open thinking of connectivity of people who are living in a bubble instead of the society that we find ourselves in. This is evident in the way that people's thoughts are being shaken. We are living on a planet that is interconnected and filled with complexities and ambiguities.

The Economic system has a direct impact on the Socio-political and Bi physical system, and these systems also have an impact on the Economic system in return. What is the purpose of the actors in the Economic system? Currently African cities need to adapt to an explosive system of people arriving into these cities, for instance, how do water systems accommodate for this?

In South Africa we sit as a poster child for global income inequality. The consequence of this, historically, is that it is a drag on grow. Income equality is not good for safe functioning of the markets system.

A Planet Under Pressure by Will Steffen
Shows over time a consistent acceleration through the use of graphs. From 'Amount of Domesticated Land' to 'Tropical rain forests' and 'Mcdonalds restaurants'. The question of 'what is the impact of this on the current capacity of the planet' has vexed scientists for a long time. Through a collaboration of work done by 40 universities around the world, which was put together by the The Stockholm Environment Institute, looked at the current capacity of the planet and the system limits, which led them to identifying a whole series of hard scientific measures that tell us about the carrying capacity of the planet. The purpose of looking at the planetary boundaries, the capacity of the earth and the carrying capacity of the planet, is to see the connectivity of the different bio, physical socio economic systems and their relevance to the market.

The idea that there is a finite amount of resources on the plant and that we are impacting the safe functioning of our biophysical systems is a hard issue to communicate to people. Through mapping out the hard scientific measures and setting limits they came up with a specific limit of safe operating space for humanity. When exceeding this limit, we can see catastrophic non-linear system failures. I.e. we don't know what will happen next..

How does climate change effect the Markets?

The Carbon Tracker Initiative reports that there are implications of climate changes on Global Listed Markets. For example, if you are a listed company and you have fossil fuel reserves (an oil company/ a coal company), from an accounting perspective you can carry the reserves on your balance sheet as an asset. It is something visible on your balance sheet. One could then go to all of the other companies on the stock exchange and back out exactly how much carbon dioxide they have on their balance sheet. With the volume of the atmosphere we can calculate how much more carbon can fit in the glass, until we hit the limit.

The global debate is then; who gets what slice of that budget?

It can be seen on balance sheets of the worlds companies with the biggest resources who have more carbon than we can burn, this leads to the idea of there being a carbon bubble in the market and as market actors how should we start thinking about this? How do we navigate into a world where this is all changing?

After the global financial crisis tough questions were raised. Can the market self-regulate for greed and avarice? Can the market actually promote social equality, environmental resilience and economic prosperity all at the same time?

The United Nations Principles of Responsible Investment was 'born'. It's a simple proposition of if you are going to manage money with a long liability horizon, look at the world through a sustainability lense, price, risk and opportunity, and show up as a responsible steward of that money as an asset. If this is done, the system will move towards a more resilient state. Recently the PRI have had to ask themselves how can they be more intentional about having impact. Which is a hard discussion to have.

The money Old Mutual gets is from other people, so they can't set global targets of sustainability on what they want to do. However, it doesn't work that way within the investment industry. These global targets can't be set, rather one needs try to find the money for it. The conversation is then with their parent life company. With questions of what role do we want to play in society, what is our purpose, and specifically what should we leave out? The business gets into a space where they need to start thinking with their own beliefs and ethics.

If you are managing someone's money you are acting as a fiduciary. Historically the definition of being a fiduciary was to maximize return at any cost. A global review done over 9 years is showing that a role of a fiduciary is to consider these issues.

Responsible investment is a voluntary, aspirational movement and journey that the financial services sector is wanting and trying to go on. It's trying to look at the world through a sustainability lense, and it's trying to show up as a responsible steward of the assets. This requires action from asset donors,

investment managers and asset consultants.
An Asset Managers could say it's not in the legal mandate (which gets given to him) to invest in sustainable ways and that there isn't enough academic research and evidence to show that it will bring return. The Asset consultants say the same thing, and that they wrote the mandate but they didn't sign it off. When speaking to the trustees of the pension fund who are the ones that signed it off, they say that actually we only act on behalf of our beneficiaries and you must go speak to them.

It's all very difficult because Responsible Investment is not a legislated thing (it kind of is), but rather, it requires action by everybody, and requires people to start acting with a different way of framing the purpose and role of a business within society. When looking through a sustainable lense and acquiring insight into environmental, social and governance issues, we will gain a deeper understanding of the ability of a company to generate sustainable cash flow into the future. By doing this we can see that a balance sheet and income sheet doesn't give deep enough insight into the long term value of a company.

Intangible value slide (looking at how business think about these things); tangible assets and intangible assets

There are many things that sit in an intangible bucket that an analysis sheet can't give us a view on. Understanding how companies act around these elements is critical. Jon works with analysts to try and build the lense for these things.

Sustainability is a macro-thematic trend, which is fundamentally reshaping the complectivness of every single landscape globally, including the academic industry. If companies and organisations can respond to this trend early, relative to their peers that don't, they should start to show a strong and longer competitive advantage in the long run, and therefore should be a better investment.

Yet all of the risks, income equality, job creation, unemployment, climate change sit in the future, so how do we understand that? UK Actuary Society in 2013 looked at 'future looking' models around risk. The Modern portfolio construction theory says that you can dial down the risk of your portfolio by adding more fixed income instruments. Fixed income and infrastructure may be the one area that is physically exposed to a changing climate. By increasing fixed instruments on your portfolio the consequence of the physical impact of the changing climate, the returns, which are modeled, have actually gone dead.

The Meta studies (studies of studies) show us with increasing clarity that thinking about these issues is not a penalty, but if used correctly it can enhance returns in the long run.
It's not just coming from the academics; brokers are also putting out research. There is a lot of research from financial houses looking at ways of stewarding into these parts of the economy.

What are some of the things that we really need to be thinking about with respect to some of these long term investment trends?

Asset Consultants are starting to think about how they need to respond. They have started telling their clients about it. Stock exchanges are responding by saying the companies listed on the exchange need to provide more disclosure. The integrated reporting framework is evidence of a shift in the Global discourse, it says that companies that are going to have value into the future are those that are able to carefully articulate the manner in which they contribute or take away from the value of national stocks of capital. A different conversation about how we think about value is starting to emerge. There is also innovation within the fixed income markets around Green Bonds, e.g. Future Growth who buys the issued debit of companies. The problem with them is that you don't have a line of sight as to where the profits go. A Green Bond recognizes that a shift needs to happen towards a Green Economic growth outcome. This is an increasing and growing market, with the biggest player in this market being municipal cities in the US. At the same time there is an emerging conversation of the next generation of buyers of financial products, who want to know what is in a product and how much risk there is of carbon assets within that portfolio. How much of their revenue comes from companies that are impacting society and the environment? Therefore, there is an opportunity to start building products that can morally serve the needs of young buyers, but who then can also be part of this shift in conversation.

Investors are quite limited in in South Africa. For example, you can't really invest in low carbon energy in the South African Stock Exchange. If you want to invest in renewable energy you have to go to the Private Equity Market. Having more influence in the South African invested market, is more about raising the bar of quality of governance. It's not only about having company level engagement, but also having market level engagement.

Old Mutual has been trying to innovate around index products. What is next after renewal energy, affordable housing, agriculture. How do you invest in water?
Old Mutual in being a responsible investor, are trying not to be an absent landlord in the market. Being an active steward of your capital is being strongly supported by academic research.

Discussions:

What key instruments are you using to measure the organisations you work with to make quantitative, qualitative and analytical decisions? There are lots of third party data providers available, which Old mutual makes use of as service providers. They currently use MSCI after completing a due diligence on six different providers. The MSCI model was favored as they use Intangible Value assessment framework. Their model asked one question; what are the externalities that this business model carries and what are the impacts of internalizing the costs over time. It's a peer rated scoring system.

If you want to invest in the South African market, you are probably going to be invested into every sector. So their sustainability lense gives them a chance to separate the sectors out into 'who is doing better than the rest from an ESG perspective?' You then slowly start to direct capital away from those companies with poor ESG practices which then becomes a self-fulfilling theory in respect to the cost of capital which goes up for those that are poor performers, i.e. their share price drops.

Announcement of a 'Green fund/Green Portfolio'? A lot of what Old Mutual do is oriented towards the Institutional market, they have a spectrum of ESG index funds which have been developed over the last 3 years. Plus, a renewable energy fund, affordable housing fund, a school's fund, agricultural fund and now a retirement fund. These are funds that are seeking out investment opportunities as well as an intention impact outcome. The goal is to get to the retail market with a balanced investment product.

Cookhouse Wind farm – Is said to be planning to release money to the community over time, which is good on paper, but given the social context within the South African environment there is fear when those funds are released, as the governance capacity within those rural areas are very low and we live in a country that is full of corruption. How are we going to manage the social risks of this? As an investor (Old Mutual) what can you do and what are you doing to put standards, systems and capacities in place so that it's not a waste?
It is a massive social risk, and how Old Mutual has articulated it to their investors is that failure to deliver on the socio-economic requirements of those funds puts their power purchase agreement with the government at risk, they are wanting to be a part of it. They aren't the only funders of Cookhouse. People's personal sense of leadership come into play, they have to show up.
But it is a challenge.

Suzette Viviers
University of Stellenbosch

Has the time arrived for greater public investment activisms?

What does the term **Activism** mean – *Sarah Scarth describes it as standing up, doing something about something which you feel passionate about. She wouldn't have put activism and Investment together. Warren Lodge suggests that it's about voting with your pocket.*

To give it a formal definition investor activism particularly talking about the shareholders and owners of a company use their equity stake to influence change, they use their shareholder rights to put certain corporate policies in place.

If they are unhappy, there are two big strategies that they can employ. The first being the selling of their shares (voting with your pocket), known as a divestment or an exit strategy. However, this isn't a popular option in South Africa because we have a small investment market. If you divest you have a smaller portfolio that has diversification consequences. In the US and bigger markets, exiting is a strategy that can be used. The other strategy and the focus on today is having a voice, making a stand for what you believe in.

It is important to distinguish that there are private and public forms of voice when it comes to investor activism. The private voice is when shareholders write letters and emails to managers, these are private and confidential. As well as negotiating behind closed doors. In contrast to that, it is often the smaller investors being limited to public forms of activism. This is done through attending the annual general meeting and then when it is time for questions, they can stand up and ask questions about burning issues.

What does resolution mean? Colin Habberton defines it as when a shareholder makes a formal engagement with a board of directors requesting a certain action or a certain decision be made by the company's direction and operation. Taking it further, at the AGM the other shareholders have to vote on the proposed decisions. This is also not common in SA as it is sometimes costly. Voting can also be against certain resolutions. Through this public activism, the media can be used to raise certain concerns.

What is a Proxy contest? It isn't popular in SA but is in the US. It's when a shareholder disagrees with the way that the board is being run. They would then suggest their own directors and at the AGM vote against the company's nominations and propose their own nominations. This is a form of public shareholder activism.

Activism is one of the strategies that social and responsible investment can use, along with norm state screening and ESG integration. Terms used within these areas are usually engagement and voting.

In the US in the 1940, there were a lot of Churches and religious organisations who started speaking out about Human Right abuses with in companies. In the 80's we have more institutional investement. In the 1980's shareholder activism really took off, where a lot of institutional investors (from the US and Europe) divested, boycotting the South African market. Which then became a corner stone of anti-apartheid campaign in the US. In the 2000'S onwards, there was a raise in hedge fund activism. This kind of activism, where investors take a very aggressive, short term, self-interested, financially oriented approach has been widely criticized. To such an extent that they are called 'barbarians'.
An article in the Harvard Business Report describes 'defending a good company from bad investors'.

The King II Report (2002) kick started the conversation of activism within a

South African context. Why should shareholders and investors take on more responsible stocks? Investors didn't realise the power they had, which, to an extent, is still true today. The challenges were that companies don't report properly. How do you question them if you don't have information? There is also a lack of skills in knowing how to take them on in public or how to get access to management? Activism requires resources, it takes time and it needs research. It's also an unfavorable cost benefit analysis.

Some investors intentionally avoid engaging companies because they have concerns about salaries, pension funds and power. It's a mindset. There have been certain developments; the implementation of UN PRI, the new Companies Act, King III and certain changes in regulation (Regulation 28 of the Pension Funds Act and the CRISA). A lot of development is taking place emphasizing the importance of activism. But it is still not widely embraced, and it has been said that the South African market still needs to mature before it can be ready to respond to shareholder pressure. There is a lack of understanding of the benefits of activism. Those institutional investors who did engage prior to King IIII mainly did so behind closed doors. Investors weren't interested in voting, and in most cases they just agreed with decisions proposed by management. Very few were for voting, and very few were excited and serious about proxy voting.

Theo Botha has a long history of critising and questioning, and has questioned many companies, who told him to go away. He then went to the media which caused the price of the company to drop dramatically. Nobody is actually holding managers accountable. Through a study of the companies targeted, a researcher concluded that Botha has a 'sting'. Share price falls, reputation is damaged, it hurts. There are companies who see his work as good and can be used to see future problems. Quite a number of Institutional Investors are starting to engage, but they do so in private.

In South Africa specifically, there is a high level of investor protection from a legal point of view. Because the market is so small you want to rather build trust and maintain relationships, as well as protect reputation. The size of the market plays a role.
Investing companies are more likely to cooperate if it is in private, if they aren't publically named and shamed. One on one engagements are more productive, plus they are more cost effective. So there are some arguments in favor of private activism. Yet there are draw backs as well, in most countries it is only the really big stakeholders that get access to management, which is a serious limitation. Therefore, some investors are left in the dark. How do managers respond? Do they make commitments to change? Are they being held accountable?

'Private activism can leave many stones unturned.'
'Public Activism is not the South African way of doing things.'

For a lot of institutional investors there are conflicts of interest.

In a case study of Andrew Cater in August 2016, who spoke out in public about not rolling over debt and not sending new debt to these 6 state owned entitles (due to particular uncertainties):

Transnet, The South African National Roads Agency, Eskom, Industrial Development Corportaion, Landbank and Development Bank of Southern Africa.

Social media showed two extremes 'Racist' and 'You are a responsible investor; I am going to move my money to you'. But reputation and trust was damaged.

Activism has different shades depending on what you own. If you own an equity of a company, you are a shareholder and have the right to vote at the AGM. For Futuregrowth, they don't have equity rights, they don't go to the AGM, they don't vote. The get asked to buy debt and they say yes or no, so the kind of engagement with the debt market is very different. The consequences of this public activism on Futuregrowth were negative responses, and it lead them to choosing a private approach rather, and getting legal advice first. For Landbank it allowed them to issue 3-year debt, allowing their ability to raise debt in the capital market much stronger.

In 2016 King IV gives much more emphasis on shareholder activism, obligating companies through the JSE listing requirement, through remuneration policies and publically disclosure on certain details. This has resulted in more against-votes on remuneration policies and more questions being asked. People's minds are changing in South Africa, and there is a growing willingness to speak the truth.

Is it time in South Africa for more public activism?

An ambiguous answer; it depends. If you are big enough as a shareholder and can access management – go private. If you are a bond holder, you are limited. But if your private engagements are not successful, there is nothing stopping you from going public. If you are small, you have no choice but to go public. But how should you do this to avoiding harming your reputation? 'If you think you are too small to make a difference, you haven't spent a night with a mosquito'. Use the media as your ally. Use publicity wisely and not in a way that could be harming your reputation and those you relate with.

Another benefit of speaking out in public, is that it deepens discussions about how we can better our society, and industry specific concerns can be addressed at the same time. As well as the opportunity to hold managers critically accountable.

Civil society, our young people in particular, are ready and energetic for the change that South Africa needs. They are demanding transformation, we are seeing more investors, shareholders and bond holders becoming active owners. However, there needs to be a balance between striking their rights and being responsible investors. We don't want the US style of the hedge fund activism; it should not be taken under expense of society. There are a number of challenges that remain; complex business relations, lack of skills and lack of collaboration. Why do we only have Theo Botha? Education is so important for these things.

Discussions:

It was stated that the level of activism is increasing in SA, and it can be seen by social media and through the marches/protests that are happening. But we are also seeing that these new found ceilings of activism are being jeopardized by the political drama that is playing up in this country. It is almost blurring the lines of what people are trying to achieve, some NPO's which have clear and decent agendas which are being hijacked by political activists/agenda's which are then being tarnished by things that they never intended.

If we look at the communities which we work in, many times we make an assumption that they need a public and private sector to deliver a service or make their lives better, and that they don't have the ability to organize themselves, to create good for themselves. What is required is a common agenda within the context of a particular geographical area/s. This needs to be placed on the table within that area and all the role players who work within this area need to collaborate around the common agenda. With the investors coming in from a different side there needs to be an understanding of the context in which they are investing. For example, investing into a school but not understanding the broader context, the macro and micro environments which is being invested into. So what is required to ensure that that investment can be sustainable? What other role players need to be in place for our work in those areas to be successful? An understanding of the macro and micro environments from a non-profits perspective is needed.