The Systemic Governance Influence of Expectation Documents: Evidence from a Universal Owner

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with

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Instutional Investors & corporate governance

• Institutional investors have multiple governance mechanisms to exert influence on their portfolio firms:
  o Negotiate with boards
  o Request board representation
  o Voting
  o Shareholder proposals
  o Launch proxy fights
  o …

• We analyze a new growing low-cost activism tool that aims to influence the entire portfolio of an investor: expectation documents
Expectation Documents

- Documents in which investors publish their expectations (preferences) on a particular topic, so firms in their portfolio address them

- Topics: climate change, CSR, corporate governance…

- Special features:
  - New growing activism tool
  - Cost-effective
  - Influence the whole portfolio of an investor
  - Investors publicly commit and this may increase the impact on firms
Expectation Documents

Which investors have used them?

- BlackRock, Norwegian SWF (NBIM), Vanguard, Japan’s Government Pension Investment Fund, platforms such as the Climate Action 100+, PRI…

- Primarily, universal investors (large global investors that have a substantial share of all listed firms in their portfolio) that have limitations for active monitoring
Expectation Documents

Why universal investors?
• Investors can diffuse their preferences to the entire market (cost-effective)
  • Creates potential for systemic change
  • Can coordinate firms into a new equilibrium

• But, investing in a broad set of firms
  • May diminish influence as threat of exit is less likely
  • Reduces incentives for stewardship

Expectation documents are becoming a common tool to deal with this trade-off

• Interactions between expectation documents and active ownership characteristics
  • Complements: can exit and stewardship, reinforces expectation documents
  • Substitutes: Do expectation documents reach where other tools don’t?
Our research:

Use an unexpected change in the governance preferences of Norwegian Bank Investment Management’s (NBIM) to see its impact on firm’s governance.

• November 2012: NBIM releases an expectation document with emphasis on effective corporate governance.
  - Board accountability and composition
  - Equal shareholder voting

• Research questions:
  • Did firms react to the change in preferences?
  • Did NBIM really target its investment to its newly stated specific preferences?
Main Findings

- **Firms** reacted by targeting the new governance preferences of NBIM
  - NBIM’s influence:
    - grows with its share of firm ownership
    - uniform across the share of the firm in NBIM’s portfolio
  - Heterogeneous effects informative about the complementarity of expectation documents with exit and stewardship

- NBIM’s **investment strategy** aligns with the announced preferences. After the announcement:
  - **entrants** have better inherent governance
  - **exits** have worse inherent governance
  - portfolio returns: NBIM willing to trade-off returns vs. governance
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