

Defining the optimal investment system

By Simon Targett

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If it ain't broke, don't fix it. That old adage was often heard on the lips of fund managers when Paul Myners, former chairman of Gartmore, was preparing his government-commissioned report on the UK's investment industry.

Fund managers warned that the government was "playing with fire" by tampering with an industry that was recognised as a world-leader.

Three years on, there is no such complaint. How could there be? The industry today is experiencing its worst crisis since the 1970s - and, in some people's estimation, the worst ever.

Since the Myners report, there have been various attempts to address some of the problems: in the UK, with reports by Ron Sandler, Alan Pickering and Derek Higgs; in Germany, with a report by Gerhard Cromme; and in the US, with new laws such as the Sarbanes-Oxley Act.

Soon, a new name is to be added to this list: Sir Richard Sykes, former chairman of GlaxoSmithKline, the pharmaceuticals giant, and currently rector of Imperial College in London.

He is chairing a committee comprising fund managers, chief executives and trustees. But, whereas the earlier committees were commissioned by the government - British, German or American - the Sykes committee is being convened at the behest of a business-led think tank: Tomorrow's Company.

Moreover, it is charged with a broader brief than earlier committees: to go back to first principles, to define the problems facing the industry, and then to engage people in the hunt for solutions.

The committee's task was announced in February: to design a better investment system for the benefit of savers and companies.

Today marks the moment when Sir Richard and his team make a "call for evidence" from the primary participants in the investment system: pension funds and other investors, actuarial consultants, fund managers and companies. There are already differences of opinion about the scale of the problem facing the industry. Mark Goyder, director of Tomorrow's Company and architect of the project, talks of "fine tuning" the system.

The idea for the project germinated before the bursting of the bull market bubble, he says. So, for him, it is about defining "an optimal system" and then finding ways of putting it into practice.

Sir Richard carries a characteristically blunter message: the bear market - and the damage it is inflicting on people's lives and livelihoods - has made the quest for a solution to the problems of the investment industry that much more urgent.

"When everything's going fine, no-one bothers too much," he says. "But it's clear everything isn't going fine: so this has come at an opportune time."

The central questions are these: what are the weaknesses in the investment system, and what are the solutions to rectify them?

The assumption is that the investment system has become too short-termist: not purposely so, but because of hidden or unintended distorting incentives which, when put together, amount to systemic short-termism.

That, says Mr Goyder, is bad for investors and bad for companies. Investors - especially pension funds -

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should be saving for the long-term. Likewise, companies should be developing durable and sustainable businesses: only then would they become appropriate havens for pension funds' long-term capital.

The Sykes committee inquiry promises to be controversial. The language, for the moment, is consensual: this is a systemic problem that can only be solved if everyone in the system puts their heads together.

But the blame game is an easy one to play. In the run up to the committee's launch in February, Sir Richard happened to say that big investors were so inactive that it was "pathetic" and "a sin". He received a storm of protest from some angry fund managers.

But he points out that there are "vested interests" all along the investment chain that links pension funds and other investors to companies.

That includes chief executives, he concedes. At this early stage, Sir Richard is reluctant to prejudge the committee's report - especially after the brouhaha surrounding his comments on fund managers.

But he acknowledges that executive pay needs to be addressed, so that business leaders are incentivised to build a company for the long term. "You pay people a salary to go to work - so any other compensation should be over and above what you pay them to do this."

In Sir Richard's view, long-term is three to five years. In the opinion of some pension funds, long-term is 10 to 20 years.

So there will certainly be a difference of opinion. Can these differences be resolved? Can there be a solution?

"I don't expect to say 'eureka!' at the end of this," he says. A system that has evolved over years will not be sorted out overnight.

"It's an educational process," he goes on, "So I'd hope to change behaviour so that, at the end of the day, everyone's better off."

But how can behaviour change? After all, unlike previous committees, the Sykes committee does not have formal government backing, and there is little chance that its recommendations will find their way on to the statute book.

Sir Richard, however, is unconcerned. He says the committee's strength is precisely in its independence from government.

He insists that ministerial intervention in the investment system lies at the root of some of today's problems.

"If the solution was to lay down yet more regulation," he says, "that would be a nightmare."

To submit evidence to the Sykes committee, send to evidence@tomorrowcompany.com

Deadline: 31 May 2003