

SECTION 4  
PRACTITIONER'S  
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SOUTH AFRICA'S LARGEST PUBLIC SECTOR PENSION FUNDS:  
A COLLECTIVE DEVELOPMENTAL ROLE?

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**Abstract**

As significant long-term domestic investors, South Africa's largest public sector pension funds have an interest in helping South Africa move onto a sustainable development path. However, this paper tentatively concludes that, although there is a possible collective developmental role for these funds, this is unlikely to occur unless leadership from government or the funds emerges. If a leadership role is chosen, government should probably focus on a transition management approach to sustainable development, trustees on the implementation of long-term investment policies, and the members of the investment community on a high leverage initiative, possibly linked to the Financial Sector Charter review. Some of the tentative conclusions reached in this paper also provide pointers for overseas pension funds and their stakeholders. Firstly, governments could support collective action between the largest public sector pension funds globally, and in return develop an unusually powerful long-term voice in support of a transition to sustainability. Secondly, a more significant role for these funds will highlight the issue of prioritisation, and the development of legitimate processes is likely to be needed. Thirdly, full implementation of genuinely long-term investment policies will probably lead to significant changes in the role funds play in the investment industry, possibly including the establishment of their own investment co-operatives.

**Keywords:** corporate governance, pension funds, South Africa

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**1. Introduction**

**1.1 Background**

This paper assumes that a transition to a sustainable development path is necessary, and that investors could collectively play a particularly important role in this transition. As Hawley and Williams point out, although sustainable development is a contested concept, "at its core ... it suggests that human welfare is best served by being sensitive to the implications of current economic activity for both current and future generations" (2006: 221).

The qualitative research reported in this paper was undertaken whilst the author was on sabbatical in South Africa in 2006. Her primary aim was to use Futures Studies processes and literature to enable tentative conclusions to be drawn about how the future might develop, and provide initial insights for various actors who want to influence it.

**1.2 Research Questions**

Herr and Anderson state that "formalizing the puzzles of practice into research is a way of working better rather than doing more of the same only harder"

(2005: 73). The primary research questions that this paper aims to tentatively answer are derived from the puzzles of recent practice. They are:

- Is there a possible collective development role for South Africa's largest public sector pension funds?

- How can interested stakeholders help ensure that any collective role is realised?

The subordinate research questions are:

- What wider lessons are there for pension funds and their stakeholders in other countries and globally?

- What extensions to this research would help validate the conclusions drawn and develop Futures Studies knowledge?

### 1.3 Research Process and Structure of the Paper

The following research was undertaken:

- Desk research covering the experience of large overseas pension funds (see section 3) and the recent history of South Africa's largest public sector pension funds (see section 4)

- Interviews with stakeholders from different disciplines and with different perspectives, and analysis of these interviews informed by systems thinking (see section 5)

- Analysis of the above inputs in order to tentatively answer the research questions, informed by both the Collective Action literature and the Futures Studies literature (see section 2). This analysis, and the provisional conclusions and recommendations based on it, are presented in section 6.

## 2 Survey of the Related Literature

### 2.1 Futures Studies Literature

#### 2.1.1 Introduction

Assumptions about the future guide action (Harman, 1976), and images of the future "can serve as the cause of future realities" by "beckon[ing] to us to make them real" (De Jouvenel, 1967: 25-27). Futures Studies recognises the importance of these assumptions and images, and seeks to understand how people 'measure' and 'make' the future (Spies, 1999). Futurists believe that this will "enable people to make informed decisions about their lives" (Bell, 1997: 42) and "contribute to the well-being of now living-people and of the as-yet-voiceless people of future generations" (*ibid*: 42).

#### 2.1.2 Understanding the Present

Spies stresses that understanding current problems and their context is an essential initial step in futures work, because "the problem to be tackled is always of a higher order than the problems you are facing" (1999: 18). Various approaches have been developed to help with this, and thereby reduce the "possibility of solving the wrong problem" (Simmonds, 1997: 15),

for example:

- The Biomatrix is a systems approach that spans multiple levels and dimensions, and uses stakeholder and organisational analysis to give a clearer picture of a systemic problem and its co-creating context (Dostal, 2005).

- Causal Layer Analysis "assumes four layers of reality" (Inayatullah, 2002: 482), and recognises that "at what level one constructs the problem changes possible solutions" (*ibid*: 486).

- Linstone's (1984) multiple perspectives approach uses technical, organisational and personal perspectives to provide different insights about a problem and potential solutions.

- Critical Systems Heuristics can "reveal the 'normative content' of actual and proposed systems designs" (Flood & Jackson, 1991: 198).

- Trans-disciplinarity addresses the fact that "we make sense of the world through particular, specialised and bounded disciplines" (Giri, 2002: 104) and that inter-disciplinarity "lacks a perspective of transcendence" (*ibid*:105).

These approaches help create a critical Futures Studies that "attempts to 'probe beneath the surface' ... to discern some of the deeper processes of meaning-making, paradigm formation and the active influence of obscured world-view commitments" (Slaughter, 2002: 495). This in turn allows us to tap into "the vast potential for constructive intervention and change upon which our collective future now rests" (*ibid*: 506).

#### 2.1.3 Measuring the Future

"Futurists seek to know what can or could be (the possible), what is likely to be (the probable), and what ought to be (the preferable)" (Bell, 1997: 42). Possible futures involve "expanding human choice" (*ibid*: 42). Probable futures can lead to a "keen understanding of the unsustainability of the current state of affairs (the threats of the 'current future')" (Spies, 1999: 18), and thereby address 'assumption drag' and discounting (Linstone, 2002). Preferable futures can offer "a vision of hope" (Spies, 1999: 18).

Scenarios can be used as "tools for ordering one's perceptions about alternative future environments" (Schwartz, 1996: 4), and one of the purposes of writing such scenarios is to check for self-consistency, i.e. "to insure that the characteristics asserted, whether arrived at from trend projections or other methods, 'hang together' and make a reasonable story" (Harman, 1976: 12). Harman includes self-consistency in his "six principles that characterise complex, highly interconnected social systems" (*ibid*: 11). The other five being: "continuity ... similarities among social systems ... cause-effect relationships ... holistic trending ... [and] goal seeking" (*ibid*: 11-14). Harman notes that various "systematic approaches have been devised utilizing these six principles" (*ibid*: 14) to outline possible, probable and preferable futures that are grounded in present realities. Slaughter also stresses the importance of

“seek[ing] social confirmation or rejection of the results” when measuring the future (2001: 410).

### 2.1.4 Making the Future

Horton (1999: 9) notes that “deriving value from foresight requires ... taking the required actions”.

Bell states that “change occurs by conflict or consensus” (1996: *xxii*), and Spies stresses that “understanding and commitment [are] only possible if ... key actors participated in the discovery and planning process” (1999: 18). Indeed several approaches used to help people make the future are highly participative and consensus seeking:

- Scenario building (Chermack, 2003) and strategic conversations (Ratcliffe, 2002) are useful approaches for “revealing, analyzing and constructing [participants’] mental models” (Chermack, 2003: 33). “Mental models shape how we act” (Senge, 1994: 236), and a scenario can “become a shared ‘memory of the future’” (*ibid*: 238) when scenarios have been used “to dream effectively about our own future” (Schwartz, 1996: 4).

- When the Biomatrix systems approach is used to redesign a system, “even more important than the actual design is to align stakeholders around [it]” (Dostal, 2005: 509).

- Critical System Heuristics addresses the fact that “no plans are rational which have not been approved by the ‘affected but not involved’” (Flood & Jackson, 1991: 198)

The Ackoff school’s interactive planning approach for corporations recognises that participative planning is an ongoing requirement because the external context is not static, and therefore requires “an adaptive-learning system” (Ackoff, Finnel & Gharajedagi, 1984: 46).

At the national level, Rotmans, Kemp and Van Asselt (2001) suggest a government-led approach to making the long-term future called transition management. This emerging and generation-spanning approach includes: “objectives and final visions [that] are determined socially, not just by expert scientific knowledge” and “are regularly re-evaluated”; “long term thinking as a framework for short term policy”; “learning-by-doing and doing-by-learning”; “systems innovation alongside system improvement” and “keeping a large number of options open” (*ibid*: 22).

## 2.2 Collective Action Literature

### 2.2.1 Introduction

Creating a preferable future can be dependent on voluntary collective action. The classical problem of collective action “occurs when the pursuit of [narrow] self-interest by each leads to a poor outcome for all” (Axelrod, 1990: 7). The problem is also known as “the Prisoner’s Dilemma, or the free rider problem, or the condition of common fate, depending on the context or discipline in which it is used” (Hardin, 1982: 7). It is reflected in the adage “everybody’s business is nobody’s business” (*ibid*: 8).

### 2.2.2 Overcoming the Problem of Collective Action

Olson states that “unless the number of individuals in a group is quite small, or unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interest” (1971: 2). However, Gillinson points out that based on a narrow interpretation of Olson’s theory, “we see more co-operation than we ‘should’ in nature, in history and in modern society” (2004: 31). Several ‘special devices’ have been identified which help explain this gap:

- Empirical work in the US suggests that we co-operate voluntarily when we are passionate about an issue, believe that others won’t act, and when mobilizing against something (Oliver, 1984; Scholzman, 1995; Walker & King: 1992).

- Ostrom’s study (1990) of successful collaboration to protect limited common resources found that the resource must be limited spatially, not be beyond repair, and its quality easily measured. The collaborators must be dependent on the resource, value the future, trust each other, have a common understanding of the system, be autonomous and have experience of organising. In addition, the most powerful actors must be disadvantaged if there is no co-operation.

- Axelrod states that voluntary co-operation based on direct ongoing reciprocity (‘tit-for-tat’) is an initially viable and evolutionary stable strategy, and can be promoted by “enlarging the shadow of the future; changing the payoffs;” and “improving ‘players’ ability to recognize each other from the past” (1990: 140-1).

- Social networks, especially homogenous groups with lots of interaction, tend to develop “social structures [that] lead to the amplification of co-operation as sanctions are more effective than they need to be in solving the original externality problem” (Gillinson, 2004: 24). However, if the group is dependent on them, the most powerful within the network are often exempt from sanctions (*ibid*).

Gillinson notes that “voluntary co-operation ... is more effective and efficient than either coerced or financially incentivised co-operation” (*ibid*: 7).

## 3. Long-Term Responsible Investment (LTRI) and Overseas Pension Funds

### 3.1 Introduction

Sustainable and Responsible Investment (SRI) combines investors’ financial objectives with their concerns about environmental, social and governance (ESG) issues (Higgs & Wildsmith, 2005). Investors’ concerns about ESG issues range from purely values-driven to purely value-driven:

- Values-driven investment is concerned with aligning investments with values, and is often called Ethical Investment (*Ethical Investors Group*, 2006).

- Investment that is concerned about the role ESG and other extra-financial issues play in long-term value creation (or destruction) is called Long-Term Responsible Investment (LTRI) (Guyatt, 2005). Extra-financial issues “tend to be of a medium- to long-term nature, and frequently difficult to quantify” (O’Loughlin & Thamotheram, 2006: 5), but they can be “material to long-term ... success” (*ibid*: 28).

Given their long-term investment horizon and the fiduciary (or similar) legal framework within which they operate, it is increasingly being recognised that all pension funds have a necessary and legitimate interest in extra-financial issues and LTRI (Freshfields Bruckhaus Deringer, 2005).

However, LTRI “advocates a holistic rethink of the investment management conventions that prevail across the institutional investor community” (Guyatt, 2005: 147). For investors with large diversified portfolios and long-term investment horizons, the universal owner theory aims to help address this challenge:

“A universal owner’s cumulative long-term return is determined not merely by the performance of each individual [asset] it owns, but by the performance of the economy as a whole. This has at least two potentially important consequences:

- First, it means that when universal owners evaluate the ... [assets] they own, one significant dimension should be how each [asset]’s activities affect ... other holdings in its portfolio ... The universal owner captures positive externalities generated by [assets] and is harmed by their negative externalities.

- A second consequence is that universal owners come to occupy a quasi public policy position as having an ... interest in the long-term health and well-being of society as a whole”. (*Centre for the Study of Fiduciary Capitalism*, 2006: 1).

These consequences indicate that universal owners are “well positioned to appreciate the need to develop policies toward portfolio companies that encourage sustainable development” (Hawley & Williams, 2006: 221). Large pension funds are classical universal owners, and in relation to aligning investee corporate behaviour with their long-term interests, public sector pension funds are in a unique position amongst large universal owners because they have no conflict of interest in relation to corporate clients or corporate parents (Thamotheram & Wildsmith, 2006). In fact nineteen of the world’s twenty largest pension funds are public sector funds (*P&I & Watson Wyatt*, 2005a), and seven of these are already signatories to the recently launched United Nations Principles for Responsible Investment (UN PRIs) (*United Nations*, 2006a). The universal owner theory “was referenced ... in the process of developing” the UN PRIs (*Centre for the Study of Fiduciary Capitalism*, 2005: 2), and the comments of the UN General Secretary, Kofi Annan, at the launch event reflect this: “if societies fail, so will markets” (2006: 1). Some of the practical implications of LTRI

are reflected in the first two signatory commitments under the UN PRI (*United Nations*, 2006b) covering the incorporation of ESG issues into investment decisions and ownership process. As the universal owner theory above indicates, incorporation of ESG and other extra-financial issues by large and diversified long-term investors should extend from specific assets through to the portfolio level, and from there to the investors’ lobbying activities (*Centre for the Study of Fiduciary Capitalism*, 2006).

Investors can incorporate ESG and other extra-financial issues into investment selection and ongoing ownership either individually or collectively (Higgs & Wildsmith, 2005). Noting the minority ownership stake that large institutional investors typically have in large investee companies (<3%), Monks and Sykes state that “it is only the latent collective power of investment institutions that could give them real influence” (2006: 231). In addition, Lake notes “there is a gap between what is needed in sustainability terms ... and what is rational for business within current policy frameworks” (2006: 182). Robbins concludes that “for this reason, it is critical that investors ... extend their focus from company level to the system”, but adds “that techniques and habits of collaborative engagement on policy matters are still in their infancy and, if investors are to fulfil their policy mission, far greater attention needs to be given to what works” (2006: 320).

## 3.2 Experience of LTRI Amongst Overseas Pension Funds

Case studies can be found in {add reference to new UN/UKSIF report}

### 3.2.1 Barriers to LTRI amongst UK Pension Funds

The increased interest in LTRI in the UK has been partly driven by the change to the 1995 Pensions Act requiring pension funds to disclose any SRI policies from July 2000, and the endorsement of shareholder activism by the Myners Review of Institutional Investment in 2001 (Mackenzie, 2006). However, to date these have not had a widespread impact on how pension fund investment is actually undertaken in the UK (Sullivan & Mackenzie, 2006a). A recent survey of UK pension fund trustees found the following barriers to pension fund adoption of LTRI policies: uncertainties about the costs and benefits of LTRI; concerns raised by professional advisers; the lack of tools to assess providers; and the existence of other priorities (Gribben & Gitsham, 2006).

Longitudinal case studies of three UK investment institutions with LTRI policies found “evidence of behavioural obstacles to [the implementation of LTRI] ... including short-termism, gravitation towards defensible decisions and reluctance to integrate corporate responsibility factors into the core investment process” (Guyatt, 2005: 139) and that this was “driven by the influence of

prevailing dominant conventions, reinforced by institutional herding tendencies” (*ibid*: 139).

However, Guyatt suggests that “collaboration amongst institutional investors is key for mobilizing institutional herding tendencies so that LTRI might get built into conventions” (2005: 139). Thamotheram calls for pension funds to create a context “where [fund] managers needed to compete on their ability to collaborate” (2006: 305) in order to win long-term mandates. Ambachtsheer (2005) suggests that pension funds should stop using external fund managers altogether and collaborate to set up pension investment co-operatives.

### 3.2.2 Pension Fund Politics

The Norwegian Government Pension Fund (NGPF) and large US public sector funds have very different approaches to the inherently political process of setting priorities within LTRI.

NGPF’s policies are subject to democratic debate: “the ethics of [NGPF] must be rooted in democratic values and enjoy legitimacy in the political community. Anchoring the guidelines in internationally recognised standards will provide a democratic basis, as will the pursuit of transparency and the promotion of public debate on the fundamental priorities that are set and the criteria on which ownership management is based” (*Finansdepartementet*, 2003: 1).

In contrast, US funds have been attacked because “the decision makers consist of a small group of people who may not represent the will of the constituents, who operate under little scrutiny, and who may be subject to financial and political pressure” (Munnell & Sunden, 2005: 37). Rounds even states that “when government gets into the investment business, social investing and political patronage go hand-in-glove” (2005: 56), and notes that “if such investments fall short ... taxpayers can be forced to pick up the tab” (*ibid*: 57).

The outsourcing to the private sector investment industry that is suggested by the political right in the US (Munnell & Sunden, 2005; Rounds, 2005) conveniently ignores the fact that “institutional investors are not ‘neutral’ actors, and [that] it would be naïve to expect that the simple pursuit of investor self-interest will necessarily result in sustainable or responsible outcomes” (Robbins, 2006: 319).

## 4. The Largest South African Pension Funds and LTRI

### 4.1 Introduction

In 2004<sup>20</sup> the South African occupational pension fund sector held assets worth R1 098bn (*Registrar of Pension Funds*, 2006), with the following public sector funds accounting for 40% of this:

**Table 4.1.** The Largest South African Public Sector Pension Funds in 2004

Pension Fund	Asset Rbn)
Official Funds (inc. the R320bn Government Employees Pension Fund)	355
Transnet Funds	43
Eskom Pension & Provident Fund	25
Telkom Retirement Fund	13
Post Office Pension Fund	6
TOTAL	442

Source: *Registrar of Pension Funds*, 2006: 28 and 38

By way of contextualisation, the South African GDP was \$213bn in 2004 (cR1 300bn<sup>21</sup>), and the total market capitalisation of JSE-listed companies was R2 566bn at the end of that year (*JSE*, 2005). Through their investments in domestic equities, South African occupational pension funds collectively own approximately 18% of JSE-listed companies (*Parliament of South Africa*, 2006). There are restrictions on the total amount that any pension fund can invest overseas and in any one company. Across the occupational pension fund sector a significant amount of the investment process is outsourced to the private sector investment industry.

The Government Employees Pension Funds (GEPF) was formed through the merger of ten funds in 1996, and it is by far the largest South African occupational pension fund. In 2004 it was the only pension fund from a middle income country to rank amongst the twenty largest pension funds globally (*P&I & Watson Wyatt*, 2005a), and it was recently reported to own more than 10% of several JSE-listed companies (Davie, 2005). However, most of its assets are still invested in bonds and cash (*Government Employees Pension Fund*, 2005). It is a defined-benefit pension fund, and currently has a small funding deficit (*ibid*).

GEPF’s first board of trustees was appointed in 2005 (*ibid*), and in line with legislation, they are half employer-nominated and half employee-nominated (with the latter half being mostly public sector trade union representatives). In the same year the Public Investment Corporation (PIC), which now primarily exists to manage GEPF’s assets, was corporatised but continues to be owned by the government (*Public Investment Corporation*, 2005). Approximately 70% of the equity investing that PIC undertakes on behalf of GEPF is outsourced to private sector fund managers including Old Mutual Asset Management and Sanlam Investment Management (*Public Investment Corporation*, 2006a), both of which are ‘Top 200’ fund managers globally (*P&I & Watson Wyatt*, 2005b). However, this outsourcing arrangement is under review (*Public Investment Corporation*, 2006).

Very recently two of the three GEPF trustees and their substitutes with investment industry

<sup>20</sup> Latest available figures at the time the research was undertaken

<sup>21</sup> At an exchange rate of \$1=cR6

experience were dismissed, even though they were reportedly “playing an essential role in establishing a proper governance framework for the relationship between the GEFP and the PIC” (Cranston, 2006: 1). Cranston goes on to speculate that “PIC had got used to being answerable to no-one while the minister of finance was the sole GEFP trustee ... it looks as though [the PIC Chief Executive] leaned heavily on the minister to dismiss [the trustee substitutes] who were making his job difficult” (*ibid*: 1).

## 4.2 LTRI in South Africa

### 4.2.1 Background

A 2004 report on SRI in South Africa concluded that “long-term investors, such as pension funds, are not walking the talk of long-term investing with very few funds taking a hands on approach to managing the longer term risk implications of their investments” (De Cleene & Sonnenberg, 2004: *viii*), and that “shareholder activism is not a widespread phenomenon in South Africa” (*ibid*: 44).

A recent survey is reported to have found that less than 0.2% of pension fund assets (Mafu, 2006) are invested in funds which aim “to maximise investor returns while paying attention to ... issues relating to the development and upliftment of previously disadvantaged communities” (*Alexander Forbes Asset Consultants*, 2006: 2).

PIC’s Isibaya Fund, which was established in 1999 to allow 3.5% of GEFP assets to be invested in SRI (*Public Investment Corporation*, 2005), returned over 40% in the year to 31 March 2005 (*ibid*), but had previously experienced poor returns (Davie, 2005). A new investment strategy “based on the focal areas of infrastructure funding, direct private equity funding (especially empowerment transactions) and a private equity fund-of-funds approach” was implemented in 2004/5 (*Public Investment Corporation*, 2005: 27).

PIC and Futuregrowth have merged their targeted property assets “to create a fund in excess of R1 billion, focused on property developments in rural and urban townships across South Africa” (*Public Investment Corporation*, 2006b: 1). Through the joint venture, PIC and Futuregrowth aim to “participate in the development of the ‘second economy’ and thereby contribute to the larger national initiative of socioeconomic transformation” (*ibid*: 1).

There is no widely recognised formal network of SRI/LTRI, corporate governance or similar investment specialists in South Africa.

### 4.2.2 Recent Initiatives

2005 saw the initiation of the Pan African Infrastructure Development Fund, “which is [initially] targeting to raise US\$1 billion [from African pension funds] to focus on infrastructure investments on the African continent” (*Public Investment Corporation*, 2006a: 4). In 2006 GEFP became a signatory to the UN PRIs at launch (*United Nations*, 2006a). GEFP subsequently “issued a strong warning that it will use

its financial might to force corporate South Africa to shape up in the areas of good governance, social responsibility and environmental protection”, and will “provide strong leadership by managing assets for the long-term benefit of fund members and the economic well-being of the country” (Cameron, 2006: 1).

Whilst the UN PRIs are beginning to be implemented globally, the first round of benchmarking based on South Africa’s Financial Sector Charter (FSC) is also underway. Occupational pension funds are formally signatories through the Institute of Retirement Funds, and have committed to undertake appropriate shareholder activism, and invest as yet unspecified minimum amounts in targeted investments (*ibid*).

A Council has been established to oversee and monitor the implementation of the FSC (*ibid*). Its first principal officer, a former senior trade union official and an African National Congress national executive committee member, was appointed in 2005 and the first set of implementation reports from signatories were due by the end of March 2006 (Robinson, 2006).

## 5. Findings from the Stakeholder Interviews

### 5.1 Background

During July 2006 twenty individuals based in South Africa were invited to be interviewed as stakeholders in a project entitled: ‘South Africa’s largest public sector pension funds: a collective development role?’ (see Appendix). Seventeen individuals, with the following professional perspectives, accepted the invitation: public policy, regulation, legal advice, investment advice, change management, environmental sustainability, corporate social responsibility, shareholder activism, ‘mainstream’ and targeted investment. Despite repeated requests, interviews with representatives from the Congress of South African Trade Unions (COSATU) and the FSC secretariat were not secured. However, the interviewees did include people with considerable trade union experience and a member of the FSC Council.

The seventeen interviews were undertaken in August and September 2006. The interviewees were sent a one page briefing note on the universal owner theory (see section 3.1 and the Appendix), and were told that the interview would ‘focus on this concept in relation to South Africa’s largest public sector pension funds, e.g. what hopes, fears, opportunities and constraints does the concept bring to mind’ (see Appendix).

The interviews were undertaken on a one-to-one<sup>22</sup> basis, either in person (Western Cape) or over the telephone (Gauteng), and typically lasted between thirty minutes and one hour. During the introduction,

<sup>22</sup> The interview with the regulator was a conference call between the interviewer and two interviewees.

the interviewees were told how the interview fitted into the envisaged overall research process. In addition, interviewees were promised confidentiality and an amalgamated summary of the interview findings. The interviewer took notes during the interviews.

A semi-structured interview schedule (see Appendix) based on the seven questions approach was used (Ratcliffe, 2002). These questions were chosen because Ratcliffe notes that they call for an “imaginative and searching set of answers” (*ibid*: 25), and “the exploration of ‘good’ and ‘bad’ worlds tend to be a very powerful trigger to creative and productive thought” (*ibid*: 26). This seemed particularly appropriate as the interviewer was keen to elicit new insights from the interviewees, many of whom have considerable experience and/or knowledge of one or more types of SRI.

All the strands from the seventeen interviews were written onto separate sticky notes and grouped together based on the ‘frog’ / ‘prince’ method (Dostal, 2005). This systems redesign technique involves “transforming ‘frogs’ (i.e. the problem co-factors within a system) into ‘princes’ (i.e. ideals that represent a preferable state of the system)” (*ibid*: 449). As public sector pension funds are part of a complex investment, and wider domestic and global system, this approach seemed a particularly appropriate way of initially categorising the information that had been gathered.

The sections below, therefore provide an initial synthesis of the interviewees’ views about the “messy field of interacting problems” (*ibid*: 446) that hinder South Africa’s largest public sector pension funds from playing a collective development role, and their views about how the system could change.

## 5.2 Global Context

Several interviewees think that the global context is not conducive to the universal owner approach becoming the dominant influence on investee companies operating in South Africa. In particular, globalisation based on market fundamentalism has increasingly meant that South African corporations have to ‘dance to the tune’ of overseas portfolio investors with short-term investment horizons, and compete with lean overseas corporations, often driven by the same investors.

However, some interviewees think that this context is showing signs of changing, and could even change quite dramatically in the future. Interviewees also felt that despite some scepticism about the concept of environmental and societal limits to growth, environmental and/or social catastrophes could accelerate a move to a longer-term approach. In the developing world resource-rich countries like Venezuela, and large countries like China, are seen as following their own socio-economic development paths, which could affect the global context in unexpected ways. Other interviewees pointed out that

global terrorism, rising energy prices and/or other factors could reverse globalisation, either worldwide or in particular regions.

Although some interviewees noted that the global context might be changing in a way that is more conducive to experimentation and/or a longer-term approach, there was concern that any change might be too late for a smooth transition to sustainable development.

## 5.3 International Pension Fund Practice

Several interviewees think that the recently launched UN PRIs provide a ready-made framework within which South Africa’s largest public sector pension funds could work. The examples of collaborative work led by CalPERS and other large public sector pension funds in the developed world are seen as examples of best practice that could be adapted to the South African situation. Secondments or extended visits to these funds were seen as a potentially appropriate way of quickly building capacity in the short-term. The merits of a collaborative learning approach undertaken with public sector pension funds from elsewhere in the developing world were also mentioned.

One interviewee would ultimately like to see a global coalition of large pension funds providing a long-term perspective to balance the perspectives of investors with short investment horizons.

## 5.4 South African Context

Several interviewees think that South Africa is still not on a sustainable development path. There is concern that the enduring levels of inequality will lead to social instability, and that the race struggle has not transformed into a class struggle. In addition, the importance of environmental sustainability to human development and the precautionary principle are often not fully factored into decision making. Lack of media capacity in surfacing these issues was also seen as an issue.

Some interviewees stated that a debate about the sort of country South Africa should become is required. The ubuntu worldview, with its focus on group solidarity, was seen as a positive indigenous model for the future.

## 5.5 South African Pension Funds’ Development Role

Several interviewees thought that the universal owner theory provided a good win-win investment model for South Africa’s largest public sector pension funds. With investment seen as a critical factor in socio-economic development, some interviewees thought that public sector pension fund investment policies should be closely aligned with government’s overall development policy. Greater information from

government on infrastructure and other policy priorities was seen as a factor which would encourage a wider set of pension funds to become more involved in targeted investments and shareholder activism. Government's own development funding agencies could also be a key part of any more integrated approach. It was also noted that there are limits to what pension funds should be expected to do.

Some interviewees stated that current pension fund capacity (see section 5.6) meant that the government would need to take the lead, although they were not confident that it would do so. It was suggested that a review similar to the UK Treasury commissioned Myners Review (Myners, 2001), which looked at whether UK institutional investment practice was aligned with the interests of beneficiaries and the wider public, should be undertaken. As with the Myners Review, regular progress reports (e.g. *HM Treasury*, 2004) over several years, covering the extent to which the review's recommendations have been implemented, were seen as important.

Interviewees felt that enabling government policies, from capacity building and transparency requirements, through to investment incentives and differential capital gains tax rates for assets held over different timeframes, might be necessary to encourage implementation of a longer-term perspective. Prescriptive policies setting the percentage of pension fund assets that have to be invested in particular targeted investments were not supported by most of the interviewees (see also section 5.9).

## 5.6 Pension Fund Capacity

Although most interviewees believed that pension funds should take a longer-term investment perspective and play a collective development role, it was widely recognised that pension funds face considerable capacity problems in doing this.

Pension funds are governed by trustees who are typically part-time and from outside the investment industry. Their responsibilities are wider than their funds' investment policies, and they are often faced with a full agenda of short-term pressing issues at trustee meetings. They therefore often rely on external investment advisers and fund managers (see also section 5.8) for input, advice and training, and often delegate significant investment authority to these external advisers and fund managers. This makes it difficult for trustees to hold their advisers and fund managers to account, particularly in less tangible areas like shareholder activism. Some interviewees also noted that some advisers and fund managers form 'cosy' and potentially corrupting relationships with some trustees, through corporate hospitality and other mechanisms. One interviewee even asked to what extent trustee boards exist as separate independent entities.

In addition, interviewees had experienced inertia, gravitation to the conventional and short-termism amongst trustees, and it was felt that trustee

rotation might exacerbate this, whilst conventional interpretations of fiduciary duty legitimise it. It was suggested that trustees should see three year rolling returns rather than quarterly performance figures from fund managers, as it was too easy for them to focus on this tangible indicator of short-term success.

Some interviewees noted that trustee diversity sometimes made it difficult to build the consensus required to move away from the *status quo* (see also section 5.10). On the other hand, other interviewees had experience of trustee boards being extremely willing to make targeted investments but finding it difficult to access projects in a cost effective manner (see also section 5.9).

Leadership from GEPF's new trustee board was seen as critical, as was its relationship with government and the Public Investment Corporation (PIC, which invests GEPF's assets). Although GEPF's recent commitment to the UN PRIs was seen as positive, interviewees noted that high level policies require detailed implementation plans, and ongoing monitoring of actual investment practice.

Interviewees noted that when trustees or their agents draw up detailed LTRI policies, staff and external providers' incentives will need to be aligned in order for them to become embedded in practice. If current practices do not change, then contracts and mandates will need to be withdrawn. It was also noted that pension fund staff and agents should not be allowed to build up personal fiefdoms that lie outside pension fund governance frameworks. One interviewee wondered whether a court case would be needed to embed a longer term view of fiduciary duty and ensure implementation of high level policies by pension funds and their agents.

## 5.7 Pension Fund Collaboration

Several interviewees mentioned that effective collaborative structures between the largest public sector pension funds do not currently exist. However, interviewees thought that such structures would be necessary for the largest pension funds to be effective in the following areas: building partnerships with government and influencing policy; shareholder activism; and developing a wider set of targeted investment options. Different reasons for this were given for different pension funds, including: cost and resource sharing, and the greater likelihood of success through setting up new organisations, rather than expecting powerful agents to change (see also section 5.8). Whereas collaborating on shareholder activism and government relations were seen as necessary over the long-term, it was anticipated that collaboration to develop a wider set of targeted investment options would only be needed over the short-term in order to kick-start supply.

The threat of prescriptive legislation was seen as important incentive for pension funds to act together to help change the current system. Again, GEPF leadership was seen as critical.



## 5.8 Investment Industry Practice

Nearly all the interviewees mentioned that the investment industry has a predominantly short-term focus. Long-term investment success is typically seen as the sum of a series of short-term wins. Index-based performance benchmarks tend to result in a focus on relative rather than absolute performance. The incentives within the industry reinforce this, with career prospects, bonuses and mandate renewal all being adversely affected by short-term relative underperformance. Investment analysis is predominantly short-term in nature, and portfolios tend to turn over quickly. The Warren Buffet approach of buy and hold is atypical, as is the use of longer-term analytical tools like scenarios, and longer-term ownership practices like shareholder activism.

Several interviewees mentioned recent ethical scandals within the financial services sector, and questioned whether it could change itself from within. It was noted that those who profit from the *status quo* have a vested interest in maintaining it, and that protection for 'whistleblowers' is inadequate. As the predominant providers of trustee training and advice, fund managers and investment advisers have a powerful influence over the beliefs of the trustees who award them mandates and pay their fees. The fact that advisers own fund management operations was also seen as a cause for concern. The need for a strong regulator to protect weaker clients was mentioned, as was education from alternative sources.

Interviewees believed that the FSC could encourage greater shareholder activism and targeted investment (see also section 5.9). However, it was noted that shareholder activism is not covered in as much detail in the FSC as targeted investment. There was also a fear that a tick-box and/or a short-termist approach to shareholder activism could develop, rather than an approach that is fully integrated into a coherent long-term investment strategy.

It was also noted that the predominant trend appeared to be one of outsourcing pension fund investment to the private sector investment industry, and that this form of professionalisation was supported and encouraged by government and the regulator.

## 5.9 Products and Services Available To the Universal Owner

The products and services that could help pension fund trustees become effective universal owners are typically still relatively new and not readily available at the price trustees are currently willing to pay. These products do, however, play an important role in demonstrating the 'art of the possible'. Innovation is still occurring, but the scale of demand that would enable scale efficiencies to be realised has not been achieved. Some interviewees saw this as a 'chicken and egg' problem. Others added that despite strong

performance of several specialist funds over the last few years, trustees remember the high profile examples of underperformance in the 1990s.

Within the targeted investment arena, despite the country's infrastructure backlog, interviewees noted that there is a shortage of appropriate projects that fund managers and/or pension funds can easily invest in directly. Australian<sup>23</sup> innovations in the infrastructure investment market were mentioned as a possible model for extending supply in the future. It was also felt that pension funds could collaborate to accelerate development and experimentation in this area (see also section 5.7). Excess returns on other parts of the investment portfolio were mentioned as a potential source of seed funding, and for collaborative structures. Ultimately ease of access and appropriate risk/return ratios were felt to be crucial to widespread pension fund interest in targeted investments, unless they became 'cool' for other reasons.

An additional concern within the targeted investment arena is that any prescriptive targets for the percentage of pension fund assets that have to be in targeted investments will lead to price distortions within this emerging asset class. Some interviewees mentioned that merchant banks are already keeping projects to themselves in order to score FSC points in the future, rather than forming syndicates as they would have done in the past. Legislative and FSC-related uncertainty in this area is believed to be delaying pension fund and market responses. Many interviewees believed that although larger funds should put more of their assets into targeted investments, transparency and stakeholder dialogue were the best way to assess whether each fund was doing enough in this area. Others felt that tighter definitions of what is and is not targeted investment were needed.

There was also a concern that a whole portfolio approach is needed, and that a focus on targeted investments will hinder development of cost-effective approaches to shareholder activism and influencing public policy. Several interviewees thought that the largest pension funds would need to act collaboratively in these areas (see also section 5.7 above).

## 5.10 Determining Priorities

The difficulties of determining priorities within targeted investment, shareholder activism and influencing public policy were mentioned by several interviewees. Some interviewees were concerned that trade union trustees might dominate priority setting, whereas others thought that the views of employer-nominated trustees, such as finance directors, were more likely to dominate. Although some interviewees wondered whether the prioritisation process could

<sup>23</sup> See

[http://www.macquarie.com.au/au/corporations/sfpc/infrastructure\\_funds/overview.htm](http://www.macquarie.com.au/au/corporations/sfpc/infrastructure_funds/overview.htm)

ever be depoliticised, others pointed to structures, such as the National Economic Development & Labour Council (NEDLAC), that bring different stakeholders together as a possible solution. The education and empowerment of trade union trustees was seen by some as important, although it was also suggested that some government ministers benefit from having unempowered trade union members on trustee boards. This is because the trade union movement can be accused of not realising the potential of the important role it has in stewarding the country's economic assets, when it complains about government economic policies.

Several interviewees were concerned that 'hot topics' and the passions or interests of individual trustees and others could become priorities without due regard to the impact on sustainable socio-economic development and investment portfolio returns.

It was noted that shareholder activism should focus on corporate practices as well as their policies, in order to highlight any implementation gaps. Appropriate forms of shareholder activism also need to be chosen, as some aggressive approaches could lead to investee companies delisting or moving their listing overseas.

### 5.11 Accountability

Several interviewees thought that the pension funds need to be more transparent and accountable to members and wider society. In addition to stakeholder involvement in prioritisation processes (see previous section), greater transparency relating to practice was also needed.

It was also noted that many members of defined-contribution pension funds take a very short-term view when assessing investment returns, and that the need for a longer-term approach would have to be carefully communicated. Members of defined-benefit schemes tend to be disengaged, and the link between their pension funds' assets and the direction of socio-economic development is not widely recognised.

## 6. Analysis, Conclusions and Recommendations

### 6.1 Introduction

This section analyses the information presented in the last three sections in order to tentatively answer the research questions initially outlined in section 1.

### 6.2 Analysis

#### 6.2.1 Understanding the Present

As noted in section 2, understanding current problems and their context is an essential initial step in futures research (Spies, 1999). Therefore, before addressing the research questions, this section uses the Future

Studies literature to provide deeper insights about the current reality of South Africa's largest public sector pension funds based on the information presented in sections 4 and 5.

Dostal points out that "the governing authority of a system can be located within the system or within the environment of the system", and that "systems thinking claims that ideally, there should be maximum self-governance" (2005: 92-3). In contrast to this ideal, a strong theme emerging from the desk research and stakeholder interviews is that the trustee boards of South Africa's largest public sector pension funds currently tend to lack self-governance capacity.

"Governance involves power and power relations" (*ibid*: 97), and the lack of effective self-governance allows the investment practices of pension funds to be captured.

Interviewees noted both:

- Capture resulting from the passions and interests of powerful trustees and/or investment industry professionals
- The powerful influence of current investment industry norms.

Linstone's (1984) multiple perspectives approach to the study of socio-technical systems helps explain these types of capture by focusing on personal and organisational influences on a system. "Self-interest motivates most [individuals] ... it may take the form of prestige, profit, power or pleasure" (*ibid*: 56), an individual might see an organisation within the system "as job security, an opportunity to exert power, or a step to gain prestige" (*ibid*: 44). In addition to the interests of the individuals within it, an organisation within a system shows "great concern [about] whether a new policy will threaten the organisation's rights, standing or stability" (*ibid*: 47), and exhibits forms of reductionism, namely "an application of a discount rate, the fragmentation of problems [and] use of standard operating procedures" (*ibid*: 52).

Although "stakeholders [can] begin to exert force or influence to have their interests considered" (Dostal, 2005: 93) and thereby reverse governance capture, interviewees noted that this has either not happened or has not been effective to date. For example, the end beneficiaries of defined-benefit pension schemes tend to be disengaged, and the trade unions have not yet capitalised on their role as providers of trustees. The government and regulator have, if anything, reinforced investment industry capture by acting to align pension fund investment practice with current global investment industry norms.

Even though an approach, like investment norms that focus on short-term relative performance, can "become entrenched ... there is no guarantee it is the 'best' one from a broader societal perspective" (Geels, Elzen & Green, 2004: 7). Unfortunately better approaches "do not emerge with their performance characteristics ready ... instead they emerge as hopeful monstrosities, which cannot readily compete"

(Geels, 2004: 26). These “radical innovations are generated in niches” (*ibid*: 35) and “require actors who believe in their potential and who are prepared to work against the odds” (Elzen, Geels & Green, 2004: 292). Within the South African investment industry many of the investment professionals with pioneering approaches to targeted investment and shareholder activism would recognise this description.

### 6.2.2 Measuring the Future

As noted in section 2, “futurists seek to know what can or could be (the possible), what is likely to be (the probable), and what ought to be (the preferable)” (Bell, 1997: 42). This section uses the literature presented in section 2 to look at how the future might develop based on the information presented in sections 3-5.

The data gathered from the interviews indicates that stakeholders believe that South Africa’s largest public sector pension funds should play a collective developmental role. Although the universal owner theory was recognised by many as a good base upon which to build this vision, others stressed the importance of prioritisation processes that are legitimate and linked to the government’s own policy making processes. The desirability of collaboration with pension funds from other countries was also emphasised. These threads provide a tentative description of the interviewees’ emerging preferable future, i.e. “what ought to be” (Bell, 1997: 42). If it is developed further, it could provide “a vision of hope” (Spies, 1998:18) for those seeking to make the future (see section 6.2.3 below).

The examples of emerging collaborative overseas pension fund activity based on the universal owner theory indicate that a collective development role for South Africa’s largest public sector pension funds is theoretically possible. As Harman notes, “one group will tend to behave somewhat like another under similar circumstances” (1976, 12). The literature on Collective Action reinforces this conclusion as the envisaged collaboration is amongst a small group (Olson, 1971) of fairly homogenous actors (Gillinson, 2004) with long-term perspectives (Ostrom, 1990), who are dependent on the sustainability of the South African economy and the society and physical environment within which it is embedded (*ibid*).

However, although a collective development role might be possible, the Collective Action literature also points to the importance of previous experience of organising (*ibid*), which is absent in this case. In addition, the importance of the most powerful actor being disadvantaged if there is no co-operation is highlighted (*ibid*). Given its relative size GEPF might be able to achieve the same net benefits domestically by acting alone.

In addition, several interviewees stressed that without leadership from government or the largest public sector pension funds emerging, a collective development role would not be realised. In particular,

it was felt that investment industry norms would probably not change significantly without such outside leadership, and that niche developments would not be mainstreamed:

- In their work on transition contexts, Berkout, Smith and Stirling point out that when an evolving system relies on its own internal resources “the transformation process will tend to be incremental” unless “radical reorientation is [stimulated by] a shock” (2004: 68-69). As interviewees pointed out (see section 5.2), various shocks could dramatically change the global context, so this could result in significant change to global, and therefore local, investment industry norms, but without external leadership or a shock to the system only incremental change is probable.

- As technology is “the systematic application of knowledge to resources to produce goods or services” (Soltynski, 2005: 5), investment approaches are a form of technology. The literature on technological niches is therefore relevant to investment niches. The development and diffusion of niche technologies can fail to happen at the pace some observers would like to see for economic and socio-political reasons, for example:

- Although the “potential for a new technology may have been around for a long time ..., there [is] no incentive to invest in its development into a practical application until there is a recognised need” (Twiss, 1992: 92).

- “[New technologies] have relatively low technical performance, are often cumbersome and expensive” (Geels, 2004: 35)

- There is a “wide and widening gap between ‘available [proven and relevant] technology’ and ‘technology in use’” (Handsombe & Norman, 1993: 7). “As long as the wider context (markets, regulations, cultural preferences) is not appropriate, new technologies may not be picked up” (Geels, 2004: 26).

- “An existing regime tends to defend itself against upcoming novelties in various ways, by throwing up barriers to the novelty, by improving performance of the regime or by absorbing elements of the novelty” (Elzen, Geels, & Green, 2004: 293).

In fact “very few local configurations developed in niches are successful in seeding system innovation” (*ibid*: 285). Although this indicates that niche developments in the areas of shareholder activism and targeted investments probably will not be mainstreamed in their current form, section 6.2.3.4 below indicates ways in which pioneers can increase the chances of meaningful uptake by the wider investment industry.

### 6.2.3 Making the Future

#### 6.2.3.1 Introduction

As noted in section 2, “deriving value from foresight requires ... taking the required actions” (Horton, 1999: 9). This section uses the literature presented in

section 2 to look at how various actors could influence the future, based on the information presented in sections 3-5.

### 6.2.3.2 Government-led Transition Management

“Although no single actor can steer [a] transition ... all social actors look to the government to take the lead” (Rotman, Kemp & van Asselt, 2001: 30). Therefore, it is not surprising that so many of the interviewees stressed the need for government leadership.

Futures Studies literature indicates that if the government chooses to take a leadership role in encouraging public sector pension funds to collaborate, then the extent of the development challenge means that it should do this as part of a wider ‘transition management’ approach (Elzen, Geels & Green, 2004). As noted in section 2.1.4, Rotman *et al* (2001) suggest an approach to government-led transition management that includes: policies that are guided by an evolving, socially-determined vision; and experimentation that is geared towards both system innovation and system improvement.

South Africa’s initial overarching vision could be a key output from the 2009-14 policy formulation process - 2009 being the Accelerated and Shared Growth Initiative (ASGISA) review point and the date of the next general elections. Although “there are serious difficulties in determining whether a vision ... is desirable from the perspective of society as a whole” (Berkhout, Smith & Stirling, 2004: 57), “by focusing on the role of guiding visions, attention is concentrated on the importance of legitimate and effective deliberation and learning, and on the crucial role of providing for plurality, reversibility and sustained dissent” (*ibid*: 59). Teisman and Edelenbos point out that government “management of transitions requires a transition of management” (2004: 187), and they stress the need for a more participative form of democracy. This would answer interviewees’ calls for a wider debate about South Africa’s future.

A participative debate of this sort could incorporate processes inspired by Causal Layer Analysis (Inayatullah, 2002) and trans-disciplinarity (Giri, 2002), in order to deepen the understanding of the current situation and surface and challenge worldviews (Slaughter, 2002; Chermack, 2003).

Determining in detail the role of the largest public sector pension funds, and other long-term investors, in realising the above vision could be a parallel and interlinking part of the vision creation process, and could be linked to the 2009 FSC review. This process could be a local version of the UK’s Treasury-commissioned Myners Review (2001), and ideally be led by an individual who is able to view the world from both an organisational and personal perspective, as well as a technical investment perspective, and who has “a longer-than-average [time] horizon” (Linstone, 1984: 75). Otherwise

“future problems [will be] discounted in contrast to near-term problems” (*ibid*: 50), and it will be assumed that the “world [is] populated by rational actors and afflicted with problems to be ‘solved’ by data and model based techniques” (*ibid*: 70). As noted in section 2.1.4, futures studies literature would suggest that this review should also be ongoing, participative and involve key stakeholders.

Positioning this review within the wider societal visioning process would encourage ‘problem reframing’ (Connor & Dovers, 2004). It is easier to see public sector pension funds as universal owners, or even as providers of “decent pensions in a decent society” (Monks & Sykes, 2006: 227), in the context of a debate about South Africa’s future, than in the context of a debate about which assets, investment styles or fund managers are going to deliver satisfactory financial returns over the period of a typical investment mandate. Trustees’ sense of the costs and benefits of different forms of investment would also change.

The participative nature of the review would help support collective action as trustees would build trust and a common understanding of the system through the process (Ostrom, 1990).

It is likely that such a review will suggest that government helps support the development and diffusion of promising investment niches as part of its transition management. Learning about how technology is developed and diffused might help policymakers understand how to do this (Geels, Elzen & Green, 2004).

In ‘*Understanding System Innovations: A Critical Literature Review and A Conceptual Synthesis*’, Geels takes “technological substitution as the entry point” (2004: 20) to the sociological, economic, and socio-technical literatures covering system innovations. His synthesis results in an “evolutionary multi-level perspective” (*ibid*: 32) which indicates that: “system innovations start in technological niches; ... diffusion and breakthrough of new technologies occurs as the outcome of linkages between developments at different levels [i.e. in the niche and in its transactional and contextual environment]; ... system innovations come about by the linking of multiple technologies ... [and] do not only involve technology and market shares but also changes of wider dimensions such as regulation, infrastructure, symbolic meaning and industrial networks” (*ibid*: 42).

This conceptual synthesis indicates that “transition policy should ... stimulate probing and learning for those [niches] that need it and stimulate market take-up when learning has sufficiently progressed” (Elzen, Geels & Green, 2004: 291). The former should include support for R&D and network building (*ibid*), and the latter “should target not just economic conditions (through tax and regulations) but also beliefs, expectations and institutional factors” (Geels, Elzen & Green, 2004: 12).

Will the South African government take this

transition management route? In some ways it is already doing so (e.g. ASGISA), but there is a significant gap between current practice and the best practice suggested in the transition management literature. One of the things that leaders from elsewhere in the system could do is encourage government to close this gap. However, capacity problems relating to South Africa's apartheid past would probably make it difficult for the government to close the gap in the near term (Mlambo-Ngcuka, 2006), unless additional help from the institutions that are advising the government on ASGISA is available.

### 6.2.3.3 Pension Fund Trustee Leadership

Lone trustees have often played significant leadership roles in relation to their fund's adoption of LTRI, e.g. at the UK Universities Superannuation Scheme (Casson & Russell, 2006). Trustee-led change has the benefit that it starts with a change in the organisation's ethos, and as "ethos describes what is important to the system ... [it] guides decision-making with respect to the other aspects of organisation as well" (Dostal, 2005: 165). For example, a genuine change in ethos at the trustee level will lead to changes in the aims and governance of the investment process, which will have an impact on how the investment is undertaken in practice (*ibid*). This would help address the implementation issues highlighted by the interviewees and the desk research.

Trustees of South African pension funds with capacity constraints could start by simply signing up to some of the existing international pension fund initiatives. These include the UN PRIs, the Enhanced Analytics Initiative, the Carbon Disclosure Project and the Investors' Statement on Transparency in the Extractives Sector. "Not only is collaborative action likely to be more effective, it also means that the costs of achieving any change are shared" (Casson & Russell, 2006: 170).

Trustees from pension funds with more capacity could also take the lead in developing local collaborative initiatives based on a shared vision. Although "it is possible to deviate from the rules, ... this takes a lot of effort" (Geels, 2004: 36), so these pension funds might seek government support for their work as part of the latter's transition management (see above). This would be appropriate given the difficulties of collaboration (see section 2.2) and given that the support would help realise the considerable potential large pension funds collectively have to accelerate development, including "creating a countervailing force to ... [the] short-term, defensive lobbying" (Robbins, 2006: 316) that can make transition management approaches to public policy difficult to implement.

As several interviewees pointed out, since the launch of the UN PRIs earlier this year trustees have an existing global network. Signatories of the UN PRIs currently include pension funds from all the continents, and the annual benchmarking process is

being designed to help pension funds make their commitments a reality (United Nations, 2006c). GEPP was a signatory at launch.

Given the fact that most South African pension funds have trustees who belong to the trade union movement, this provides these trustees with a local support network. A wider global 'workers' capital' movement which "promot[es] trade union concerns through investment" (Powdrill, 2006: 266) also exists. Carefully developing initial trade union priorities for pension fund LTRI that are widely seen as legitimate will probably help these trustees begin to drive the agenda (*ibid*).

Will trustees take this leadership role? Some trustees might become passionate about LTRI, and this passion can help drive collective action (Walker & King, 1992). However, other stakeholders cannot rely on this happening, especially as GEPP's trustee board is new, and therefore probably working on more pressing priorities (Gribben & Gitsham, 2006; Powdrill, 2006). The trade unions are already active in this area, and they could probably use the knowledge being built up in the global 'workers' capital' movement, including which issues to prioritise initially. Leaders from elsewhere in the system could encourage trustees to prioritise LTRI, and help them build the capacity to do so (*ibid*).

### 6.2.3.4 Leadership from LTRI Pioneers

Glenn, Gordon and Dator note that in order to create change it is important "to inspire decision-makers with alternative futures and choices, demonstrating their technical feasibility, and warning of the consequences of inaction" (2001: 177). The South African LTRI community can and does play an important role in each of these respects.

The latter point reflects the fact that in most cases "concerted (and often successful) regime-changing engagement by social actors has targeted the incumbent regime", rather than its potential successor" (Berkout, Smith & Stirling, 2004: 61). "When ... tensions become pressing, a system may lose its stability, creating opportunities for change" (Geels, Elzen & Green, 2004: 6)

In addition to targeting trustees and the mainstream investment industry, it should be noted that "social aspirations that are becoming embedded in an institutional order typically first need to engage at the macro-level ... of general opinion, legislation, and so on, before they can become effective in seeding a transition" (Berkout, Smith & Stirling, 2004: 60).

All of the above is likely to be more cost-effectively achieved through collaboration, and the industry groups working on the FSC process are a good starting point for this, due to the trust and common understanding that is being built (Ostrom, 1990). Given the challenges of collective action, it might even be possible to get government support as part of its own transition management (see above). However, without support, it might be sensible for the

LTRI community to focus on one high leverage initiative (Berkout, Smith & Stirling, 2004; Dostal, 2005), perhaps triggering a government-commissioned Myners-style review at the FSC review point in 2009.

However “there cannot be a long term without a short term” (Spies, 1999 :4), and the LTRI community will also need to deliver products and services that reflect what a sufficient number of trustees, their advisors and other clients are prepared to spend money on in the short- to medium-term.

Given PIC’s size it could play a critical role in triggering change in the wider investment community, although like the trade unions and the LTRI community above it will need to be careful to set priorities that are widely seen as legitimate (Teisman & Edelenbos, 2004).

### 6.3. Conclusions and Recommendations

Governance of South Africa’s largest public sector pension funds has largely been captured by personal agendas and/or global investment industry norms. There is currently very little effective resistance from stakeholders regarding the impact on society of the latter, although there are interesting developments relating to targeted investments and shareholder activism within investment industry niches.

Stakeholders believe that the largest South African public sector pension funds should play a collective development role (preferred future), and emerging examples from overseas and the literature on collection action indicate that this is theoretically possible (a possible future). However, without leadership from government or the largest public sector pension fund(s) emerging, the future will probably only reflect any changes in the global investment industry (probable future). These changes are likely to be incremental, unless there is a shock to the global system.

In short, the tentative answer to the first primary research question is that there is a possible collective development role for South Africa’s largest public sector pension funds. However, this is unlikely to happen without leadership from government or the pension funds themselves emerging.

Given the enormity of the sustainable development challenge, the emerging transition management approach is likely to provide the most useful insights for government leadership. Given current capacity constraints, this might require further support from the institutions working with the government on ASGISA.

Impassioned trustees will need to focus on implementation as well as LTRI policies, and ensure that priorities are widely supported. The UN PRIs and other global initiatives provide potential useful networks for trustees.

In the absence of external support, the LTRI community will probably need to focus on a high

leverage initiative, perhaps relating to the FSC 2009 review point. Whilst doing this they will need to ensure that their products and services meet the near-term needs of clients, so that they survive to serve the LTRI needs of pension funds.

In short, the tentative answer to the second primary research question is that the government should focus on a transition management approach to sustainable development, impassioned trustees on LTRI implementation, and the LTRI community on a high leverage initiative. In the latter cases external support might be forthcoming as part of the government’s transition management approach. This would create an unusually powerful long-term voice that would help reinforce government’s ongoing transition management efforts.

### 6.4 Wider Lessons

Some of the insights above are potentially relevant to large non-South African pension funds and their stakeholders, as they work towards creating an investment system that supports and encourages sustainable development:

- Large pension funds that have decided to work collectively as universal owners could seek government support as part of the latter’s management of the transition to sustainable development. This would be appropriate given the problems of collective action, and how unusual large pension funds are in having both a long-term perspective and the potential to collectively accelerate the transition, critically including “creating a countervailing force to ... [the] short-term, defensive lobbying” (Robbins, 2006: 316) that can make transition management approaches to public policy difficult to implement. The same argument applies to the largest pension funds in the world asking for support from inter-governmental organisations like the United Nations.

- If public sector pension funds are to take a bigger role in the transition to sustainable development, the chosen priorities will need to be seen as legitimate. These funds could start to experiment with forms of participative democracy that commentators believe will be necessary to achieve a transition to sustainable development (Teisman & Edelenbos, 2004). The largest pension funds in the world could, with the support of the United Nations, start an ongoing participative process to determine what their role should be in the twenty-first century in order to help the PRI process live up to its potential (Thamotheram & Wildsmith, 2006).

- A significant change in the ethos and aims of an organisation requires change in all other aspects of organisation (Dostal, 2005). Large pension funds adopting an LTRI policy will need to ensure that their policies are fully implemented by making these changes. This might include setting up pension fund investment co-operatives (Ambachtsheer, 2005), if external fund managers, despite the best efforts of

those working within their organisational constraints, cannot deliver the services that universal owners need due to conflicts of interest.

In addition, large pension funds could further help accelerate sustainable development by using action research to achieve the above (see section 6.5 below).

## 6.5. Limitations and Recommendations For Further Research

### 6.5.1 Limitations

As noted in section 2, Slaughter stresses the importance of “seek[ing] social confirmation or rejection of the results” when measuring the future, and Critical Systems Heuristics suggests that “no plans are rational which have not been approved by the ‘affected but not involved’” (Flood & Jackson, 1991: 198). These steps have not been undertaken in this case due to the time-limited nature of the research process. As such the conclusions above can only be seen as tentative, and the reader should be aware that:

- No interviews with non-South African residents were undertaken, and nearly all the interviewees were sympathetic to SRI to some extent. As Spies notes “a long view needs a broad view” (1999: 3).

- Semi-structured interviewing is a relatively subjective technique and although the author endeavoured to be as objective as possible when identifying and analysing the themes for inclusion, “not all self interest can be disclosed since we all operate from epistememes that are outside of our knowing efforts” (Inayatullah, 2002: 480).

- Introducing the universal owner theory to interviewees might also have affected the results of the process, although there were reasons for doing this (see section 5.1) and the introduction of ‘interim visions’ does have a valid role to play in co-creating a vision (Senge, 1994).

It had been envisaged that the research process would only be the first step in a longer participative process that would have involved visioning and learning-by-doing. Unfortunately this will not now be the case, but the author hopes that the analysis, conclusions and recommendations above will prove useful to some of the people in the investment and wider South African and global communities who are working towards a sustainable future.

### 6.5.2 Further Research

Much is still not understood about transitions (Elzen, Geels & Green, 2004). Although Elzen *et al* note that “given the complexity of transition processes there are good reasons to argue that transition management is merely a contradiction in terms” (2004: 287), they also point out that emerging approaches to transition management “hold promise if only for the reason that they address the shortcomings in existing policies” (*ibid*: 288). They go on to suggest that the focus should be on whether “transitions can be managed in

such a way that major upheavals do not occur” (*ibid*: 296). Berkhout, Smith and Stirling (2004) introduce the concept of ‘transition contexts’ to highlight that transition processes and paths are likely to be context dependent, and that highly co-ordinated government-led management of a transition, might lead to very different paths and processes than historical transitions that have tended to be un-coordinated and/or co-ordinated from within.

The FSC process in South Africa, and the UN PRIs and other collaborative pension fund initiatives globally, could provide interesting case studies for Futures Studies generally, and the study of transitions more specifically. An action research approach could be used (Herr & Anderson, 2005), allowing the researcher and participants to draw on and generate Future Studies knowledge as they collectively make the future more sustainable.

In parallel, the question of how governments can help realise the collective role large public sector pension funds, with their unusual combination of economic power and long-term perspective, could play in helping underpin a shift to government-led transition management could be explored.

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## Appendix: Materials Relating to the Interviews

### 1. Invitation

July 2006

Dear .....

Invitation to Participate as a Key Stakeholder in an Action Research Project entitled  
South Africa's Largest Public Sector Pension Funds: A Collective Developmental Role?

As part of my business school MPhil/PhD programme I am undertaking a piece of action research that aims to:

- Establish whether South Africa's largest public sector pension funds could play a wider role in building a sustainable future for their members, their communities, and their country.
- Build commitment to collective action (if appropriate) in the areas of shareholder activism and targeted investments (e.g. infrastructure bonds, empowerment-focused private equity, and social housing).

A core group of pension fund trustees will meet for a maximum of three half-day group meetings next year to discuss the above issues.

Input from key stakeholders will be collected prior to and between these meetings, and I am writing to invite you to join the stakeholder group. The time commitment is a 1 hour 1:1 interview this August, followed by two 1 hour 1:1 interviews next year.

I will be undertaking all aspects of the project personally, and will be building on my experience of co-authoring a recent stakeholder-led UK trustee toolkit (available at [www.justpensions.org](http://www.justpensions.org)). I was formerly the Executive Director of the UK Social Investment Forum and I am now living in South Africa for two to three years

I will call you at the end of July to answer any questions you might have, and hopefully schedule an interview for August.

Yours sincerely

Helen Wildsmith

### 2. Confirmation E-mail

.....,

It was good to speak to you today. Here is a one page note on the universal owner concept. The (telephone) interview (..... on ... ..) will focus on this concept in relation to South Africa's largest public sector pension funds, e.g. what hopes, fears, opportunities and constraints does the concept bring to mind. Apart from quickly reading the attached, there is no need to do any further preparation.

Thanks again for agreeing to participate,

Helen

### 3. The Universal Owner Concept: A Brief Introduction

Universal owners are long-term owners of a significant slice of the economy. Large pension funds, with their long-term investment horizons and diversified portfolios, are classic universal owners.

The following quote about the implications of being a universal owner is taken from [www.fidcap.org](http://www.fidcap.org) where further

information about the universal owner concept can be found:

“A universal owner’s cumulative long-term return is determined not merely by the performance of each individual [asset] it owns, but by the performance of the economy as a whole. This has at least two potentially important consequences:

- First, it means that when universal owners evaluate the ... [assets] they own, one significant dimension should be how each [asset]’s activities affect ... other holdings in its portfolio and hence the returns earned by other [assets] in their portfolio. The universal owner captures positive externalities generated by [assets] and is harmed by their negative externalities.
- A second consequence is that universal owners come to occupy a quasi public policy position as having an economic interest in the long-term health and well-being of society as a whole. The universal owner’s unusual position suggests they have an interest not only in standard macroeconomic policy issues, but more specifically in regulatory policy and the provision of public goods such as education and health, tort law, and infrastructure generally, both physical and human”

Being a universal owner therefore requires specific policies and practices in the areas of investment analysis and decision-making, ongoing ownership, and public policy engagement. Universal owners can act individually or collectively in any of these areas.

The universal owner concept was influential in the development of the UN’s recently launched Principles for Responsible Investment, and Kofi Annan’s comments reflect this:

“Today it is increasingly clear that UN objectives - peace, security, development - go hand-in-hand with prosperity and growing markets. If societies fail, so will markets”.

4. Seven Interview Questions:

- i) When you think about the universal owner concept and South Africa’s largest public sector pension funds what hopes spring to mind?
- ii) When you think about the universal owner concept and South Africa’s largest public sector pension funds what fears spring to mind?
- iii) Given these hopes and fears what three questions would you ask someone who can see into the future?
- iv) What pivotal events from the last few years provide good lessons for South Africa’s largest public sector pension funds in their role as universal owners?
- v) What major decisions with long term implications are faced now by South African universal owners, particularly large public sector pension funds?
- vi) What constraints do South African universal owners face, particularly large public sector pension funds?
- vii) If all the constraints were removed what should South African universal owners do, particularly large public sector pension funds?

<sup>1</sup> 2004 figures are used throughout this mini-thesis because, for some of the data sets used, this is the latest available information. The GDP figures are from the World Bank (2005), and the figures relating to the assets of pension funds and fund managers are from P&I & Watson Wyatt (2005a) and P&I & Watson Wyatt (2005b) respectively.