

Stewardship of Mutual Funds / Asset Management Companies – Strengthening Corporate Governance, Safeguarding Investors Interest

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Abstract

Mutual funds /Asset Management Companies (AMCs) are in the possession of pool of funds created from the investments of varying amounts from the investors. Since myriad investors from all walks of like invest their hard earned money in varied schemes of mutual funds for both long and short term with the expectations that returns from their investments will soar and financial interests will be safeguarded. In view of this, mutual funds / AMCs have fiduciary obligation towards its investors and so they need to act as 'Stewards' to ensure that the investments made in the stocks, debentures, preference shares, other financial assets of the companies are adhering to the canons of corporate governance or not so that the probability of wealth erosion of the investors is mitigated.

In view of this, it generates paramount academic and research interests to reconnoitre the performance of select mutual funds / AMCs on vital yardsticks that is themes, priorities and engagements by teams.

Keywords: Stewardship; Vital Yardsticks; Governance

JEL Classification Code: G2 (Financial Institutions and Services)

Introduction

Mutual funds (MFs) / Asset Management Companies (AMCs) invest massive funds in various companies through varied financial assets. Since funds of large number of investors are involved, it is extremely important that mutual funds / asset management companies monitor the performance of investee companies on certain vital yardsticks such as board effectiveness; board diversity; shareholder rights and grievances; transparent voting and disclosure policy; strategy, purpose and financial buoyancy; financial value creation; environmental matters, i.e., climate and natural capital etc.

In light of the aforesaid facts, Stewardship Codes of MFs / AMCs plays a crucial role in ensuring corporate governance of the investee companies. As it involves exploring critical dimensions of a company where a MF/AMC invest its funds, it provides solace to the investors that their funds are safe.

In view of the paramount role the Stewardship Code plays in ensuring corporate governance and safeguarding the interests of the investors, the ensuing paragraphs delve into the significant facets of Stewardship Codes bundled into themes, priorities and engagements to comprehend its efficacy.

Literature Review

Fisch Jill E. (2020) highlighting the challenge of stewardship movement in mutual funds have stated that institutional investors comprising of big asset managers are treated as shareholders rather than intermediaries.

Varottil Umakanth (2020) have undertaken a research study to ascertain the UK's Stewardship Code possibility of being recast into other countries also in view of the fact that it was designed as per the economic, legal and political conditions prevailing in UK.

Gomstian Suren (2021) have attempted to ascertain whether activist campaigns inform and widens the spectrum of institutional investor stewardship by undertaking both empirical and theoretical analysis of the interactions between activists and institutional investors. The theoretical analysis revealed that big investment managers and a substantial chunk of activist shareholders have varying perspectives of stewardship. On the other hand, empirical observations confirmed that big asset managers do not have a free ride on the endeavours made by shareholder activists, particularly large hedge funds to expand stewardship.

Bansal Sikha and Malu Neha (2023) have defined the term "Stewardship". According to them it implies the act of safeguarding the rights of the person to whom it is acting as a steward. With reference to shareholders' governance and capital markets, the institutional investors act as a steward for their clients or beneficiaries as the funds invested by the institutional investors in various companies are owned by a mammoth number of investors who had sacrificed their savings by investing in various schemes of institutional investors and thus it can be stated that the institutional investors are not the owners rather steward of the funds.

Kochar Sumit and Gera Shivam (2023) have opined that under the patronage of an Indian Stewardship Code, efficient corporate governance and responsible shareholder investment have the potential to cajole both Indian and foreign investors to invest in Indian capital market.

Research Questions / Hypothesis

1. Whether Black Rock's Mutual Funds Stewardship approach has given same emphasis on all the themes (Governance, Climate and natural capital, and Company impacts on people) across the regions (Americas, APAC and EMEA) it serves as per the BIS Report 2022?

Null Hypothesis (H0): *There is no significant difference in the emphasis on all the themes by Black Rock's Mutual Funds, i.e., Governance, Climate and natural capital, and Company impacts on people across the following regions- Americas, APAC and EMEA.*

Alternative Hypothesis (H1): *There is a significant difference in the emphasis on all the themes by Black Rock's Mutual Funds, i.e., Governance, Climate and natural capital, and Company impacts on people across the following regions- Americas, APAC and EMEA.*

2. Whether Black Rock through its Stewardship have focused equally on all the Priorities (Board quality and effectiveness; Strategy, purpose and financial resilience; Incentives aligned with financial value creation; Climate and natural capital and Company impacts on people) it reconnoitres in the companies where it invests investors funds?

Null Hypothesis (H0): *There is no significant difference in the focus on all the Priorities by Black Rock Mutual Funds.*

Alternative Hypothesis (H1): *There is a significant difference in the focus on all the Priorities by Black Rock Mutual Funds.*

3. Whether Goldman Sach's Asset Management Stewardship approach has given same emphasis on all the engagements by teams, i.e., Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams across the regions (Americas, APAC and EMEA) it serves as per the BIS Report 2022?

Null Hypothesis (H0): *There is no significant difference in Goldman Sachs Asset Management's engagements by teams i.e., Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams across the following regions- Americas, APAC and EMEA.*

Alternative Hypothesis (H1): *There is a significant difference in Goldman Sachs Asset Management's engagements by teams i.e., Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams across the following regions – Americas, APAC and EMEA.*

Methodology and Data Collection

1. Chi-Square Test: The chi-square test is a useful measure of comparing experimentally obtained results with those expected theoretically and based on the hypothesis. It is used as a test statistic in testing a hypothesis that provides a set of theoretical frequencies with which observed frequencies are compared. In general, Chi-Square test is applied to those problems in which we study whether the frequency with which a given event has occurred, is significantly different from the one as expected theoretically.

The advantage of Chi-Square test is that it enables us to find out the degree of discrepancy between observed frequencies and theoretical frequencies and assist in determining whether the discrepancy so obtained between observed frequencies and theoretical frequencies is due to error of sampling or due to chance.

The Chi-Square test have been applied to conduct analysis of the Region-wise and Theme-wise Engagement of BlackRock Mutual Funds (please refer tables 1 and 2) to ascertain whether the company has given equal focus or not on the mentioned themes and emphasis on engagements by teams i.e., Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams by Goldman Sachs Asset Management in Americas, APAC and EMEA (please refer tables 5 and 6)

2. F-Test (One Factor Model): This test is also known as Fisher's F-test or simply F-test. It refers to a test of hypothesis concerning variances derived from two samples. It is based on the F-distribution, which is defined as the ratio of two independent chi-square variates which is derived by dividing each variable by its corresponding degrees of freedom, i.e.,

$$F = \frac{\frac{\Psi^2}{v_1}}{\frac{\Psi^2}{v_2}}$$

The advantage of F-test is that it can be used for categorial independent variables with more than two levels.

The F-test have been applied to analyse the focus on Priorities (Board quality and effectiveness; Strategy, purpose and financial resilience; Incentives aligned with financial value creation; Climate and natural capital and Company impacts on people) by BlackRock Mutual Funds (please refer tables 3 and 4).

The data pertaining to themes, priorities and corporate engagements have been collated from the Stewardship Reports of the MF / AMC considered for the research study. The Stewardship Reports referred are – “BlackRock Investment Stewardship Annual Report, 2022” (<https://shorturl.at/CDGSW>) and “Goldman Sachs Stewardship Report 2022” (<https://shorturl.at/gipA8>).

Background and Findings

As this research study has been undertaken to have a broad idea regarding the efficacy of Stewardship of selected Mutual Funds or Asset Management Companies by engaging in various themes and priorities constituting corporate governance of the companies in which the investors funds are invested, so consistency in terms of years of Stewardship Reports of the MF /AMC that have been referred may not be considered highly significant, i.e., with reference to BlackRock’s Mutual Funds, its Stewardship Reports for three years- 2020, 2021 and 2022 have been referred and for Goldman Sach Asset Management Company, Stewardship Report of only 2022 have been referred.

In case of India, the capital market regulator, Securities and Exchange Board of India (SEBI) through its Circular – CIR/CFD/CMD1/168/2019 dated December 24, 2019 came out with Stewardship Code for all Mutual Funds and all categories of Alternate Investment Funds (AIFs), in relation to their investment in listed equities.

SEBI came out with Stewardship Code after recognizing the fact that significance of institutional investors in capital markets across the globe is soaring and as custodian of investors funds they are expected to espouse higher responsibility towards their clients / beneficiaries by stoking monitoring and engagement with their investee companies. Such activities are known as Stewardship Responsibilities of the institutional investors and are intended to preserve their clients’ wealth. The Stewardship Code came into effect from April 1, 2020. The Stewardship Code is based on the following principles:

Principle 1: Principle 1 Institutional Investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically.

Principle 2: Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

Principle 3: Institutional investors should monitor their investee companies.

Principle 4: Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors where required, to preserve the interests of the ultimate investors, which should be disclosed.

Principle 5: Institutional investors should have a clear policy on voting and disclosure of voting activity.

Principle 6: Institutional investors should report periodically on their stewardship activities.

To have an idea regarding the extent of corporate engagement by a mutual fund company, the corporate engagement data of SBI Mutual Funds referred from its Stewardship Report 2022-23 as a sample is being presented in exhibit 1.

Exhibit 1

Corporate Engagement of SBI Mutual Fund in FY23

Categories of Corporate Engagement	Number of Corporate Engagements in FY23	Percentage of Corporate Engagements
Disclosures	50	22.52%
Environmental	25	11.26%
ESG	24	10.81%
Governance	120	54.05%
Social	3	1.35%
Grand Total	222	

Now coming to the analysis of the performance of MF /AMC on vital yardsticks, the same have been undertaken in the following manner:

1. BlackRock's Mutual Funds Stewardship approach have been analysed region-wise (America, APAC and EMEA) and Theme wise (Governance, Climate and natural capital, and Company impacts on people) by applying Chi-Square Test. This aspect is analysed based on Black Rock's Stewardship Report of 2022.
2. To comprehend the priorities wise performance of BlackRock's Mutual Funds for a period of three years i.e., for 2020, 2021 and 2022, F-Test (One Factor Model) have been applied to ascertain whether all the priorities have received equal emphasis or not.
3. To comprehend the efficacy of Stewardship approach of Goldman Sachs Asset Management in terms of engagement by teams on the following engagements: a) Global Stewardship, b) Fixed Income, c) Fundamental Equity, d) Multiple teams, Chi-Square Test have been used.

The region-wise and theme-wise engagement of BlackRock Mutual Funds across Americas, APAC and EMEA, and the analysis of its engagements have been provided in Table 1 and Table 2 respectively.

Table 1

Region-wise and Theme-wise Engagement of BlackRock Mutual Funds

Regions Themes	Governance	Climate and natural capital	Company impacts on people	Total Engagements (Companies)
Americas	541	142	123	806
APAC	318	116	109	543
EMEA	262	59	57	378
	1121	317	289	1727

Table 2

Application of Chi-Square Test of Region-wise and Theme-wise Engagements

Observed Value (O)	Expected Value (E)	(O - E)	(O-E)²	(O-E)²/E
541	523.1766068	17.82339317	317.673344	0.607200972
318	352.462652	-34.462652	1187.674383	3.369646049
262	245.3607412	16.63925883	276.8649344	1.128399487
142	147.9455704	-5.945570353	35.34980683	0.23893792
116	99.67052693	16.32947307	266.6516909	2.675331406
59	69.38390272	-10.38390272	107.8254357	1.554041089
123	134.8778228	-11.87782281	141.0826748	1.046003501
109	90.86682108	18.13317892	328.8121779	3.618616498
57	63.25535611	-6.255356109	39.12948005	0.618595522
				$\sum[(O - E)^2 / E]=14.86$

$$\chi^2 = \sum [(O - E)^2 / E] = 14.86$$

$$\text{Degrees of freedom } v = (r-1)(C-1) = (3-1)(3-1) = 4$$

$v=4, \chi^2_{0.01} = 18.465$

Decision: The calculated value of χ^2 i.e., 14.86 is lower than the table value, i.e., 18.465. Thus, we fail to reject the null hypothesis. Hence, all the themes, i.e., Governance, Climate and natural capital, and Company impacts on people are given equal emphasis across the following regions- Americas, APAC and EMEA.

The engagements of BlackRocks Mutual Funds priorities-wise for the years 2020, 2021 and 2022 is provided in table 3.

Table 3
Year-wise focus on Priorities

Years Priorities	Board quality and effectiveness	Strategy, purpose and financial resilience	Incentives aligned with financial value creation	Climate and natural capital	Company impacts on people
2020	1593	1427	1185	1260	750
2021	2142	2038	1213	2293	1247
2022	2349	2118	1509	2115	1469

The analysis of the data provided in table 3 using F-Test (One Factor Model) is provided in table 4.

Table 4
Analysis of Priorities

Anova: Single Factor						
SUMMARY						
Groups	Count	Sum	Average	Variance		
1427	2	4156	2078	3200		
1185	2	2722	1361	43808		
1260	2	4408	2204	15842		
750	2	2716	1358	24642		
ANOVA						
Source of Variation	SS	Df	MS	F	P-value	F crit
Between Groups	1237370	3	412456.5	18.85688	0.007995	6.591382
Within Groups	87492	4	21873			
Total	1324862	7				

Decision: The computed value of $F=18.85688 >$ Tabled value of $F_{0.05} = 6.591382$, which implies that the null hypothesis H_0 is rejected, i.e., all the Priorities are not equally focused Black Rock Mutual Funds.

The data pertaining to Goldman Sachs Asset Management’s engagements by teams across the regions it serves, i.e., Americas, APAC and EMEA and analysis of its performance on the basis of its engagements is provided in Table 5 and Table 6 respectively.

Table 5
Engagements by teams in Americas, APAC and EMEA

Regions / Engagement by Teams	Global Stewardship	Fixed Income	Fundamental Equity	Multiple Teams	Total Engagements
Americas	204	329	137	98	768
APAC	239	72	353	99	763
EMEA	90	378	185	35	688
	533	779	675	232	2219

Table 6
Analysis of Performance in terms of Engagements by Teams

Observed Value (O)	Expected Value (E)	(O - E)	(O-E)2	(O-E)2/E
204	184.4722848	19.52771519	381.3316604	2.06714879
239	183.2712934	55.72870662	3105.688742	16.94585488
90	165.2564218	-75.25642181	5663.529024	34.27115849
329	269.6133393	59.38666066	3526.775464	13.08086415
72	267.8580442	-195.8580442	38360.37346	143.211579
378	241.5286165	136.4713835	18624.43852	77.11069101
137	233.6187472	-96.61874718	9335.182307	39.95904618
353	232.0977918	120.9022082	14617.34395	62.9792461
185	209.283461	-24.28346102	589.686479	2.817644912
98	233.6187472	-135.6187472	18392.44459	78.72846169
99	79.77287066	19.22712934	369.6825026	4.634188283
35	71.93150068	-36.93150068	1363.935742	18.96159164
				$\sum[(O - E)^2 / E]=494.77$

$\chi^2 = \sum [(O - E)^2 / E] = 14.86$

Degrees of freedom $v = (r-1) (C-1) = (3-1) (4-1) = 6$

$v=6, \chi^2_{0.01} = 22.457$

Decision: The calculated value of χ^2 i.e., 494.77 is higher than the table value, i.e., 22.457. Thus, we reject the null hypothesis. Hence, Goldman Sachs Asset Management's Engagements by teams i.e., Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams are not given equal emphasis across the following regions – Americas, APAC and EMEA.

Analysis and Discussion

From the above analysis we got conversant with interesting facts. In case of BlackRock's Mutual Funds, theme wise across all the regions it serves is doing exceedingly well. As evident from the figures given in tables 1 and 2, theme-wise engagement i.e., Governance, Climate and natural capital, and Company impacts on people of BlackRock is soaring in all the regions, i.e., Americas, APAC (Asia-Pacific) and EMEA (Europe, the Middle East and Africa).

For instance, for the theme Governance in Americas is 541, APAC is 318 and EMEA is 262, thus total engagements for the Governance theme stood at 1121. Similarly, if we look at the Climate and natural capital theme it is quite heartening to note that across all the regions it is quite impressive, i.e., in Americas it is 142 and in APAC it is registered at 116, thereby exhibiting the proclivity of the BlackRock Mutual Funds towards environmental matters.

It is to be noted that climate and natural capital has gained mammoth significance across the globe in view of the growing emphasis on the concept of ESG (Environmental, Social and Governance), wherein E which relates to environment have become focal point of various international organisations like UN Framework Convention on Climate Change (UNFCCC) that conducts series of COP (Conference of the Parties) to the UNFCCC (very recently COP 28 was held in Dubai from November 30 – December 12, 2023), Global Reporting Initiative (GRI), corporate houses reporting about their environment protection initiatives under 'Natural Capital' component of Integrated Reporting etc. and the same is being reflected to a large extent in the stewardship of BlackRock Mutual Funds

Now on observing the year-wise Priorities of BlackRock Mutual Funds, it may be opined that broadly equal focus has not been given on all the Priorities. As on referring table 3, it may be stated that the following Priorities – Board quality and effectiveness; Strategy, purpose and financial resilience; Incentives aligned with financial value creation and Climate and natural capital have been high focus in comparison to Company impacts on people, as in the year 2020 its value stood at just 750 which is quite less compared with the values of other Priorities in the same year.

Further, it is interesting to note that the Priorities – Board quality and effectiveness; Strategy, purpose and financial resilience and Incentives aligned with financial value creation have exhibited an increasing trend. In case of Board quality and effectiveness it is 1593, 2142 and 2349 for the years 2020, 2021 and 2022 respectively. For Strategy, purpose and financial resilience it is 1427, 2038 and 2118 for the years 2020, 2021 and 2022 respectively and for Incentives aligned with financial value creation, the figures are- 1185, 1213 and 1509 for the three consecutive years respectively.

However, there is a silver lining that despite the focus on the Priority – Company impacts on people being less, a rising trend can be observed, i.e., it has enhanced from 750 in 2020 to 1469 in 2022.

Similarly, looking at the performance of Goldman Sachs Asset Management Stewardship approach, it is observed that its engagement by teams (Global Stewardship, Fixed Income, Fundamental Equity and Multiple Teams) for various engagements are not same (please refer table 5). As it can be observed from the figures of engagement by teams, Fixed Income is extremely well and is the highest at 779 and Multiple Teams being the lowest at 232. Global Stewardship and Fundamental Equity's performance is quite well with their engagements value being 533 and 675 respectively.

On referring table 6 in continuation to table 5, it may be stated that the difference between the Observed Values and Expected Values (O – E) is quite high resulting into huge calculated value of Chi-Square i.e., 494.77, which is significantly higher than the table value of Chi-Square i.e., 22.457, resulting into rejection of null hypothesis.

Finally, in case of India, on undertaking a descriptive study it can be opined that the Stewardship Code of SEBI is a game changer and possess the potential to usher in a renaissance in Indian mutual fund segment. Especially, looking at the six principles propounded by SEBI, it may be stated without an iota of doubt that the investors funds invested in various investee companies will be safe, thereby averting wealth erosion.

Conclusion

As business organisations are constantly influenced by ESTEMPLE factors (E-Economic, S-Social, T-Technological, E-Ecological, M-Media, P-Political, L-Legal and E-Ethical) and so mutual funds / asset management companies also needs to ensure that the companies, i.e., investee companies where investors funds are invested in equity, debt, index funds and other financial assets are safe by engaging them in various critical dimensions which assist in ascertaining the corporate governance scenario of the investee companies. Since a robust corporate governance will assist in holistic growth of an organisation as well as investors wealth.

In the past we have witnessed various financial fiascos of renowned corporate houses, thereby jeopardizing the serendipity of the investors, in light of this, the stewardship of mutual funds / asset management companies will go a long way in providing succour to the investors and refrain investee companies from embracing unfair or non-ethical business practices.

Limitations and Scope for future research

A) Limitations

1. This research study is based on the secondary data.
2. For comprehending the efficacy of Stewardship Codes of MF / AMC only two global mutual fund / asset management companies' data have been analysed.
3. Due to technical constraints the study of other global MFs / AMCs could not be undertaken.

B) Scope for future research

1. In near future, an extensive study on the efficacy of Stewardship approaches of Indian mutual funds / asset management companies may be undertaken based on their priorities or engagements to comprehend the progress made by Indian mutual funds / asset management companies in ensuring best corporate governance practices of investee companies.
2. A sustainability study of Indian mutual funds / asset management companies operating in both public and private sectors may be undertaken with reference to their Stewardship approaches to comprehend as to how stewardship codes have played an outstanding role in upholding the dogmas of corporate governance and safeguarding investors interest.

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