



The AMBACHTSHEER Letter

Sustainable Pension Design • Effective Pension Management

March 2024

TRAVELLING THE ROAD TO ‘PENSION FUND CAPITALISM’:

A PROGRESS REPORT

“We have seen that pension fund socialism will create new problems and demand new policies. It is creating a new ‘interest group’, and through their pension funds this interest group can organize. These institutions will represent the concerns and priorities of the new center of population and social gravity: older people in retirement and older employees to whom retirement provisions are becoming increasingly important.”

Peter Drucker
“The Unseen Revolution”, 1976

*“The **Portfolio Value Creation (PVC)** group is responsible for driving value-creation across **CPP Investments’** global portfolio of material direct equity investments. We work closely with deal teams, portfolio company managements, and deal partners to create value within portfolio companies. Working across all sectors, geographies, and deal phases, **PVC** helps with diligence, enhances governance, actively monitors portfolio companies, drives organizational change, and ensures transfer of best practices across all areas of **CPP Investments’** asset management and value-creation activities.”*

CPP Investments, 2024

A Confession

This *Letter* starts with a confession. Peter Drucker used the term ‘Pension Fund Socialism’ in his 1976 book “The Unseen Revolution”. Note that it became ‘Pension Fund Capitalism’ in the title of this *Letter*. Why make the change from ‘socialism’ to ‘capitalism’ here? Because properly structured, institutions managing pools of retirement savings are not owned and managed ‘by the community as a whole’ as ‘socialism’ requires. Instead, as Drucker actually set out in his book, pension funds should be arms-length entities legally bound to create value for clearly defined groups of stakeholders. Arguably, this makes pension funds the capitalist tools required to effectively invest retirement savings in the best economic interests of those stakeholders. To be clear, we write here of the ‘enlightened’ version of capitalism, not its nasty ‘winner take all’ version.

Canada’s *CPP Investments* has become a classic example of such a value-creating capitalist tool. It manages a C\$600 billion asset pool backing the accrued pension obligations of its 22 million plan members. Under the *CPP Act*, its purpose is to maximize the pool’s long-term return without exposing the pool to ‘undue risk’. *CPP Investments* is governed by a 12-member Board of Directors with a legal obligation to oversee and assess if the 2000+ people organization has a good strategic plan and has the requisite resources to achieve its purpose. The above description of the *PVC* group’s activities suggests *CPP Investments* is at the leading edge of determining where ‘pension fund capitalism’ is going.¹

The goal of this *Letter* is to capsule the almost 50-year journey of ‘pension fund capitalism’ from 1976 to date, and to lay out where, ideally, that journey goes from here.

As further explained below, a new book by Bartley Madden titled “My Value-Creation Journey” plays an important role in addressing the ‘where that journey goes from here’ question.

The 50-Year Journey to Date

Prior *Letters* have described various phases of the journey to ‘pension fund capitalism’. My most detailed description was set out in the 2021 *Journal of Portfolio Management* article titled “[The Canadian Pension Model: Past, Present, and Future](#)”. PSP Investments CIO Eduard van Gelderen has just posted his version of the journey on SSRN in a paper titled “[On the Sustainability of the Canadian Model](#)”. In summary, he writes:

“The Canadian Model is generally regarded as one of the most successful investment models. Historical performance shows good risk-adjusted returns, outperforming passive strategies and other investment models. This performance is attributed to four specific characteristics: 1. Its governance, 2. Large allocations to private markets, 3. Internal management, and 4. The focus on long-term value-creation.”

Of these four characteristics, the first three, while challenging to implement, are at least relatively easy to understand. Less so for the fourth characteristic. In the context of investing, what does ‘long-term value creation’ mean?

Long-Term Value-Creation

There is no simple, single right answer to the question. However, with the passage of time, I am increasingly leaning toward Bartley Madden’s “The Pragmatic Theory of the Firm” as providing the most useful answer. The best way to describe Bartley is as the non-academic that academics turn to when they really want to know what is going on in the business world. His theory of the firm competes favorably with other theories of the firm, some of which led to Nobel Prizes for their developers (e.g., Ronald Coase, Oliver Williamson). However, rather than take the academic route, Bartley chose to work relentlessly as an intermediary between the theory of economics and finance, and the practical world of actually creating measurable value. That is why I believe his “Pragmatic Theory of the Firm”, clearly set out in his new book, is so powerful.

So what is this Pragmatic Theory? A starting key tenet is that ‘maximizing shareholder value’ is an outcome, not a purpose. Instead, what is important is to understand and implement the four drivers of shareholder value:

1. Communicate a vision of the firm that includes its economic and social mission in a way that motivates and inspires employees.
2. Achieve sustainable gains in efficiency and innovation that provide operating returns at least equal to the firm’s cost of capital. Achieving such gains requires an explicit, ongoing commitment to maintaining the firm’s knowledge-building proficiency.
3. Build and maintain win-win relationships with all of the firm’s stakeholders.
4. Invest in the well-being of future generations. For example, the design of products and their manufacture and delivery should aim to minimize waste and pollution, including carbon emissions.

Madden comments that his pragmatic theory views the firm as a holistic system connecting purpose, major activities, and long-term performance.

He recognized that a firm’s actual long-term performance will be impacted by the stage of its lifecycle. It starts with a high innovation/reinvestment phase with high economic returns, but those returns will likely fade towards the cost of capital with the passage of time. Eventually, the firm enters its mature phase. Without ongoing innovation, it will likely descend to the failing business model stage.

This is important framing for long-term investors such as pension funds. For example:

- Are the firms they invest in using the ‘Pragmatic Theory of the Firm’ to guide their decision processes?
- Do the firms they invest in have a clear sense of where they are in their corporate life-cycles?
- Do the firms they invest in have a viable transition plan to net-zero emissions?
- Do the firms they invest in have sufficient systems thinkers on their Boards and C-Suites?
- Do the firms they invest in have flat organizations that foster innovation, or are they pyramid organizations that foster innovation-deficient ‘command and control’ cultures?

Does the ‘Pragmatic Theory of the Firm’ create value in practice? Madden’s book offers many affirmative examples. One of them is the case of *Cummins*, a company that designs, manufactures, distributes, and services diesel, natural gas, electric, and hybrid powertrains.

The *Cummins* Story

Cummins entered the 21st century as mature enterprise losing market share and generating a real return on capital well below its 6% benchmark. When Tim Solso became CEO in 2000, the firm began to dramatically increase its R&D outlays, which with the passage of time began to generate innovations that improved market share and profitability. This path continued when Solso passed the CEO baton to Tom Linebarger in 2012, who continued the R&D, innovation, improved market share and profitability path initiated by Solso. Once investors understood what was happening, *Cummins* stock price transitioned from a market laggard to a material outperformer.

Madden attributes this successful turnaround story to what he calls ‘systems thinking’. Its essence is the understanding that complex systems evolve in non-linear and hard-to-predict ways. This is a new and emerging phenomenon in manufacturing. In his words, “*technologies compete by increasing efficiency and reducing costs, infrastructure develops, regulations change, and value as perceived by customers changes. Today, Linebarger continues to position Cummins to be a leader in the Net-Zero transition with a range of solutions to customers’ needs....*”.

So how does the *Cummins* story relate to Madden’s four drivers of shareholder value? It fits very well:

1. The firm’s stated *vision* is to make people’s lives better by powering a more prosperous world through innovation that inspires its employees.
2. The firm has been generating *investment returns well above its cost of capital*, which in turn is financing the investments required to accelerate its Net-Zero transition.
3. The firm is widely respected for working to sustain *win-win relationships* with employees, customers, and other stakeholders.
4. Its vision and actions are very much in line with *taking care of future generations*.

In closing, Madden adds the requirement for corporate Boards to be part of the solution (i.e., knowledgeable and fully engaged) and not part of the problem (i.e., traditional box-tickers).

Pension Fund Capitalism Today and Tomorrow

All this defines the essence of ‘pension fund capitalism’ today. For retirement savings pools to serve their purpose, they should be invested in businesses that embody Madden’s four drivers of shareholder value. This raises a fundamental question: how many businesses out there in the world today can pass the ‘four drivers’ test? While it is impossible to answer the question precisely, a plausible answer is ‘far too few’.

The 'far too few' answer takes us back to *CPP Investments' Portfolio Value Creation (PVC)* initiative. Recall its intent is to *"drive value-creation across CPP Investments' global portfolio of material direct equity investments. We work closely with deal teams, portfolio company managements, and deal partners to create value within portfolio companies. Working across all sectors, geographies, and deal phases, PVC helps with diligence, enhances governance, actively monitors portfolio companies, drives organizational change, and ensures transfer of best practices across all areas of CPP Investments' asset management and value-creation activities."*

Based on the logic of Madden's 'Pragmatic Theory of the Firm', *PVC's* job description could be expanded to explicitly include his four value-drivers. They are worth repeating here for their clarity and impact:

1. Communicate a vision of the firm that includes its economic and social mission in a way that motivates and inspires employees.
2. Achieve sustainable gains in efficiency and innovation that provide operating returns at least equal to the firm's cost of capital. Achieving such gains requires an explicit, ongoing commitment to maintaining the firm's knowledge-building proficiency.
3. Build and maintain win-win relationships with all of the firm's stakeholders.
4. Invest in the well-being of future generations. For example, the design of products and their manufacture and delivery should aim to minimize waste and pollution, including carbon emissions.

Shifting now from today to tomorrow, let us visualize a world where all major pension institutions have such *Portfolio Value Creation* groups. That would make the world a better place and make Peter Drucker very happy.ⁱⁱ

Are you ready to become a Pension Fund Capitalist and join the Value Creation movement?ⁱⁱⁱ

Keith Ambachtsheer

Endnotes:

- i. *CPP Investments states that its PVC team is comprised of experienced professionals based in Toronto, London, Mumbai, San Francisco, and Hong Kong. It provides bios for 13 senior members. Education-wise, their backgrounds range from science, engineering, information technology, business, law, and history. Experience-wise, it ranges from manufacturing, media, marketing, energy, infrastructure, to organization design. Many have spent time with top consulting organizations such as Bain, Boston Consulting, and McKinsey.*
- ii. *In spirit only. Peter Drucker died in November 2005. In a meeting with him that August I reported to him that his pension revolution was unseen no longer....and gaining momentum. We should also note here the passing of Malcolm Rowan, the author of the 1987 Report titled "In Whose Interest?", which led to the creation of Ontario Teachers' Pension Plan, and ultimately, the Canadian Pension Model.*
- iii. *Assuming a 'yes' answer to the question, the Bartley J. Madden Foundation has funded the creation of the 'The Madden Center for Value Creation' at Florida Atlantic University. The Center hosts visiting scholars from all over the world who are conducting value-creation research. It also convenes a wide range of conferences and events. Last year, it began to offer a free online course leading to a '[Certificate in Value Creation](#)'. Each of the two 2023 offerings attracted a full capacity 1500 participants from many countries around the world. Bartley has also created a [series of 5-minute videos](#) setting out his 'Pragmatic Theory of the Firm' principles.*

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Published by KPA Advisory Services Ltd., 1 Bedford Road, Suite 2802, Toronto ON Canada M5R 2B5
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