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Sovereign Funds Offer a Wealth of Benefits

By Peter Weinberg
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When Zhou Enlai, the former Chinese premier, was asked about the effect of the French revolution over 150 years after its conclusion, he replied: "It's too early to say." While few investors in 2008 have investment horizons of that duration, vestiges of this type of long-term thinking are displayed by the capital markets phenomenon of the first decade of the 21st century, the sovereign wealth funds. Western companies should embrace and reward the SWFs' interest.

The past 25 years have seen dramatic advances in the development of the global marketplace. Companies are more global, capital is traded more freely and investing institutions can seek opportunities far outside their own borders. There are many tangible benefits.

But there is a troubling movement afoot that threatens to set back globalisation: American and European aversion to SWFs, which are pools of capital controlled by energy-producing or newly industrialised countries. Public Strategies, a research and consulting firm, said in February that 55 per cent of all Americans, for example, think that investment by foreign governments harms US national security.

Since the start of 2007, SWFs have invested most actively in the US: approximately $85bn (€54bn, £43bn) or 0.5 per cent of the total value of the US equity market. It is hard to see why these investments have harmed Americans. They are a tiny fraction of the total market. In each case, the entities receiving the capital decided that the price and terms were superior to what they could secure elsewhere.

More important, this is how the markets are supposed to work. Ben Bernanke, Federal Reserve chairman, last week urged financial institutions to "remain proactive in their capital raising efforts – doing so will help the broader economy". While certainly not to the exclusion of domestic sources, SWFs have already provided, and it is hoped will continue to provide, capital to financial institutions. After the Fed's provision of support to JPMorgan Chase in the Bear Stearns situation, SWFs may well have been the next most critical player in having helped avoid a worldwide market crisis.

As a generality, SWFs do have a longer investment horizon than most institutional investors and hedge funds. While more immediate-term investors provide a needed discipline to public companies, it is good to have long-term investors in the mix. Some say they would have given companies the backbone to surrender short-term gains that were the root of the recent problems in the financial sector.

Truly global companies can learn a lot from SWFs – and some have over many years. These funds contain extremely sophisticated people, the best and brightest from both their own nations and more recently, from the older economies.

A question on which protectionist forces focus in relation to SWFs is whether their investment should be accompanied by board representation. Like many institutional investors, they may choose not to serve as board members because it can constrain their flexibility to exit quickly. But it is only a matter of time before SWFs are represented on boards of companies in which they invest – and they should be. All shareholders would benefit from a large, important SWF in the boardroom. Not only are they commercial, but they would provide a much needed global perspective. They would bring experience and expertise gained in their many other investments around the world. They also represent a well informed inside shareholder that could provide additional capital in the future, potentially even against an activist shareholder or a raider not willing to pay a fair price for the company.

Critics of SWFs often state that government investors have different constituencies, different objectives and play by different roles – and to some extent, that is true. There may be sectors where investments may not be appropriate but these should be the exception. SWFs that invest in the west must have a positive relationship with the host government. In addition, SWFs do need to demonstrate, over time, more transparency and reciprocal investing privileges.

SWF investing is good for markets and our global community. Corporate leaders, market participants and politicians should resist the temptation to adopt a bunker mentality just because the security, financial and political systems are stressed. It is because of these stresses that we need them.

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