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The Myth of Who Runs our Corporations and Mutual Funds?

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Does anyone believe shareholders are in charge of companies they own? Do investors really control the mutual funds they buy? On paper, this might be true, but in reality, these are myths.

Like all good myths, there is an element of truth. Technically, shareholders control the boards that in turn determine major policies and senior managements' compensation. However, the truth on the ground is very different - shareholders have no power! It's about time this country had a straight discussion of these issues, so we can carefully chart a course forward.

Can you imagine a real owner of a company paying huge sums to retiring chief executives? For instance, Lee Raymond, who just retired as Chairman of Exxon may have done a good job, but would you give him almost \$400 million in retirement benefits? What owner would have done that?

Mr. Raymond spent his life at Exxon. He never invented anything or risked starting a business. Yes, Exxon's stock is up five-fold since he became chairman, however that's only slightly better than the industry. Don't forget, he was well paid for the job and had a staff of over 83,000 people.

What I find most objectionable is that while shareholders nominally control our public companies, in fact they have no control. This leaves the system wide open to abuse. These pay packages are approved and there is no "owner" feeling the "pain" that accompanies pulling your wallet out and parting with hard-earned dollars.

We need the "keepers of the kiddy" to feel an emotional impact, like when they spend their own money. This is the only way to control a group with authority to spend other peoples' money. Exxon's compensation committee has a lot of talent including the current or former Chairmen of Chase Manhattan, Corning, IBM and J.C. Penny. How do we get them to "feel the pain?" I see very little incentive for them to keep retirement packages under control. As long as their actions can be justified on a relative basis, they are free of liability.

Everyone knows shareholders have no control and it is ludicrous to think otherwise. In Exxon's case, we shareholders were told the size of Lee's package after he left. The

fantasy that shareholders are in control only serves as a shield. Corporate democracy reminds me of all the dictatorships around the world that present their subjects one slate of candidates - and then claim virtuous victories.

The Wall Street Journal's Alan Murray, when discussing Mr. Raymond, writes that companies should "acknowledge" shareholders' "outrage" and make some changes. He thinks the time has come for "giving shareholders an advisory vote on executive compensation." How nice – he wants to give the owners an "advisory" vote.

Shareholders face a similar problem with mutual funds. Does anyone out there really believe shareholders are in control? Look at the numbers - most funds under-perform their benchmarks and their advisors are never fired.

We should abandon the myth of shareholder control. It is a false construct, a Potemkin Village, and everyone knows it! We need to design a system that does not rely on a wink and a nod.

This should be easy in the mutual fund area. Right now, the fiduciary responsibility of the Board and the profit incentive of the fund company are in irreconcilable conflict. So let's drop funds' boards in order to eliminate this conflict. There are better methods to protect consumers. For a provocative discussion of this topic, see a paper by Paula Tkac, a staff member of the Federal Reserve Bank of Atlanta.

Corporate governance is a more difficult nut to crack with very tough issues. Do we really think shareholders are owners? What decisions should owners make - no, this is not a trick question. Who should decide how "green" Exxon should be?

These are hard issues where reasonable people may disagree. However, I doubt any of the accomplished members of Exxon's board truly believe the system treats shareholders as owners. Let's cut the nonsense and design a better system.

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