

# **The Winston Churchill Memorial Trust of Australia**

**Report by James Thier**

**2006 Churchill Fellow**

**To examine the mechanisms of shareholder advocacy, especially resolutions proposed at Annual General Meetings, used to improve the ethics of corporations and promote ecological sustainable and socially just enterprises**

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**James Thier, 10<sup>th</sup> September 2007**

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## Introduction

Ethical/sustainable investment is a field I have been variously involved in for two decades. The Churchill Fellowship enabled me to view this global trend, not just theoretically, but from a practical perspective through visits to leading organisations in the US, UK and Netherlands. The meetings, investigation and assessment program I was able to undertake over an extended timeframe is something rarely achievable. The exercise and experience was a rare opportunity and one I would encourage anyone to seek as their goal.

I therefore wish to thank the Trust and all those involved in making such a pursuit possible.

The following two quotes, respectively, summarise what I'd like to accomplish in the research and what I hope to achieve with its implementation.

*Begin at the beginning and go on till you come to the end; then stop.*  
Alice in Wonderland

*Never doubt that a small group of thoughtful committed citizens can change the world; indeed it is the only thing that ever has.*  
Margaret Mead

## **Executive Summary**

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Fellowship travel was undertaken from April 4 to June 6, 2007. The intent was to visit organisations actively participating in a variety of shareholder advocacy roles. These included the more traditional/corporate perspectives of investment houses through to activist undertakings of NGOs. A significant element in the mix is faith-based organisations, which are increasing willing to attend to matters outside their normally prescribed domain, such as climate change. In addition, there is a growing profile which sees the need to address policy formulation in the endeavour to effect real and lasting improvement.

The dimensions of this investigation were not only significantly different from what is often the case in Australia, but equally there proved to be considerable variation within norms of the countries visited.

### **Highlights**

*Sacramento* – CalPERS is one of the largest pension funds in the world and a leader in corporate governance with respect to issues of shareholder value.

*Boston* – Attending the Ceres conference on Climate Change. Meeting with Tim Smith, Senior Vice President, after his move to Walden Asset Management to enhance their active proxy voting as a means to secure public and management attention.

*New York* - Interfaith Centre of Corporate Responsibility provides guidance and co-ordination on social issues to faith-based members and a broader constituency, including acting as a clearing-house for information on shareholder actions.

*Amsterdam* – Meeting Professor Harry Hummel of SNS who is pre-eminent in socially responsible product innovation.

### **Recommendations**

Shareholder activism is a broad paradigm through which individuals or groups can exert pressure on companies to affect a particular corporate practice.

- Provide procedural infrastructure/produce alternative products to enable new possibilities whereby Australians can influence corporate decision-makers in a concrete, non-confrontational manner
- Establish a framework/methodology for co-ordinating participants and institutional investors to act in a common interest
- Consider an integrated approach to the often disparate programs of corporates, NGOs and faith-based organisations

### **Implementation and Dissemination**

Research findings will be disseminated through regular public presentations and in association with a broad range of networks – professional and community, as well as media contacts and via publications. Promotion to 40,000 people occurred through newsletter and a keynote speaker at a Climate Change summit comprising hundreds of attendees, in July 2007.

Possibly new approaches to investment product formulation and manufacture.

## **Fellowship Program**

### **4<sup>th</sup>–15<sup>th</sup> April, California, USA**

- Glass Lewis and Co
- California Public Employees Retirement Scheme (CalPERS)
- California State Teachers Retirement Scheme (CalSTRS)

### **16<sup>th</sup>–30<sup>th</sup> April, Boston, USA**

- Boston Common Asset Management
- Ceres
- Domini Social Investment
- Board of Pension and Health Benefits of the United Methodist Church
- KLD Research and Analytics
- Trillium Asset Management
- Walden Asset Management
- Winslow Management Co

### **1<sup>st</sup>–14<sup>th</sup>, May, New York and Washington, USA**

- Amnesty International
- Calvert Asset Management
- Developing World Markets
- Institutional Shareholder Services
- Interfaith Centre on Corporate Responsibility
- State Employees International Union
- TIAA Cref

### **15<sup>th</sup>–24<sup>th</sup>, May London, UK**

- 3IG
- Ethical Investment Research Services
- Generation Investment Management
- Hermes Equity Ownership Services
- Impax
- London Bridge Capital
- Morley Fund Management
- The Ecumenical Council for Corporate Responsibility
- Universities Superannuation Scheme
- UK Social Investment Forum

### **24<sup>th</sup>–31<sup>st</sup> May, Netherlands**

- 3IG
- ABP
- Global Reporting Initiative
- SNS Asset Management

### **1<sup>st</sup>–5<sup>th</sup> June, Hong Kong**

### **6<sup>th</sup> June, Return to Sydney**

## Overview

Over recent years shareholders (and their agents) along with stakeholders have sought to exert greater influence over company practices and actions. Generally this means shareholders are no longer willing to cede all responsibility to a management class. Initially the focus, more often than not, was on corporate governance matters. This has begun to expand into sustainability and the initiation of climate change directives. So significant has this one matter become that whole organisations have been established or changed orientation in order to more comprehensively address this global concern. Climate change is recognised, by its magnitude and potential – environmental, humanitarian, health, political, as an overarching issue to rival the consequences of war in its magnitude.

Although there exists only limited literature addressing the respective impact of screening versus activism/advocacy, virtually all evidence indicatively points to the latter as more effective in improving firms' social performance and directly changing corporate behaviour and firms' policies. For Timothy Smith the power of the resolution process lies in it serving multiple constituencies: 'alerting the Board and management of an important shareholder concern; supporting an organised public campaign to influence a company position or practice; or educating investors and the public on a particular social, environmental or corporate governance issue.'

Correspondence with the Interfaith Centre on Corporate Responsibility confirms the lack of hard data yet the increasing appeal of this field of study. '[T]here isn't a great deal written about the impact of shareholder advocacy in quantitative terms (although it seems an increasing area of interest judging from the requests I get from students and journalists).' And in respect to a broader (sustainability) paradigm, even the icon of advocacy/engagement clearly reveals, in recent communication, their emphasis has thus far been limited to corporate governance. 'CalPERS has not done any research on the impact of environment shareowner resolutions on corporate behaviour, nor have we filed any such resolutions.' [pers comm]

## The Streams

The two dominant streams able to influence corporations are via the active portfolio screening practices of ethical/responsible investment and through activism/advocacy. Each is able incorporate engagement or dialogue with companies.

The Australian investment industry is much more familiar with the pros and cons of positive/negative screening. We are less familiar with shareholder advocacy other than the occasional resolutions put at Annual General Meetings (AGMs) in the realm of corporate governance – pretty much the sole emphasis of domestic attention. As benchmarking research by the Ethical

Investment Association showed: there were no sustainability related shareholder resolutions put to general meetings in the 2005-6 financial year.

Conversely, sustainability issues are relatively familiar in the US – it is far easier to achieve – though the total number of resolutions remain comparatively constrained (hundreds a year), often ad-hoc or piecemeal. This is in part because in the context of screened investment, resolutions are usually considered a last resort. As a consequence resolutions, on the occasions they are used, act as leverage to force companies to the table for dialogue; thereby elevating the act of engagement to the dominant process.

In other words, in the US shareholder activism is anticipated to go hand-in-hand with portfolio screening.

### **What is Shareholder activism and advocacy?**

Shareholder activism is an all encompassing term used here (definitions seem to vary by location) to refer to various methods/practices entailing anything: from protests to proxy voting, from engagement/dialogue to boycotts/contentious consumerism, or letter writing to advocacy. All these are simply part of the Socially Responsible Investment (SRI) armoury and, in the US, are more progressed and sophisticated, in sharp contrast to Australia. Shareholder activism has two objectives: to affect a particular corporate practice and to alter the view/elevate public awareness and understanding of a matter.

My particular area of interest is the advocacy function. For me, this is akin to the active putting of resolutions at AGMs and its associated activities, such as engagement and dialogue and letter writing. It seeks to do much the same as activism – provide an educative role, alert management to alternative perspectives – though all within the less confrontational framework.

Advocacy, including resolutions put at AGMs, is used by a majority of SRI funds, and increasingly the broader set of fund managers. This is either done individually or in co-operation with one-another. The extent to which it is undertaken varies, from ad hoc occurrences to whole departments within a manager producing structured programs, such as CalPERS. However, the specific resolution dimension remains restricted. On average, only a few each year per major fund, and is generally considered by most US SRI groups to be a last resort and almost tantamount to failure. This is because by-and-large the mechanism is used by groups to bring companies to the table for dialogue as a way to promote/achieve solutions to outstanding issues.

The resolution itself can be seen as potentially aggressive and time consuming. Part of the reluctance is the likelihood of poisoning a desirable relationship with the company concerned. There is also the impact of the Securities Exchange Commission (SEC) whom companies can appeal to in order to quash a resolution even becoming part of the AGM agenda.

In contrast and alternative to the resolutions route a sole engagement *modus operandi* is internationally more acceptable. Despite the fact that its major

weaknesses are the lack of transparency and surety of outcome, as all dialogue takes place *'in camera'*. Indeed, throughout Europe this is virtually the only expression of advocacy.

## **The Impact of Climate Change**

Until the past few years the environmental and social issues focus yielded positive community outcomes, orienting corporate policies and practices to protect endangered forests, fight workplace discrimination, and end ties with repressive regimes, just to name a few.

Today climate change holds centre stage. It represents **the** issue outside established corporate governance concerns. In fact, a number of NGOs, such as Ceres, and the leading institution for guidance and co-ordination on social issues, The Interfaith Centre on Corporate Responsibility asserted during interviews that climate change had virtually become a cross-over issue.

That is to say, of the environmental and social matters that are often addressed at AGMs - though traditionally receiving lesser levels of support – climate change is taken as seriously and starting to attain the same level votes as the more 'tangible' issues. It is not hard to understand why either – it can directly and dramatically affect the bottom line of virtually every company worldwide.

Climate change resolutions in the current US proxy season number in the many dozens. As an example, votes for shareholder resolutions that would force General Motors and ExxonMobil to take action on greenhouse gas emissions received record levels of support at the companies' annual meetings.

A resolution asking General Motors' board of directors to commit to hard goals for reducing greenhouse gases received votes representing some 25 percent of the company's shares. The GM resolution showed a massive increase in support from previous votes. Since 1998, resolutions at the company that sought even simply disclosure of emissions rates received only 3 to 7 percent approval.

Whilst outcomes such as these are non-binding, resolutions receiving a quarter of shareholder votes, are enough to make management stop and think about what steps it needs to take.

ExxonMobil stockholders backed a similar resolution – asking the board to set quantitative goals for reducing greenhouse gas emissions from the company's operations and products – which was supported by 31 percent of the companies shares. Those supporters represented \$121 billion worth of shares including several states' pension funds. That said, within EM some board members have shown intransigence in dialoguing on climate change.

## Values Verses the Business Case

An interesting aspect exemplified in this elevation of climate change concerns the dichotomy of approach now permeating the larger debate. Two camps are apparent, also reflected within sustainable/ethical investment *per se*.

Perhaps a way to describe/divine the approaches is via a practical example of what many see as cutting-edge technology. The impact of energy costs and greenhouse gas emissions is nowhere more obvious than in the use of our motor vehicles and people's consciousness - and its influence on changing the world.

Just as I arrived in the US it was announced Toyota had become the largest manufacturer of motor vehicles. Toyota sells the Prius, unashamedly, on its environmental benefits. So, a significant part of its growth occurred on the back of this 'new' technology. More than 1 million have now been sold in the US. Whether it is new technology or just a clever amalgam of minor adjustments to create 'more than the sum of the parts' is largely beside the point. A bit of aerodynamics here, some battery storage there and an efficient engine design ....resulting in substantial fuel savings. (This is the business-case/risk control argument for corporations and some individuals.)

What is important is what seems to me to be two strands providing support for a climate change mitigation agenda and concomitantly the whole investment sphere. One is values oriented and the other business focussed. And though they are not mutually exclusive, I would argue there is a tendency for individuals to focus more on the values premise and corporates to have a business-case orientation. In this Prius elucidation, the company certainly has, in initial years at least, largely promoted (to early adopter clients) the environmental benefits rather than the fuel economy. This is despite the fact that behind the scenes, underpinning any to decision to proceed, there will be reliance on a business justification.

There must be some deeper intention at work here than mere marketing hype aimed at eco-customers.

It is no longer sufficient to use/argue on the basis of moral suasion – though some investment organisations and many mission-based groups argue for such. Just as in the investment arena there has developed a schism between the originators and the newcomers in investment; between the financially tangible and the less tangible proposals; or the SEC directed submissions and those with broader emphasis.

## **Portfolio Construction and Screening**

A growing number of larger pension funds see an advantage to be able to address disclosure, and obtain information which would aid in their assessment of risks and the management/mitigation of these, for the purpose of maintaining and increasing shareholder value. One such outcome was a global framework on climate risk disclosure. Letters were sent to various industries and a call to action to the US Federal Government, based on getting the SEC to give guidance on material risks and what should be disclosed on annual filings.

CalPERS is a case in point. As one of the largest pension funds in the world it plays a dominant role by being a universal owner (needing to hold all stocks in its portfolio) and so capable of substantive influence. Their primary attention, it should be noted however, is on corporate governance – the structures created by legal documents for the operation of a corporation.

Collaboration with non-financial umbrella bodies, such as the Network on Climate Change, takes place as well as investment dealings with the likes of hedge funds - seen as a way to add shareholder value. And though there is some commonality of interests and a perceived shared focus on corporate responsibility and responsiveness, as far as the social side of the fence is concerned it seems to me corporate-governance activists have shown little interest in the societal effects of their positions or social issues generally. This means the thrust and impact of environmental and social matters is noticeably lesser.

Both CalPERS and the CalSTRS have a focus list of the worst 20 or so performers and/or offenders, company-wise, based on criteria such as number of lawsuits or magnitude of impact (size of stock holdings, potential loss). There is little in the way of any issues-based focus, however. That is, a comprehensive or global approach to identification of matters of concern.

Risk control in pension fund behemoths is certainly a central theme. Yet the global trend toward more expansive ethical or the so-called next incarnation of sustainable or responsible investment is unmistakable. It can be seen to address a broad range of environmental and social concerns and increasingly, and especially, that of climate change.

The meeting with Al Gore's Generation Investment Management's defines this. Its philosophy has sustainable development as the 'primary driver of industrial and economic change over the next 50 years.' Where shareholders are best served by companies who maximise their financial return by strategically managing their performance in this new economic, social environmental and ethical context.

This long term focus on performance is expressed through research and responses often thematic in nature. That is they cover big picture issues which have the potential to impact (both positively and negatively) the long-term operating context for business such as: Climate Change, Pandemics,

Demography/Urbanisation, Water, Poverty, Bribery/Corruption etc.

There is little real difference between this stance and the reason why Australian Ethical has long thought it necessary to address similar environmental and social issues, along with the usual financial considerations in its investment practice. For instance, we viewed the consequences of global warming for society and ecosystems as potentially serious and far-reaching, and we believe steps to address the risks of such warming have been prudent for some time, even while the science continues to evolve.

As a consequence, Australian Ethical's 20 year mission, through the positive principles of its Australian Ethical Charter, is to identify and invest-in what these days would be thought of as climate-change inhibiting activities. Most obviously these are renewable and alternative energy, water saving and water quality improvements, efficient transport, organic farming and adaptive technologies. But the investment philosophy also flows into sectors such as recycling and waste management as well as education, health and well being. Whilst at the same time ensuring less appropriate or destructive practices are not supported – for instance native forest logging, uranium mining, armaments, gambling, repressive regimes etc.

### **In summary**

Increasingly individual shareholders do not see themselves as passive participants within the corporate landscape. And from an investment perspective there is increasing evidence of companies acting or seeking to act more responsibly and fund managers and superannuation trustees taking this into account when making investment decisions.

If genuine ethical investment seeks to support companies – though there is little evidence it can reduce the cost of capital - then activism works from the other end, trying to elevate poor(er) performers on a generally rising tide.

The strengths of an advocacy approach are numerous. It brings the matter to the forefront of agendas making them issues of public domain. By making matters visible and public it is likely media attention will add pressure to achieving a positive result. This makes the whole approach pro-active when compared with conventional ethical investment – possibly more powerful even than positive screening.

## **Recommendations**

Shareholder activism is a broad paradigm through which individuals or groups can exert pressure on companies to affect a particular corporate practice.

- Provide procedural infrastructure/produce alternative products to enable new possibilities whereby Australians can influence corporate decision-makers in a concrete, non-confrontational manner
- Establish a framework/methodology for co-ordinating participants and institutional investors to act in a common interest
- Assist with greater involvement in the policy formulation aspects of engendering change
- Consider an integrated approach to the often disparate programs of corporates, NGOs and faith-based organisations

## **Implementation and Dissemination**

Even prior to my study departure I already had the opportunity to promote the fellowship to 40,000 people through our ethical investment newsletter and an offer to disseminate some of my research findings on my return as a keynote speaker at a Climate Change summit comprising a few hundred attendees, in July 2007.

These avenues will be supplemented through my regular public presentations and in association with a broad range on networks – professional and community, as well as media contacts and via publications and hopefully new approaches to product formulation.