Biz-War and Socially Responsible Investing

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SOCIALLY responsible investing (SRI) is all the rage these days, and who could quarrel with the impetus to channel investment funds toward pro-social applications and away from antisocial ones? It is a movement that, by its very name, has an inherent claim on the moral high ground of the global economy, a claim that gives to the movement its legitimacy, its appeal, its dynamism and its growing power.

It is a claim to moral authority that deserves closer examination.

RECONCEPTUALIZING THE CORPORATION

Let us begin that task by rethinking the nature of the corporation whose behaviours are the target of SRI activism. Traditionally, economists and business people alike have thought of the corporation primarily as an engine of wealth generation—a mechanism for producing and selling goods and services for financial gain. That conceptualization carries with it a whole series of values, preferences and expectations about how corporations will *and should* behave, and most particularly, about the kinds of goals toward which they should progress.

But suppose we take as a starting point a rather different premise. Suppose we view the corporation as an institution in social space whose purpose is to balance precisely a large number of sometimes reinforcing and sometimes competing interests—held by the corporate stakeholders—only some of whose goals are economic in character. Think of this social space as a large sheet of an elastic material stretched out in a frame, and think of each stakeholder as a ball bearing of some variable magnitude (depending on its importance to the corporation in question) that occupies a location somewhere on the sheet. Each causes a dimple in the surface; the heavier the weight, the deeper and broader the dimple. Then mentally place the corporation—the largest ball bearing of all—at that place on the sheet where it lies closest to, but will not disrupt the locations of, its stakeholders (in other words., where its placement will not cause them to move).

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Take your hands away. Don't breathe. The system is in balance. Now very carefully move the smallest (least important) stakeholder to a slightly different location. Not much happens. But do the same with the largest (most important) stakeholder and the stability of the system is disrupted. Some other stakeholders may move as well, but what is certain is that the corporation at the centre of this figurative little grouping will have to move in the same direction as the largest stakeholder if it is to restore the balance in the system.

The SRI movement is designed to move the corporate system in precisely this way, both one company at a time and in the aggregate. It is designed to generate leverage on corporate behaviours through the pooling and application of wealth in sufficient volume to force changes in corporate governance, in corporate behaviour, and, collectively, in public policy. More than that, it is designed to take maximal advantage of the growing interconnectedness of the global economy.

RECONCEPTUALIZING SRI

Though I have been referring here to an SRI 'movement', at least one critic suggests that it is more appropriate to think of SRI as an industry—one whose lifeblood is a constant stream of attack messages against corporations. In the words of business consultant Sarah Fuhrmann, 'Far from promoting the corporate good, the CSR/SRI industry depends on being able to continually characterize and point to 'bad' companies that can both perpetuate the industry and make it look 'good' by comparison.'[1] At the very least, this view directs our attention to the centrality of anti-corporate rhetoric in the advancement of SRI interests—to the need to power a movement not only with affirmative appeals to moral rectitude, but also with the construction of an enemy against which to mobilize. Claims to moral authority, it seems, require demons as well as angels.

SRI AND FIDUCIARY RESPONSIBILITY

For more than 30 years now, various individuals and groups have been developing ever-more-sophisticated means of pressuring corporations to behave in ways these activists deem more appropriate, whether with respect to workplace, environmental, human rights, consumer or other issues. Organized labour, environmentalists and others have taken on companies by employing what are generally known as corporate, or anti-corporate, campaigns. These efforts, grounded in a technique termed 'power structure analysis', follow very much the pattern described above, which is to say, they are designed to exploit vulnerabilities in various stakeholder relationships to move the targeted companies through social space. Included have been such tactics as boycotts, community protests, regulatory and legislative attacks, litigation and reputational warfare. There have been literally hundreds of such campaigns—against banking and insurance interests, mining and timber companies, oil companies, manufacturers and retailers. But despite some successes—Mitsubishi does not process salt in Baja California, Pepsico does not operate in Myanmar—all of this activity has by-and-large failed to bring about large-scale change. One possible explanation for this outcome is that most such efforts have been devoted to moving the least weighty stakeholders.

The SRI movement addresses that fact by bringing pressure on those stakeholders with the greatest clout at publicly-held companies—institutional investors. Many companies have demonstrated that they can withstand pressure from customers, vendors, regulators, the courts, the media and the public—or at least that they have the means to respond sufficiently to rebalance perceptions without substantially changing their behaviours. But pressure wrapped in a cloak of social responsibility and brought by those who own the largest portions of corporate shares is far more difficult to resist.

To exert that pressure with growing effectiveness, the SRI movement has taken two vital steps. First, it has expanded its resource base in a series of stages that have given it control over progressively larger pools of other people's money and, importantly, of the proxy votes that come with share ownership. Second, it has moved to free itself of certain shackles that generally attend to those who manage other people's money.

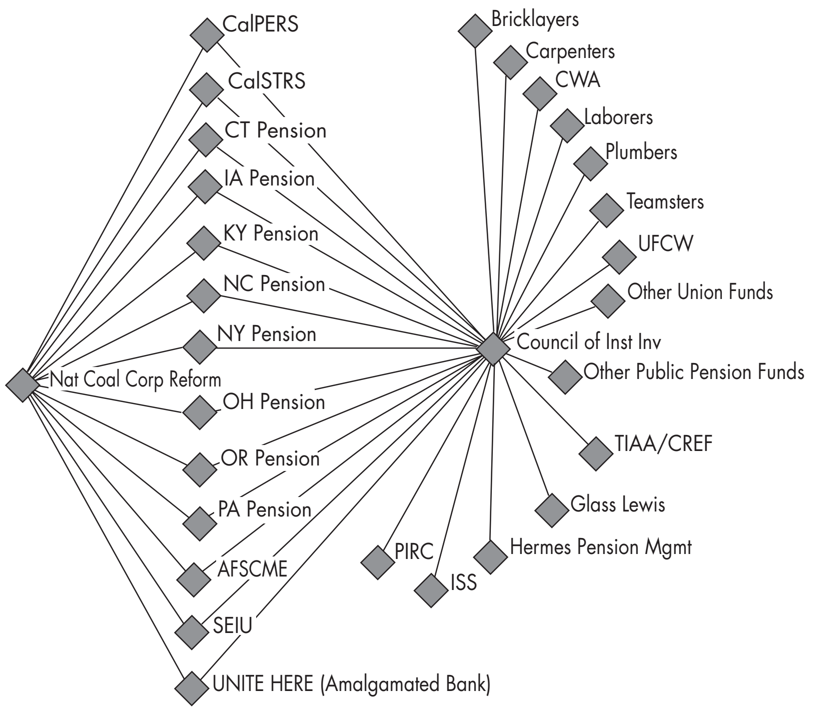
> ***The question of whether investors can do well financially and do what they regard as social good at the same time and with the same resources is an important one***

The SRI movement has systematically expanded its zone of control over resources, beginning in the 1980s with the establishment of specialized mutual funds such as Domini Social Investments or Walden Asset Management. These were created as investment vehicles for those who sought to use their funds to support companies and industries they regarded as having adopted socially responsible lines of business and business practices. The SRI movement used their share-votes to advance progressive policies in and through the boardroom. This specialized mutual fund sector then expanded as mainstream investment firms began their own SRI funds. This created a substantial base of capital to be invested in line with SRI objectives, but in the grand scheme of the global economy, it was barely consequential.

The 'real' money in this arena is that managed by union, public employee and other pension funds (such as CalPERS, the activist American fund, or Hermes Pensions Management Ltd in the UK), and by such major mutual fund managers as Fidelity Investments or Barclay's. And that money is by law or custom invested and voted in a manner consistent with the trustees' fiduciary responsibility to the beneficiaries.

Traditionally, fiduciary responsibility has been defined narrowly as maximizing the financial return on investment, and trustees have been reluctant (or prohibited) to use their shareholder power to advance corporate policies that might produce what some regard as pro-social outcomes *at the expense of* financial outcomes. But over the last decade, SRI advocates have worked to remove this limitation. In the US, for example, they have produced studies purporting to demonstrate that SRI strategies equal or out-perform more traditional approaches,[2] and they have begun developing explicit statements of support for multiple-objective investing. The AFL-CIO (the principal US labour federation), for example, has published a set of *Proxy Voting Guidelines* for trustees of union pension funds, spelling out the long-term benefits of favoured workplace and environmental policies (among others) and explicitly endorsing their advancement as being consistent with the trustees' fiduciary responsibility. These moves have been accompanied by initiatives that have successfully pressured the securities regulators in the US to open the agendas of corporate shareholders meetings to more such issues and to strengthen outside influences on corporate boards of directors.

Figure 1: Membership in the Council of Institutional Investors and the National Coalition for Corporate Reform, 2004[3]



THE NETWORK STRUCTURE OF THE SRI MOVEMENT

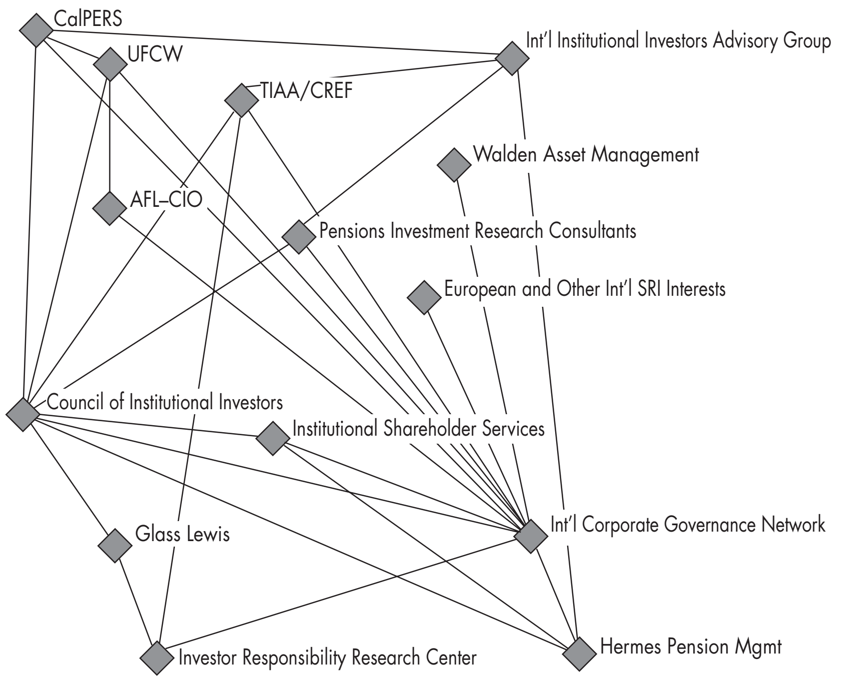
At one level, it may be a misnomer to speak of a single, unified SRI movement, for it is comprised of several different elements. Among them are altruistic advocates of greater corporate accountability, whom we might characterize as the 'true believers'; left-thinking opponents of the corporation and the corporate-based economy *per se*, or the 'anti-corporate ideologues'; and still others who have less quarrel with the corporation itself than with their proportionate share of gains from its operation and who see the SRI banner as a flag of convenience for advancing their more prosaic interests. We can think of this latter group as the 'pragmatists'.

But at another level, it is reasonable to argue that the SRI movement could never achieve its full potential but for the combination of these different elements. From the corporate reformers it takes its moral authority. From the ideologues it takes its energy. And from the pragmatists—most notable among them union and public employee pension funds—it takes its muscle. There are aspects of self-interest that divide each of these components from the others. But, at least for the moment, there is sufficient shared interest to draw them into common cause, and their collective weight is beginning to move the system.

There is, in fact, a visible organizational structure to this movement, both within individual countries and internationally. Figure 1, for example, shows a portion of the network that links union and public employee pension funds within the US in two principal organizations. The Council of Institutional Investors (CII) was established in 1985, and today numbers among its members 130 pension funds, mostly union and public employee funds, whose assets total more than $3 trillion, along with 125 partner organizations, some of them prime movers in the SRI movement. The group hosts conferences and other activities through which it plays a central role in advancing and legitimizing investing policies consistent with the objectives of its members. The National Coalition for Corporate Reform, established in 2003, includes a small subset of the most activist CII members, including CalPERS and several public pension systems led by activist State-level politicians.

As illustrated in Figure 2, this domestic network is connected through a series of links to its international counterparts. For example, the International Institutional Investors Advisory Group was established in March 1999 for the stated purpose of expanding country-specific corporate governance guidelines into a set of international standards. These are then advanced by the members of the Group in private negotiations and through introducing and/or supporting shareholder resolutions. Membership is limited to four organizations—CalPERS, TIAA-CREF (another influential US pension manager), Pensions Investment Research Consultants (PIRC, a UK proxy-voting advisory firm) and Hermes Pensions Management Ltd (wholly-owned management company of the British Telecom and British Post Office pension schemes). Note that all four are also members of CII. Similarly, but less exclusively, the International Corporate Governance Network (ICGN), formed in

Figure 2. Selected International Pension Fund Network Interlocks[4]



1995 at the initiative of CalPERS and heavily influenced today by Hermes, is also devoted to developing international standards of corporate governance. ICGN links US, European and other pension funds and advisors.

An example of this networking in action—particularly between the US and the UK—is provided by a 2004 effort to force US companies to separate the roles of Chairman and Chief Executive Officer, with the former post to be occupied by a director who has never been an officer of the company in question. This is a common practice in the UK, where it is incorporated as a default in the basic law of business practice, and elsewhere in Europe, but it is uncommon in the US, where less than five per cent of companies listed in the Standard & Poors 500 Index, as an example, are governed by such a structure. Union pension funds have engaged in a campaign to advance this change at approximately 50 companies in 2004, even citing in some instances as a rationale the fact that it is common in the UK. And this Chairman/CEO division initiative is but one of a half dozen or more similarly organic resolutions—others have to do with such matters as the cumulative voting of shares—that collectively are intended by organized labour to increase its influence with corporate boards and senior management. Even as they advance the self-interest of labour, however, the packaging and legitimacy of these efforts owe everything to the moral claims of SRI.

THE BOTTOM LINE ON THE BOTTOM LINE

The question of whether investors can do well financially and do what they regard as social good at the same time and with the same resources is an important one. Should it be answered in the affirmative, the SRI movement will grow in size and influence; should it be answered in the negative, that movement will surely whither. Whether the issue is to be resolved in the marketplace, the media, the boardroom or the courtroom, however, is yet to be determined. To the extent that SRI investors are inclined, and are able, to demonize corporations, their executives and directors, they are likely to retain the upper hand, at least in some of those venues. The challenge to corporations themselves is more difficult—to demonstrate that SRI activists do not have a monopoly on the definition and advancement of responsible corporate behaviour.

NOTES

1 Sarah Fuhrmann, 'Corporate Philanthropy in Unfriendly Times: The Consequences of Social Investing Advocacy', paper presented at the Conference on Socially Responsible Investing and Pension Funds, American Enterprise Institute, Washington, DC, June 2004.

2 For a critique of the methodology employed in these studies see Jon Entine, 'The Myth of Social Investing: A Critique of Its Practices and Consequences for Corporate Social Performance Research', *Organization and Environment*, 20:10 (September 2003), pages 1–17.

3 Based on CII membership lists posted at www.cii.org, 1 November 2004, and on NCCR membership as listed in Mary Williams Walsh and Jonathan D. Glater, 'Pension Fund Trustees Taking Aim at Safeway', *The New York Times*, 26 March 2004. Figures 1 and 2 were prepared using S.P. Borgatti, M.G. Everett and L.C. Freeman, *Ucinet for Windows: Software for Social Network Analysis*, Version 6.12 (Harvard: Analytic Technologies, 2002).

4 Based on the summary of members and their roles found at www.icgn.org/history.html on 17 May 2004 (since removed) and at www.icgn.org, 1 November 2004.

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