Critical shareholding: how to use a financial leverage to promote human rights and the environment

In several countries, civil society organizations and networks have started to buy a few shares of companies accused of having negative social and environmental impacts, namely in their investments in the global South, in order to actively participate in the life of the firm. This is a new form of advocacy, and a new campaigning tool: critical shareholding. The targeted companies are criticized for their poor democratic governance and controversial sustainability record and performance. If the financial actors and managers still want to invest in unsustainable companies, violating human rights and harming the environment playing in a casino economy, let's make clear that we don't want to be their accomplices and prevent them from playing with our chips.

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The "Pioneer Fund," created in Boston in 1928 is usually considered the first case of an institutional investor looking at non-economic parameters in its investment strategies. The fund encouraged investment in accord with religious belief, excluding the "sin shares" of companies operating in sectors such as tobacco, gambling or arms.

A new idea of ethical finance emerged in the late 1960s in the US, when civil rights and later antiwar protests began to explode. In 1968, students at Cornell University demanded that the board divest in shares of companies involved in trade with South Africa. The "Pax World Fund" was created a few years later, excluding companies involved in the Vietnam war.

The rationale for excluding some investments was therefore broadened, and started to include social considerations. More importantly, beginning in the late 1960s, not only some specific sectors, such as armaments or gambling, were excluded, but so too were individual companies and banks involved in such activities. Later, some new criteria started to be taken into account, namely, the companies' human rights and environmental records. This turned out to be a powerful way to boycott companies doing business with racist regimes (e.g., South Africa under Apartheid) or dictatorships (e.g., Chile under Pinochet).

Boycotting versus participating

Historically, these first cases were extremely important in highlighting the role that shareholders can play in influencing the behaviour of a company. Several cases of disinvestment in and of boycotting specific companies, countries or sectors achieved impressive results. It is widely recognized, for instance, that the massive campaign against companies maintaining economic and trading relations with the Apartheid regime in South Africa played at least some role in propelling the change to a modern, democratic system.

However, divesting in company shares means cutting all relations with the company, together with the chance to try to influence its behaviour. By contrast, being a shareholder means owning a part, however small, of the company, thus maintaining a relationship and actively participating in the life of the company to try and shift its overall social record.

The role of financial markets

This idea is becoming more and more important in the context of modern financial markets. The scope and role of finance have grown enormously in the last years, as seen in the so called "financialization" of the global economy. Apart from a few exceptions, the majority of the shares of the companies listed on today´s stock exchanges are owned by investment funds, pension funds and other institutional investors. Accordingly, to meet the demands and expectations of these institutions, the daily value of the company´s shares becomes the main objective for its managers, steadily replacing the long-term goal of sustainable development. The stock options and other bonuses for top management have dramatically increased this trend.

More broadly, "shareholders interest" is rapidly replacing "stakeholders interest." Some of the worst consequences of modern finance, including excessive volatility and speculation, may be at least partially linked to this shift. At the same time, the huge power of the financial world could be used to challenge the social and environmental behaviour of individual companies.

The principles of critical shareholding

In several countries, civil society organizations and networks have started a new form of advocacy, and a new campaigning tool: "critical shareholding." The idea is quite simple: buy a few shares of companies accused of having negative social and environmental impacts, particularly with regard to their investments in the global South, in order to actively participate in the life of the firm. In general, companies are targeted for their negative environmental, social and human rights records, their questionable impact on local and national development processes, their lack of transparency, weak democratic governance, and for their overall lack of accountability.

The goal of critical shareholding is at least three-fold:

First, it provides an opportunity to bring the voice of Southern communities and international civil society organizations directly to the company boards and shareholders. Too many projects carried out by Northern transnational corporations badly impact on the life and the fundamental rights of local groups in the global South. The latter have no chance to make their voice heard in the country where the mother company is based. The critical shareholding initiative may therefore be an effective tool to try to bring this voice directly to the board, the managers and the shareholders of the company. From a campaigning point of view, given the prominent role of the financial markets and the share values, acting directly as a shareholder will gain greater company attention. This is all the more true for the top managers, whose annual income depends more and more on stock options and other bonuses directly linked to the company´s stock market performance. This kind of engagement may therefore serve to highlight the social and environmental performance of the company in order to reduce its broader negative development impacts and to foster a more active dialogue between the company and all of its stakeholders.

Secondly, with regard to the general financial culture, critical shareholding is an instrument of "economic democracy," increasing the knowledge and the participation of small shareholders and of the general public in financial matters. Being a shareholder doesn't merely mean looking for the highest profits and dividends in the shortest time. The current crisis has shown the threats of a financial system based upon the short-term maximization of profits. Being a shareholder implies rights as well as duties, namely to actively participate in the life of the company; this is regarded as central in any development process both in the North and the South, given the prominent role of the private sector in most societies.

Finally, from the investors' point of view, critical shareholding increases the representation of the small shareholders in the life of the company. A 2009 OECD report points out that one of the main reasons for the crisis was the poor corporate governance schemes of many companies.[1] The same OECD report pledges to increase the participation of the small shareholders in the life and the decisions of the companies. Critical shareholding goes precisely

1 Kirkpatrick, Grant, *The corporate governance lessons from the financial crisis.* OECD, 2009. Available from: <www.oecd.org/dataoecd/32/1/42229620.pdf>.

in this direction and may contribute to increase democratization and accountability of private sector operations.

International networks and initial results

In several European countries, as well as in the US, active shareholder engagement has become a widespread practice. The interventions and proposals of small active shareholders helped in many cases to improve companies´ environmental and social responsibility, governance and accountability, and long term sustainability. This strategy has already been used in campaigns targeting Northern corporation responsibility in solidarity with affected communities in the global South in order to promote their right to development.

The pioneer in shareholder engagement practices is certainly the Interfaith Center on Corporate Responsibility (ICCR) based in New York.[2] As a coalition of 275 religious orders, Catholic, Evangelic and Jewish, ICCR engages US companies it invests in, filing and voting resolutions at the companies Annual General Meetings (AGM) and meeting the companies' directors and managers. The first of such resolutions was submitted in the early 1970s, asking companies such as General Motors to withdraw their financial and commercial support from Apartheid South Africa. ICCR South Africa resolutions, presented by the Episcopal Church, never got more than 20% of shareholders votes, but indeed helped influence public opinion and put Apartheid under the spotlight of financial markets. In the years before the end of Apartheid (1994), the direct investments of US companies in South Africa declined by 50% and, as Timothy Smith – one of the first executive directors of ICCR – put it: "Without responsible shareholding initiatives the fight against Apartheid would have been far less effective."

The ICCR mission statement declares: "We believe that investments should offer something more than an acceptable financial return.... Instead of selling the shares of companies that acts against environmental, human rights or governance rule, we prefer to act as shareholders and press for change." As of 2010 it has submitted more than 200 different resolutions at AGMs of US companies on issues such as excessive executive compensation, toxic chemicals in products, animal testing, weaponization of space or foreign military sales. Many resolutions have been withdrawn before the AGMs, because the companies have agreed to negotiate with ICCR members. The percentage of shareholders that voted for ICCR resolutions varies from the nearly 40% of derivatives resolutions submitted at Bank of America, Citigroup and Goldman Sachs' AGMs, asking for more transparency in the trade in financial derivatives, to the record 97.9% of HIV/AIDS resolutions submitted at Coca Cola's AGM in 2004, asking the multinational to disclose a report on the potential financial impacts of HIV/AIDS and other pandemics on the company's balance sheet and business strategies in developing countries. After the resolution, which was meant to make Coca Cola aware of the HIV/AIDS emergency in East Asia and Africa, the company has started publishing a detailed report, as required by the active shareholders, investing in prevention and health care for its employees in poor countries.

Similar ICCR resolutions have convinced the US clothing giant The Gap, to disclose the full list of its subcontractors in developing countries as well as an assessment of social and environmental risks for each of them.

But not only religious investors are putting the companies under the spotlight in shareholders meetings. In the last 10 years also the big pension funds have started to raise their voice. In the US the most known is Calpers (Californian Public Employees Retirement System). Calpers, with 1.4 million members and nearly 200 billion dollars under management, have started to use its investment shares as a way to engage US corporations. Calpers' campaigns, aimed mainly at condemning bad governance practices (e.g., excessive executive compensation), have obtained a broad and unexpected success, so that Sean Harrigan, Calpers' chairman until 2004, had to resign due to mounting pressure from US multinationals. On September 2006, California Governor Arnold Schwarzenegger, supporting the Sudan Divestment Task Force, adopted a targeted divestment policy from companies that operate in South Sudan (where the Darfur civil war continues) for the California Public Employees Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS) and decided to indemnify the boards of both funds for this action.

Besides Calpers and Calstrs, many other public employee pension funds have started putting pressure on US companies in their AGMs, including the New York State Common Retirement Fund, the Connecticut Retirement and Trust Plans of the New York City Comptroller's Office. "In the last years," according to a survey by the US Social Investment Forum, "these funds have submitted tens of social resolutions based on ILO (International Labour Organization) Conventions, on climate change issues or equal opportunities."

In Canada the attention of pension funds for social and environmental issues is stimulated by Batîrente, the Quebec-based pension funds of Caisse d'économie Desjardins (a bank created and entirely controlled by trade unions).[3] Batîrente manages about EUR 350 million, has more than 20,000 members and selects the shares it invests in according to ESG (environmental, social and governance) criteria. "In the beginning we have supported resolutions submitted by other funds or organizations", says Daniel Simard, Batîrente's coordinator. "But in the last few years we have started presenting our own resolutions." Together with Oxfam, Batîrente has convinced Metro, a retailer in which the fund invests, to sell fair trade coffee, while it has asked Sears, another retailer, to publish a social report according to GRI (Global Reporting Initiative) guidelines.

With the exception of Great Britain, where some financial institutions such as the Co-operative Bank, Hermes or F&C Asset Management have been pioneering shareholder engagement, in Europe this practice is still marginal and rarely hits the headlines. In the continent of familial and banking capitalism, stock exchanges have never played an important role. And, as a consequence, activists have preferred other ways of pressuring companies. But something is changing also in continental Europe. The most interesting news comes from Switzerland. Its name is Ethos. Born in 1997 by the initiative of two public pension funds, Ethos Foundation for sustainable investment, manages today EUR 500 million on behalf of some 90 public pension funds in Switzerland. Ethos is delegated by pension funds to exercise voting rights (connected to the shares the funds invest in) at Swiss companies AGMs. Excessive manager remuneration, directors' reputation and mismanagement, and scarce transparency when dealing with "toxic" financial products are the main issues that Ethos presents. Most of the targets are financial or pharmaceutical corporations, like UBS or Roche. In some cases Ethos' proposals are backed also by other investors or by common shareholders and are able to get more than 50% of shareholder votes, as it happened this year in the UBS Annual General Meeting, where the Board proposed to discharge former UBS board members of their responsibility for the company's financial collapse. Ethos voted against, and with it the majority of shareholders, who are now thinking of suing the company for mismanagement and financial damage to its customers. Ethos votes in more than 100 Swiss company AGMs each year. For non-Swiss companies it delegates international partners belonging to ECGS (European Corporate Governance Service).

In some cases, shareholder engagement is associated with traditional campaigning strategies. In March 2010, a coalition of UK trade unions, NGOs and investors attempted to get thousands of pension scheme members to join an e-mail bombing campaign aiming at forcing oil giants BP and Royal Dutch Shell to reconsider investments in environmentally controversial oil sands developments in the Alberta province of Canada. The coalition included UNISON, the UK and Europe's biggest public sector union with

2 For further information see: <www.iccr.org>.

3 See: <www.batirente.qc.ca>.

more than 1.3 million members and the Public and Commercial Services Union (PCS), the fifth largest trade union in the UK. In what they said was an "unprecedented public mobilization," the coalition has asked savers to e-mail their own pension fund manager to push them to support shareholder resolutions against oil sands projects that were due to be voted on at the BP and Shell AGMs in May. Other coalition members included Greenpeace, World Wildlife Foundation and the Co-operative banking group. Over 140 pension schemes, fund managers and private investors joined forces with FairPensions, a London-based lobby group, to file a shareholder resolution at Shell's AGM on May 18.

In Italy, the Fondazione Culturale Responsabilità Etica (FCRE), controlled by ethical-ecological bank Banca Etica, has also decided to combine traditional NGO campaigning tools with a new form of engagement through investment in big companies.[4] Back in 2008, FCRE bought some shares of Italian oil and utility companies (Eni and Enel, respectively), in order to take part in their Annual General Meetings, giving voice to environmental and social NGOs, such as Greenpeace Italy and CRBM, based in Italy and developing countries. In the last three years, the Foundation has challenged the social and environmental record of both companies, backed by a number of associations in Nigeria, Chile, Congo-Brazaville, Kazakhstan and other countries where Eni and Enel are involved, along with their subsidiary operations in countries listed as tax havens.

Critical shareholding as a campaigning tool

While several results have been achieved through the active participation of small shareholders, some critical aspects shall not be underestimated. Firstly, it must not be acknowledged that the dialogue with a company has to pass only through the ownership of shares. This assumption would precisely reinforce the idea that shareholders are gaining more and more weight with respect to the other stakeholders. Being an investor may grant some rights, but in no way should substitute the other channels of dialogue and of putting pressure on a company. This is all the more true if the dialogue or the confrontation with the company deals with something as fundamental as human rights.

Quite the opposite, critical shareholding must be considered as one tool among a range of different instruments that have to be put in place in a campaign, and it should come together and reinforce other campaigning tools.

Moreover, the small shareholders shouldn't expect impressive results and shifts in the companies' behaviour, just after participating in a few AGMs. Critical shareholding is an instrument that may bring results in the long run, insisting year after year in a difficult dialogue with the company and the other investors.

Another major criticality is the difficulty of raising correct information regarding specific companies or projects. This is all the more true given the flow of information that has to be faced. The biggest share of information on the company is delivered to the investors and the specialized media usually from the company itself.

Almost all the companies listed on the stock markets have developed strong CSR policies in order to show their correct behaviour, and often to picture themselves as "green" or "sustainable". Moreover, the great and growing role of the firms specialized in rating the companies after their social and environmental record should not be underestimated. Being included in some indexes, such as the Dow Jones Sustainability Index or the FTSE for good is often publicized as a major argument for "demonstrating" the commitment towards sustainability. In fact, even though several of these index and rating companies have been criticized for not providing a serious screening among the companies, and for not investigating deeply into the overall behaviour, they represent a major source of information for the financial community.

To overcome this flow of information, the activities should therefore be carried on in close cooperation with the affected communities. More broadly, a serious research work is needed in order to obtain results.

Conclusions

Most companies listed on the stock exchanges are owned by a multiplicity of shareholders: institutional investors, investment funds, pension funds and retail shareholders. This extreme fragmentation, among other things, gives enormous power to financial groups holding just a small percentage of different companies. A related problem has to do with the excessive power in the hands of the top managers with respect to shareholders. On the other hand, this same multiplicity of small shareholders opens up new opportunities. In the last few years, millions of women and men worldwide have started to shift towards more responsible consumption. More and more, people are aware that they have the power to "vote through the supermarket basket." We can choose the products of some companies and not others, depending on their behaviour. The fair trade movement has shown how important critical consumption has become. This is a major cultural change, one that began some decades ago and is still taking place.

A similar cultural shift must now take place regarding our money and investments. How many people would lend money to someone asking it to finance an anti-personnel weapon or cluster bombs business? How many people would lend their money to someone intending to bet it in a casino? On the other hand, how many of us ask our banks, pension or investment funds how our money is used? In a few words, our money, channeled through financial investments has a huge power and can heavily influence, both positively and negatively, the social and environmental record of both companies and banks.

A strong alliance is needed to take control of this power. Responsible investors have the technical capacity to engage in critical shareholding. NGOs have the knowledge and the relationships with the communities impacted by the investments of the transnational corporations. The media have the chance to inform small investors and workers about the use they could make of their savings. Potentially, a huge amount of people and capital could be mobilized for critical shareholding activities, thus leading to concrete changes in the behaviour of the biggest companies in the world.

Active shareholding has already produced some results in several cases, and has led to better company governance and more participation from small shareholders. At the same time, more involvement and coordination from civil society, socially responsible investors and small shareholders is needed in order to bring about concrete improvements in companies´ social and environmental record in the medium term.

Finally, but most importantly, critical shareholding is not only about improving the social and environmental record of the listed companies. Promoting an "economic democracy" means much more. The recent financial crisis has proved that our savings were put at risk in a casino economy. We have to take back control of our money and our investments. Through critical shareholding, the financial culture of the small investors may be increased. It is not just a matter of improving the behaviour of a company. A new financial culture is needed.

To summarize the impact of the financial crisis: first, our money was not used to promote a better economy; second, it was put at risk; third, investment in the financial casino contributed to bursting the bubble and precipitating the financial crisis; fourth, the crisis has had huge impacts on peoples lives all over the world; fifth, huge bailouts have been made to save the financial system that caused the crisis. Ultimately, these bailouts will be paid by our tax money.

Enough is enough. If the financial actors and managers want to continue to invest in unsustainable companies, violating human rights and harming the environment, if they still use our money to play in a casino economy, let's raise our voice and make clear that we don't want to be their accomplices and prevent them from playing with our chips. ■

4 See: <www.fcre.it>.