Winter Week 2: Consumer and Investor Activism

SOSC 3040

Corporate Social Responsibility

Ethical Consumption/Investment themes

- Civil regulation via market
- Avoidance of buying products or shares of immoral/ socially irresponsible enterprises
- Buying products /shares of good enterprises
- Motives:
- “Clean hands”, integrity (non-consequentialist)
- Create market incentives for responsible enterprise (consequentialist)

Civil regulation campaigns via social media

- CR now often supported by slick media use:
- E.g this clever ad in support of a palm oil boycott, and this counter to Pepsi CSR spin

CONSUMER ACTIVISM

Origins

- England: Slavery abolition movement
- Boycotts of sugar, rum, cotton etc
- Quaker practice 1750-80
- 1791 failure of slave trade abolition bill → widespread sugar boycott → 1807 Act
- 1845: American Quakers, abolitionists establish “free produce” association, stores

US 1950s-70s

- <u>Civil Rights Movement:</u>
- boycotts of segregated stores, transit, businesses that discriminated in hiring
- <u>Anti-Apartheid Movement:</u>
- Boycotts of products from South Africa
- <u>Anti-War Movement:</u>
- Boycotts of consumer products made by firms that supplied Vietnam War
  - E.g. plastic wrap made by Dow (napalm mfg)

Effectiveness of Boycotts

- Significance in relation to major change (e.g. S.A.) debated—can be important for particular firm (e.g. Nike, Nestle)
- Klein et al: bad publicity + boycott hurts brand image more than bad publicity alone.

Friends of the Lubicon example

Daishawa pulp mill logs traditional lands of Lubicon Cree in northern Alberta

Makes cardboard packaging for fast food

Friends of the Lubicon campaign: all 40 companies approached by FofL switched from Daishowa as supplier of paper packaging (pizza boxes, bags etc), at least after picketing by FofL activists (1994)

Company sues activists and loses

Limitations of Boycotts

- Hard to get enough people to participate
  - Klein study: 16% participation rate, 4% decline in market share
  - People, esp. boycott participants, overestimate how many people participate
- Promotion expensive
- Message “sticks” in a few cases but hard to predict
- Works best with branded consumer products

Ethical Consumption

- Positive ethical consumption advantage: “good” firms have incentive to promote as CSR/marketing
- BUT effectiveness diluted by spin, “greenwashing” →
- 3d party certification, NSMD
- More effective in Europe

ETHICAL INVESTING

Investor Driven Civil Regulation

- Two investor strategies for encouraging CSR:
- 1. Ethical/ Socially Responsible Investing (SRI)
  - Passive/ screening approach
  - Invest in more socially responsible firms
- 2. Shareholder Activism
  - Invest in less socially responsible firms
  - Use shareholder democracy to press “from within” for more CSR

Two Kinds of Ethical Investment

- SRI screening approaches:
- Positive (e.g. “Ethical” Mutual Funds””): invest in “good” firms that pass CSR screen
- Negative (e.g. divestment campaigns directed at institutional investors): avoid/ divest from particular firms or classes of firms targeted as particularly irresponsible

Two Kinds of Ethical Investor

Prudential: premised on business case for CSR: CSR→ better investment (higher returns and/or lower risk)

- Reasons to be skeptical of this

Normative: investor willing to accept lower returns for ethical reasons

Normative ethical investing undermines Friedman's principal-agent critique of CSR

Ethical Investing as Civil Regulation Strategy

- Increases demand for shares of responsible firms→
- Boosts share price→ rewards, protects management of responsible firms
- **NOTE: This does not make the company more profitable**

Critical issues

- Compare civil regulation vs “clean hands” motives for ethical investment/ divestment
- Consider that almost all ethical investment/ divestment involves shares in the secondary market (not IPOs)
- **Therefore “investment in the company” does NOT go to the company**

Limitations of strategy

- Increasing demand for shares of responsible firms→ boost price/earnings ratio→ less attractive investment for "non-ethical" investors
- Depresses relative price/earnings ratio of less responsible firms→ their shares become a "good buy"
  - Notes that "unethical funds" [e.g. Barrier] do well
- Market restores equilibrium; little over all effect on stock market?

An Empirical Test of “Limitations” Hypothesis

- Kumar et al (2002) found that stocks of firms with South African operations out performed the market following Mandela’s approval of the lifting of divestment sanctions in 1993, suggesting that investors’ avoidance of those stocks had depressed share prices.
- Implication: if there is enough focus on a single issue, it can make a difference to share prices

Further Research on Limitations of Ethical Investment Strategy

- Allen Goss (2011) econometric study finds over-all no relationship between CSR and equity financing→ confirms limitations hypothesis
- Divestment by ethical investment → purchase of shares by others
- E.g. Norwegian pension fund divested $180 M worth of Barrick Gold shares due to human rights concerns → no effect on Barrick

Further Limitations

- Ethical investors usually “price takers”—don’t affect share prices (too small a proportion of investment to make a difference)
- Most “ethical screens” are very crude, porous—little difference between portfolios of ethical funds & other mutual funds

CSR and debt financing

- CSR → risk of default → cost of borrowing
- Allen Goss finds lenders (banks, bond market) demand higher interest from firms with very bad social performance
- BUT very good social performance does not result in lower interest
- Esp. for small firm, too much CSR might increase borrowing costs

SHAREHOLDER ACTIVISM

CSR-related shareholder activism

- Active strategy: buy stocks of “unethical” or “irresponsible” firm, and then advocate as shareholder to change corporate policy [e.g., filing proposals to be voted on by shareholders at AGM]
- Note: most shareholder activism not CSR related, focused on shareholder value

CSR Resolutions (at AGM)

- Resolutions usually non-binding (except where firm by-laws stipulate)
- CSR resolutions seldom garner majority support BUT may influence executives even at 10-20% of votes.
- CSR resolutions often framed in business-case terms to appeal to $-oriented investors

Monk findings: Resolutions in 81 top corporations 2000-3

- 55% Corporate Governance-related
- 38% CSR-related,
- 7% “crossover”
- Support for CG resolutions 20-30%,
- Support for CSR resolutions <10%

CSR Resolution Issues (Monk study)

- 47% social, human rights or animal welfare related,
- 28% environmental,
- 14% re employment equity,
- 9% re: political lobbying or campaign donations.

Exxon Shareholder Activism

- One of the top venues for shareholder activism;
- Over half CSR, especially environmental issues such as Arctic drilling, alternative energy & global warming
- Climate change related resolutions attracted up to 20% pro-votes

Barriers to success

- Management usually recommends against shareholder resolutions
- Institutional investors (e.g. insurance companies, mutual funds and pension funds) usually vote as management recommends [e.g., b/c fund managers want to manage firm's pension fund, or just due to policy]

General assessment of shareholder activism

- Goss finds “hard” shareholder activism (resolutions, proxy fights) → small, temporary effect on social performance of corporation
- “Soft” advocacy (lobbying of management, etc.) more difficult to assess quantitatively

CSR and CG activism

- CSR shareholder activism depends on conditions advocated by CG advocates
  - e.g. transparency and oversight of executives by Board of Directors.
- BUT if investors only interested in $, this might make it harder for executives interested in CSR