

Social Investors Rising By Ann Monroe

Everybody is after Coca Cola. Not only was the company forced this year by animal activists to stop funding product tests that used animals, but a former stockbroker turned “financial anarchist” named Max Keiser is trying to hit the company in its two most vulnerable areas at once. He’s pushing activists to boycott its products, hurting sales, and urging hedge funds to short its stock, driving the price down. Keiser’s campaign has yet to gain real traction (though he does claim at least part of the credit for a drop in Coke’s sales and stock price a few years ago). But social investors are collecting more and more scalps in their campaign to make corporations more socially responsible.

In just the past couple of months, SRI investment firm Trillium Asset Management forced Apple to agree to dramatically reduce the toxic chemicals in its products, Trillium and the activist group As You Sow forced Apple to cut toxic wastes and begin recycling its used computers, and SRI investment firm Walden Asset Management forced Hershey to agree to improve its suppliers’ labor practices.

Back in the 1960’s, when social investors – money managers and mutual funds that screen investments according to social criteria -- first began pushing companies to change their ways, this kind of success seemed beyond reach. Indeed, the whole idea came under attack from no less an expert than economist Milton Friedman. In a free society, Friedman famously wrote, the only social responsibility of a company is “to engage in activities designed to increase its profits.” To say it had any further responsibilities (except to obey the law) was, he declared, to preach socialism.

Well, if pushing corporations to behave responsibly is socialism, then social investors are turning the world economy into a socialist paradise.

What’s behind their growing clout? One big factor is the ballooning concern over global warming, which has got

companies racing to establish their green credentials. Social investors have also learned a trick from activist groups – to leverage their campaigns with publicity that hurts companies where it matters most – in their brand. Indeed, though the two groups differ – activists focus on single issues, while social investors look at companies more broadly – they often work closely together. Some activist groups (like People for the Ethical Treatment of Animals, or PETA) buy shares in companies they’re targeting so they can lobby at annual meetings, and social investors often work together to pressure companies. (In their campaign against Apple, social investors worked closely with Greenpeace and other activist groups that were attacking the company in the media.)

The fundamental change, though, is that both parties in this debate have gotten a whole lot smarter. Social investors have learned how to leverage their strength and how to speak the language (profits) that businesses understand. Corporations, for their part, have learned how to help social investors grasp the realities of business. They’re also learning how to take and hold the moral high ground - without either stonewalling the investors or surrendering completely to them.

The result is that, in many instances, companies are beginning to cooperate with social investors instead of stiff-arming them. In perhaps the most dramatic –and controversial – example, Wal-Mart, long a bete noir of social investors, has changed its tune (at least on their environmental concerns). It’s working with environmental consultants including Rocky Mountain Institute and Conservation International on its mammoth green initiative, and has hired former activists from the Sierra Club and the Environmental Defense Fund to present its new green face to the world.

Social investors haven’t won every battle. ExxonMobil is still – successfully – fighting off every attempt to push it to acknowledge global warming. Wal-Mart hasn’t changed its labor practices or the low-ball pricing that can drive competitors and suppliers out of business. But many on both sides are demonstrating a new willingness to listen, learn and change.

In the UK, and increasingly in Europe, it's standard practice for companies to talk to social investors on a regular basis, says Claudia Kruse, Associate Director for Governance & Sustainable Investment at F&C Asset Management, a large UK investment firm. "I've been doing this for seven years," she says, "and I'm definitely seeing a tremendous uptake by companies in terms of their openness to talking with investors."

AstraZeneca, the leading company in this year's ranking, maintains a regular dialogue with investors over social issues, says Sally Shackleton, the vice president who handles corporate social responsibility, explaining that not only does the company want to hear about their concerns, but it also wants to make sure investors understand where the company's coming from.

AstraZeneca sometimes goes beyond what social investors demand, says Veronique Menou, pharmaceuticals industry specialist at SRI research firm Innovest Strategic Value Advisors. "Take the case of the clinical trialing of new drugs. "The pharmaceutical industry has always been under pressure over the health and safety and the environment, now shareholders are leaning on them over trials," says Menou.

These days industry guidelines state that results of new trails should be made public on government or corporate websites. But AstraZeneca has gone further. Even the results of past and ongoing trials are being disclosed."

One reason for UK social investors' clout is that in the UK, investors have rights US investors can only dream of, like the right to nominate directors. In the US, and many other parts of the world, on the other hand, the first challenge for social investors is to get the company to talk to them in the first place. In the US, the wedge they use to pry open a corporation is most often the shareholder resolution, which can be filed by any stockholder who's held at least \$2,000 worth of stock for a year.

And boy, do they use it. This year, social investors and activists filed more than 400 resolutions asking companies to do everything from report their political contributions to cut their greenhouse gas emissions to develop renewable energy sources to change the way they slaughter chickens.

But the shareholder resolution is indeed just a wedge, designed to force a reluctant company to negotiate seriously. "Most

social investors don't rush out to file a resolution," says Timothy Smith, Timothy Smith, a senior vice president at Walden and chair of the Social Investment Forum, an SRI trade group. "If you see a resolution, it means discussions haven't borne fruit." What social investors really want is serious discussions with company management.

Increasingly, they're getting them. Among the companies pushed by resolutions this year to sit down at the table with social investors, in addition to Apple and Hershey, are chewing gum maker Wrigley, which agreed to develop a vendor conduct code based on International Labour Organization standards, with independent monitoring; Pfizer, which agreed to give shareholders a non-binding, advisory vote on executive pay (a big issue this year); and Coke and Pepsi, which agreed to stop financing research that used animals to test or develop products. One of the year's most dramatic victories, though, didn't come from a shareholder resolution, as the targeted company – Fidelity – is private. An ad campaign by savedarful.org accused the firm of financing the Sudanese government's human rights violations by investing in PetroChina (PetroChina's oil massive oil purchases are one of the Sudanese government's biggest props). Berkshire Hathaway, prodded by shareholders to take the same step, refused. But Fidelity, like other companies whose profits depend on their reputation, is deeply vulnerable to activist attacks.

Companies that nurture their brands have learned not to let shareholder resolutions take them by surprise, says Dave Stangis, director of corporate responsibility at Intel. At a meeting with social investors last year, Stangis says, Walden's Smith told him that this year's big issue was going to be the so-called "say on pay" resolution, which would give shareholders an advisory vote on executive salaries. "He asked, 'Are you going to work with me?'" Stangis recalls. Intel joined an investor-company taskforce on the issue. On another hot-button issue, disclosure of campaign contributions, Intel had some real reservations. "We had thought that it would just give people a chance to attack us," Stangis says. But with pressure building in the CSR arena, this year the company decided "Let's just do it." The upshot? More than 60 companies faced

resolutions this year on a pay vote, and more than 50 on campaign contributions, but Intel wasn't in either group. If companies don't talk to them, activists can make their lives pretty miserable. PETA has been known to feature bloody KFC buckets picturing Colonel Sanders as a homicidal maniac at its anti-KFC demonstrations. Perhaps fearing similar tactics, Pepsi this year agreed to a PETA demand to stop animal testing before the organization even threatened a shareholder resolution. "Companies really don't want us speaking at their annual meetings," says VP for campaigns Bruce Friedrich. Some companies, he says, have moved their annual meetings when they heard PETA was planning to show up, to decrease the opportunity for photo ops.

Public embarrassment can take many forms. Activists and investors have been pushing Apple, a company described by one CSR player as "a company social investors have beaten their heads against" for years, to improve its grudging computer recycling program. (Customers couldn't return old computers unless they were buying a new Apple, couldn't return them to Apple stores, and had to return them within 30 days of buying a new one – all features that seemed design to discourage recycling.)

So last spring, over 70 consumer and environmental groups and social investors sent a well-publicized letter to Apple board member Al Gore, asking him to prod the company to change its ways. They had reason to wonder what role Gore was playing there: he had voted against two environmental resolutions filed this year. While Gore's subsequent role hasn't been revealed, two months later Apple CEO Steve Jobs announced in London that he wanted to make Apple "the greenest company on earth." (Like many companies when they surrender, Apple managed to announce this turnaround without ever quite admitting that was a turnaround. "It is certainly clear," Jobs wrote to shareholders, "that we have failed to communicate the things that we are doing well.")

In addition to teaming up with activists, social investors are boosting their clout by joining up with some investors much bigger than they are -- wealthy allies in state and local governments, including the California Public Employees Retirement System (CalPERS), the nation's largest pension

fund. CalPERS manages almost \$235 billion in assets, and when it talks, companies listen. “Shareholders have gotten more creative about how to harness their energy,” says Phillip Rudolph, the former CSR head of McDonald, who now runs an ethical consultancy.

One of the most active of these coalitions is the Investor Network on Climate Risk, of which CalPERS is a member, which boasts that its members control \$4 trillion in assets. Of the 40-odd climate resolutions filed this year that the network is involved with and tracks, 15 were withdrawn because the companies targeted (which include Wells Fargo, Prudential, Costco and ConocoPhillips) agreed to negotiate. (The rest were either voted down or haven’t yet come to a vote.)

What gives the INCR its clout – beyond the money it controls – is its business savvy. Initially, social activists depended on moral arguments to make their case. Business should do what they asked, they insisted, because it was right. Now, led by CERES, an SRI coalition that’s one of the founders of the INCR, they are making a new argument that might even have won over that great skeptic, Milton Friedman. Companies should do what’s right, they say, because it’s profitable. And they’re citing the data to back them up. In a report on Ford, one of the companies the INCR went after this year, CERES argued the company faced severe competitive risks if it didn’t aggressively pursue fuel economy. It cited a University of Michigan study that predicted that \$3.10 a gallon gas would cost Ford roughly \$1 billion in profits if it pursued a business as usual strategy, but bring it \$1.4 billion in new profits with a strong push on fuel efficiency.

Whether or not the oil and auto companies buy them, those arguments are beginning to resonate with other investors. Merrill Lynch has joined INCR, Bank of America has joined CERES, and both firms, along with several others, have recently said they will take sustainability issues into consideration when making investment decisions. “Global warming is changing the playing field in terms of the kind of support we’re going to get,” says Peter Kinder, president of SRI research firm KLD Research & Analytics.

Despite all these gains, one significant vote this year showed that the activists still have a ways to go. In a

multinational effort that included F&C Management, INCR turned its guns on ExxonMobil, pushing hard against the reelection of board member Michael Boskin, who chairs the board's public issues committee and had refused to meet with the group. Despite INCR's arguments that ignoring global warming was hurting Exxon's financial competitiveness, 93% of shareholders supported Boskin.

That's the big gap in the activist playbook. Despite the trillions of dollars in assets they now wield, SRI activists still depend more heavily on the power of public opinion than on their financial clout or even their financial arguments.

And that's where Max Keiser comes in. Activists need to do more than simply push companies to do the right thing, he argues. They also need to punish them for doing the wrong thing by hitting them where it hurts – in their stock price. His plan is to take that old weapon, the boycott, and combine it with one of the financial industries newest devices, the hedge fund.

Here's how it works – in theory: Keiser has set up a virtual market for boycotts called Karmabanque, which calculates how much harm a dip in sales will do to each company's stock price. Keiser's urging hedge funds to sell short the companies whom a boycott would harm the most. (Selling short is a way of making money when a stock drops in price; the investor borrows shares, sells them, then buys new shares at the lower price to return the borrowed shares.) "I think this could become a standard piece of the activist playbook," he says.

It sounds like a cockamamie theory, but according to Damon Barglow, a portfolio manager at Eastern Investment Advisors, who tracks the SRI hedge fund business at esgalph.com, about 10 hedge funds, including Green Cay Asset Management, Winslow Hedge Fund and Civic Capital Group, do make short sales from an SRI perspective, shorting the stocks of bad companies (as well as investing in those of good ones). The Mann Group, a big UK hedge fund company, is also adopting an SRI strategy in some of its funds, he says, as are some religious investors. "As more hedge funds enter the market, the opportunity for them to make money is eroding," he says. "This is an under-exploited opportunity for them."

Whether or not Keiser's scheme works, he's onto one thing: the public – the consumers and investors on whom corporations rely – increasingly expect those corporations to pay attention to more than profits. In a May survey by Fleishman-Hillard and the National Consumers League, a stunning 82% of Americans said they wanted companies to address social issues. What's more, they also said they wanted the US Congress to make sure they did.

Now there's a threat that might even make Exxon back down.