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Stay Tuned: IR Professionals and the Market Reform Forces

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IR Professionals and the Market Reform Forces – Do Tune In!

This year NIRI celebrates 40 years — an organization life spanning four decades, with many individual members experiencing numerous bull and bear market phases during their career. Long-term members may feel they have "seen it all," and still can be surprised by starting developments — such as the Madoff Scheme or the absolute seizing up of the credit markets in 2008.

The forces for reform typically come out in force in the down cycles, and especially after public anger bubbles up and triggers new legislation, financial markets regulation, and investors register extreme displeasure with companies and equities markets in opinion polls. We are in one of these times of dramatic market and societal stress, with ever-more powerful forces aligning today to force change, including imposition of new regulations and restrictions on business, and on a number of investing activities (such as regulation of hedge funds and measures on short-selling). The forces playing off each other today include a growing army of activist institutional investors, elected public officials, media, third party issue advocates, and non-governmental organizations (NGOs) with some implied of the powers of the public sector.

An issue or bundle of issues may begin to register with shareholders this way: an investor or coalition of investors (usually the asset owners) unite on an issue. Let's say…*climate change…global warming…carbon emissions.* And this year, especially, Say on Pay (shareholders voting "yes" to proxy proposals to give owners an advisory and non-binding vote on executive compensation). The shareowners go to work individually and often now through their coalitions to effect change in corporate policies, behavior, practices and performance on a specific issue or bundle of issues.

TARGETING UBER-INVESTOR BUFFETT

No company is exempt: Take famed investor Warren Buffett and the mega-cap company he heads, Berkshire Hathaway. Its annual meetings are love-fests in Omaha, with thousands of adoring owners in attendance and hanging on his every word. But for some investors, there are not enough words — that is, words published describing Berkshire's sustainability issues. Trillium Assets Management, a leading Socially Responsible Investor (SRI), teamed with the International Labor Rights Forum and the environmental group International Rivers, to call on the company's 2,000+ institutional owners to back a shareholder-sponsored proposal requesting that the company issue a sustainability report on its ESG issues (environmental, social and governance). PROXY Governance and CalPERS backed the proposal.

The Berkshire portfolio is a hybrid sort of mutual fund, holding company and investment banker rolled into one. Wholly-owned companies in portfolio have issues of concern to certain investors. PacifiCorp has water pollution issues. Russell Athletic is accused of labor violations in Honduras. PetroChina — which equity guru Buffett somewhat disposed of with nice profits — is linked to human rights abuse in Darfur, in western Sudan. So the shareholder forces would have all this and more published in a sustainability report that the company seems to be resisting.

TUNE IN TO INVESTOR COALITIONS

These kinds of campaigns are going on with increased frequency these days. The critical issue may bubble up from an activist or advocacy group, domestic or international, and be brought to forums where activist shareholders gather. Like-minded investors may lend their weight to the issue, and bring it back to the investor coalition, such as the Investor Network on Climate Risk (INCR), or the Investor Environmental Health Network (IEHN).

IEHN institutions manage $41 billion in assets and generate publicity about toxic materials and contaminants in toys and consumer products. The approach: IEHN states that government regulations and product bans and negative headlines can damage corporate reputations and cause "toxic lockout" for investors. Therefore, it's better to limit use of toxic substance and improve corporate reputation and market share. To help things along, member institutions filed or re-filed 46 resolutions at 28 companies between 2006 and 2008 proxy contests. Companies listen, and change their processes and practices (including Whole Foods, Sears, Apple and J&J). Positive or negative media coverage may result, depending on the company's actions.

The INCR is managed by Ceres, which is the largest network of investors, environmental organizations and advocacies. INCR's 70 member institutions manage $7 trillion in assets. Ceres membership includes corporations — American Airlines, Dell, McDonald's, Sunoco, and others, including 25 of the *Fortune 500* companies. Ceres has other networks and coalitions and the spider web spun includes interests such as the Sustainable Governance Forum, Yale University, Marsh (insurance), Interfaith Center on Corporate Responsibility (ICCR), and more. ICCR members manage $100 billion in assets and influence as much as $1 trillion in assets among members, affiliates and network partners.

IN 2009, THE HOT BUTTON: SAY ON PAY:

We're watching headlines galore this proxy season on this issue. Thanks to a change in the Troubled Asset Relief Program (TARP) legislation, every bank recipient of federal funds (300+ institutions) had to schedule a non-binding advisory vote on executive compensation. At this writing, 29 companies had votes with an average of 46 percent of shareholders favoring the move (80 to 90 more companies have votes this year). ("Yes" votes have been confirmed at Apple, Hain Celestial, Honeywell, Pfizer and other companies.)

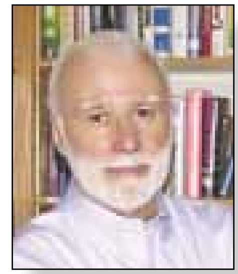
Shareholders are angry, said Gerald McEntee, president of the AFSCME union, "and we are starting to have an impact." Tim Smith, senior VP at Walden Asset Management, notes: "Say on Pay votes plus expanded communications programs combine to let boards know of investor views on irresponsible perks or pay not linked to real performance or poor reporting on pay."

TUNE IN TO: EXPANDED COMMUNICATIONS

And that's the key — *expanded communications.* Companies need to pay close attention to what third parties are saying, and saying with increasing frequency. Investors, investor collations, advocacy groups, public officials: all are descending on print, broadcast, cable and online media to make their case, tapping into the public anger and disappointment in the wake of corporate scandals and high-flying financial services firms that crashed to earth. Companies are the topic of conversation.

The system works this way: institutions coalesce around an issue. They create committees, working groups, draft position papers, draft proxy resolutions, generate peer institution support — and begin communicating with other advocates, public officials and all manner of media. The issue may generate a large feature in *The New York Times* or *The Wall Street Journal,* on National Public Radio, or be presented to 12 million U.S. households on CBS "60 Minutes."

Increasingly asset managers hired by the institutions are instructed to pay attention to the issues of importance to the asset owners (board and staff). CalPERS, with $175 billion in assets, issues strict guidelines for the asset managers hired. Corporate targets are bombarded in various ways on the issue, and the issue moves up to the board and C Suite level. (CalPERS CEO Anne Stausboll, an attorney, is on the board of Ceres and the UN Principles for Responsible Investment.)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Industry has learned to respond: the Business for Innovative Climate and Energy Policy, a Boston-based collaborative that includes Levi Strauss, Nike, Starbucks, Sun Microsystems and Timberland Companies, addresses climate change issues, and collaborates with Ceres to bring together investors and environmental interests to work toward solutions.

Another coalition is U.S. Climate Change Action Partnership, which favors strong federal government action on climate change issues. Members include Caterpillar, John Deere, Dow Chemical, Ford Motor, Rio Tinto, Shell Oil, and others. The Partnership issued a report, *A Blueprint for Legislative Action,* to get out ahead of issues and to spur innovation in new technologies related to low carbon activities.

Lessons for IR professionals: The corporate IRO is not always involved in the issues and actions outlined here. When a shareholder campaign starts up or gets in gear, the "thud" usually lands on the desk of corporate communications, or public affairs, supply chain managers, or the corporate secretary and maybe the legal department; or, increasingly, is aimed as high as possible in the corporate hierarchy, including the board level with some targeting of individual directors.

But this is about the company's relations with its institutional shareholders — all of them, at times, not just the squeaky wheels. The issue advocates are targeting large mutual funds, working to influence the billions of votes cast at proxy time by the fund advisors. Vanguard Funds and Fidelity are now experiencing pressure from ballot-box battlers to cast their votes with the reformers.

The IR officer is the critical nexus for those outside (shareholders, and asset managers) and for those inside (corporate management and board). While some of the above activities may seem outside the scope of their job description, there are real and tangible consequences and outcomes in the types of issue campaigns outlined here. ***Definitely worth staying tuned in!*** IRU

Hank Boerner *is editor of* IR Update *and has monitored market and investment trends and commented on critical events and emerging trends for more than 30 years. He thought he had seen it all…until Fall 2008. E-mail:* ***hank@hankboerner.com***