MAKE YOUR VOICE HEARD – VOTE YOUR PROXIES

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Edmund Burke, an Irish philosopher, once said that "All that is necessary for the triumph of evil is that good men do nothing". Within the context of a developed and stable economy, this is especially true for publicly held corporations. Over the past five years, we have witnessed a number of examples of complacency leading to disaster in some of America's biggest companies. Corporate directors, who were too cozy with management, were ill-equipped to serve as guardians of shareholder assets, or were just plain lazy, failed to stop Enron, Worldcom, Adelphia, Tenet Healthcare and other managements from committing fraud to inflate earnings and prop up their share prices. Anyone would feel justifiable outrage at the actions of these corporate leaders and their greedy, short-sighted tactics. Tempting as it is to place all the blame for managements' poor decisions on the perpetrators and their directors, shareholders also bear some responsibility. We must ask ourselves: are we doing all we can to be active shareholders with our church endowments and with our own stock holdings?

Why Do Shareholders Bear Responsibility?

Shareholders are the ultimate owners of any publicly traded company. If anyone is in a position to insist on ethical standards and robust corporate governance, it is the shareholder-owners. And yet, shareholders, to a large extent, have not done this. Why not? Shareholders have proven surprisingly ineffective at being active owners for a number of reasons, including the very nature of the asset management industry, the perceived expense and the time commitment required to be an active shareholder, and the belief that one's vote is too insignificant to bother. However, by not taking responsibility for voting proxies carefully and in accordance with guiding principles, share owners give managements the impression that no one is minding the store, leaving the door wide open for unscrupulous managements to act in destructive or deceitful and self-serving ways.

Institutional investors (pensions, endowments and foundations) own about 60 percent of all traded stocks in the US and account for roughly 80 percent of the trading volume. According to *The Financial Times*, "Between 1998 and 2000, more than 600 companies restated their financial results. Yet these [money management] institutions failed to use their influence to protect their clients from the companies responsible for some of the worst acts of financial misinformation."[1] During this time period, managements of many large, publicly traded corporations were able to dilute shareholders ownership (which diminishes the value of the stock held by current owners) and issue huge pay packages in the form of stock options. According to *BusinessWeek*,[2] the average CEO made 42 times what a typical factory worker earned in 1980. That multiple rose to 85 times what the factory worker earned by 1990. By 2000, the ratio of what the average CEO made in salary to the factory worker pay was an eye-popping 531. Similarly, dilution from issued

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[1] *Institutional Investors Hold the Key to Better Governance*, **Financial Times,** July 21, 2003**.**

[2] *BusinessWeek*, CEOs: Why They're So Unloved, April 22, 2002.

but unexercised stock options rose to 17 percent in 2003[3] from 13.4 percent in 2000[4] for companies in the S&P 500, MidCap, and SmallCap indices—a total of 1,219 companies, according to studies published by the Investor Responsibility Research Center.

What Is Going On?

How have CEOs and boards of directors been able to jack up executive compensation (sometimes without commensurate revenue and earnings performance) and dilute shareholder equity? Unfortunately, the very nature of our equity markets creates a climate of complacency by shareholders. Most institutions with significant assets (more than $500,000) use mutual funds or hire portfolio managers to buy and sell securities on their behalf. Very often, when churches or individuals hire a portfolio manager, they delegate the duty of voting the proxy to their money management firm. Sometimes, the proxies are not voted at all. *When proxies are left unmarked or voted, they are automatically cast with management*. When asset management firms do accept the responsibility for the proxies, they are required to vote "in the best interest of the shareholder". Most firms interpret this to mean in the best ***financial*** interest and will have proxy voting policies that specify how they meet their obligation.

Too often, proxy voting policies of various investment firms are inconsistent, as they have differing views on proxy issues. For example, some firms might vote against a management plan that dilutes the outstanding stock by a percentage threshold (e.g. 20%) while others will only vote against management if certain earnings or revenue criteria are not met. Similarly, firms differ on their approach to shareholder resolutions, which are not legally binding but do impact corporate management behavior by sending clear messages to the company. In 2004, there were many shareholder initiatives calling for increased disclosure from oil companies regarding plans to deal with the build up of CO2 in our atmosphere and global climate change. Some firms view increased reporting as an unnecessary burden to place on companies while others view that as vital information for understanding a company's competitive position. Thus, if an endowment has two portfolio managers, each holding the same stock, who interpret a proxy item or shareholder resolution differently, the shares may be voted at odds and cancel each other out!

While there certainly are limits to shareholder oversight, there are important benefits to adopting a proxy voting policy that covers important governance matters, such as board independence and CEO compensation. It is equally important to have policies that pertain to shareholder initiatives that cover things like environmental, human rights, supply chain, product safety and labor issues. If a shareholder group or endowment has a coordinated approach to voting proxies, they can rest assured that their voice will be heard clearly and consistently by the managements of the companies in which they invest.

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[3] *Option Grant Rates Began to Slow in 2002*, **IRRC** Study Confirms, IRRC, April 7, 2004.
[4] *Dilution Continues to Rise Finds Latest IRRC Study*, **IRRC**, March 7, 2002.

How Can This Be Done?

Investment committees are bound to protest if a congregation member suggests an active approach to proxy voting. Common complaints are that it is too complex and time consuming for an individual to do the voting, too expensive to hire a proxy service and just impossible for a congregation to agree on a proxy policy. Another common complaint is that the vote of a few shares does not matter in the big scheme of things. Just imagine having that attitude in a national presidential election! While a voter may be only one of 200 million, it is terribly important to participate to have an effective democracy. So it is with equity ownership and, where there is a will, there is a way! Proxy services, ready-made proxy policies and a determination to take responsibility for one's equity ownership are all that is required to be heard by corporate managements.

Proxy Services

While it would be a big job for anyone to have responsibility to vote more than about 20 proxies, a number of excellent proxy services are available. Most proxy voting services have questionnaires to enable automated voting for the great majority of proxy issues. The questionnaires cover corporate governance issues like acceptable levels of dilution, minimum meeting attendance standards for directors, and guidelines on board independence. Further, they have a detailed list of typical shareholder initiatives where an endowment's preferences can be set so that all shares will automatically be voted in accordance with these directions. Issues not covered by the questionnaires (like mergers or acquisitions) are typically emailed to be voted by an individual designated by the endowment. Most services charge a nominal fee per proxy but have a minimum fee to cover their costs. An automated approach can greatly simplify the process of voting across a number of accounts with many different equities.

Another issue that groups have to tackle is developing proxy guidelines that reflect the values and goals of their organization. For churches, much of this work has already been done! Nearly every denomination posts their proxy policy which can be adopted by the individual churches or modified to reflect the character of the group. For example, Methodists can download the General Board of Pensions and Health Benefits Proxy Guidelines by logging onto www.gbophb.org/sri/pdf/proxy_guide1103.pdf. Similarly, the Pension Boards of the United Church of Christ post their proxy guidelines at http://www.pbucc.org/csr/proxyvoting.php. An excellent source of information and links to sample proxy guidelines has been created by the Social Investment Forum, the trade organization for socially responsible investment managers, at http://www.shareholderaction.org/proxy.cfm. Nearly every denomination and numerous socially responsible investment managers and practitioners have posted guidelines. The first step is to become educated on the issues. The second step is to adopt guidelines (borrowing where appropriate) that are a true reflection of the values of the shareowners.

Proxy Voting Does Have An Impact

There are a number of examples of companies changing their behavior as a result of shareholder pressure through proxy initiatives. In 2002, EMC added an independent director to its board because a shareholder resolution proposing that a majority of the board be independent directors with no other ties to the company, passed with 56 percent of the vote. Also in 2002, CBRL, the parent company of Cracker Barrel, was pushed by a majority shareholder vote to adopt an Equal Employment Opportunity policy that bans discriminating on the basis of sexual orientation[5]. It is often through shareholder initiatives that managements are persuaded to enact better corporate governance policies, to be more careful stewards of the environment, to work toward a sweatshop-free supply chain, to support fair trade, to adopt global human rights policies, and to be more balanced and thoughtful in their pursuit of profit. We can expect more from the companies in which we invest if they know that shareholders are watching.

A conservative twentieth century philosopher, Ayn Rand, once wrote that the "spread of evil is the symptom of a vacuum, whenever evil wins, it is only by default: by the moral failure of those who evade the fact that there can be no compromise on basic principles."[6] Complacency is the enemy of those who hope to hold accountable the leaders of our economic enterprises. By actively and conscientiously voting our proxies, we have taken an important step toward demanding corporate accountability on economic performance as well as on social and environmental stewardship.

[5] Baue, William, *Top Five Social Investing News Stories of 2002*, http://www.institutionalshareowner.com, January 14, 2003

[6] Rand, Ayn *Capitalism: The Unknown Ideal*, 1966