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Brief considerations on the effectiveness of shareholder activism. A virtue ethics approach[1]

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Abstract

Shareholder activists engage with companies in order to influence behaviour and to foster social responsibility (CSR). Although investor groups and regulators continue to see shareholder activism as key to building a healthy business system, research on the effectiveness of such activism to date is inconclusive. We may ask why practitioners continue to devote time and energy to activism if its results are uncertain, and suggest that the current answers to this question in the business literature are not convincing. We analyse the main lines of research on the effectiveness of shareholder activism to date, and suggest that one of the reasons for the mismatch between practitioner interest in activism and research results on its effectiveness is that researchers adopt an incomplete vision of what counts for success for shareholder activists, especially where socially-responsible investors are concerned. We propose that a virtue ethics perspective could provide a more complete picture of what is going on in the activist-business relationship.

Keywords: shareholder activism, socially responsible investment, virtue ethics.

1. Introduction

Companies need the pressure and/or encouragement of shareholders and other stakeholders in order to take their social responsibilities seriously (Sethi, 2005). In particular, financial markets are increasingly viewed as a possible and

[1]L'articolo è stato sottoposto a doppio referaggio anonimo.

effective tool to influence corporate social responsibility, where shareholders are pursuing greater participation to foster shared strategies for CSR (Ingley et al. 2011). Shareholders, as owners, are interested in the companies in which they invest, at least to some extent, and, on the basis of their ownership claim, have a right to engage with company management. This is of crucial importance if, as the Executive Director of Eurosif has underlined, "legislators realize that one of the contributing factors to the recent global financial crisis was shareholders' lack of engagement in holding company managements responsible for their actions" (Eurosif, 2013, p. 5).

In this context, shareholder activism (SA) is seen as one of the most promising and powerful tools to influence behaviour and to foster social responsibility (CSR). However, research regarding the efficacy of SA is still somewhat inconclusive. Different studies concentrate on proposal topics, voting results and typical targets for such activism and on the nature of activists (NGOs, unions, pension funds, hedge funds, etc.) but, while most argue that there is need for further research to validate their claims, in the meantime they either point to the lack of real empirical evidence for the effectiveness of SA, and that there are "theoretical reasons for thinking that mainstream shareholder activism is quite unlikely to be socially effective" (Sandberg, 2011), or they suggest that, despite some contrary results, the evidence that exists largely indicates that SA is not really effective in bringing about change in corporate behaviour (Sjöström, 2008; Haigh and Hazelton, 2004).

If this is so, why do shareholder activists continue their activities? Why would authoritative figures in the field regard the lack of SA as a "contributing factor" to the crisis? In the face of such strong commitment to SA, it seems inadequate to offer the explanation that activists are searching for social recognition, or that they are motivated by the "symbolic significance" that SA has for them (Rojas et al, 2009). Shareholder activists invest much time and effort in engaging with the businesses in which they have invested, and legislators, regulators and directors of social investment fora would be unlikely to encourage SA if they thought it had little or no effect (Eurosif, 2013). There is much to be explored here; as part of such an exploration, we suggest that existing results, while they contain interesting and valid insights, may suffer from an incomplete vision of what counts as success for SA.

The main aim of this paper, therefore, is two-fold: to identify weaknesses in the research on SA so far, and to investigate if adopting a new approach, namely the virtue-ethics approach, could help us understand better how effective shareholder activism can be in inducing changes in corporate social performance, behaviour and character.

2. Does shareholder activism have any effect?

There are several ways in which shareholders seek to influence companies' behaviour. In a broad sense the term "shareholder activism" refers to the process by which, once specific areas of improvement have been identified, investors seek to control, inform and persuade companies to change their policies. This action could be formalized in different ways: from the exercise of the right to vote at the Annual General Meeting (AGM) to the possibility of submitting resolutions; from meeting and dialoguing between companies and investors to support to companies in the formulation and adoption of specific strategies (Carleton et al, 1998; Rojas et al. 2009; Vandekerckhove et al. 2008; O'Rourke, 2003, Rehbein et al., 2013; Logsdon and Van Buren III, 2009, Graves et al., 2001).

Based on a 'voice' approach (for the concepts of "voice" and "exit" see Hirschman, 1970), shareholder activism is typically implemented by institutional investors or groups of organized people: mutual, pension and hedge funds; groups or coalitions of ethical investors; opinion, advocacy or consumer groups; churches and religious groups; trade unions, non-governmental organizations, and so on.

These different actors are moved by different values and use their shareholder rights for different purposes: advocacy groups or NGOs, for example, might be interested in stopping a specific behaviour, perceived as being wrong or harmful; socially-responsible investors may be primarily interested in getting firms to implement the CSR practices of "good" companies which they have already selected through a screening analysis, while more traditional institutional investors could engage in activism to ensure that management decisions are made in the best interests of shareholders.

The presence of different positions suggests considering shareholder activism according to at least two different paradigms: the 'shareholder' and the 'stakeholder' paradigm (McLaren, 2002). This dual vision has obvious implications for the choice of companies in which to invest and on the mode of assessing the effectiveness of such investment.

According to the first model, the investor is driven by the belief that better performance with regard to governance, environmental impact and social factors also improves economic and financial performance (there are many studies on this question; for an overview see the meta-analysis proposed by Orlitzky et al., 2003).

Despite findings indicating that the efficacy of SA on stock or firm performance is still controversial (Sjöström, 2008; Gillan and Starks, 1998 and 2007; Black, 1992; Karpoff, 2001; Nordén and Strand, 2011), recent studies demonstrate that even low-cost actions, like a "just vote no" campaign against a director's election, motivates boards to take immediate action in shareholders' interests and so improve operating performance (Del Guercio et al., 2008; Grundfest, 1993). The main parameter for measuring the effectiveness of SA within this framework is, obviously, the stock price or the overall company's economic and financial performance. Such a parameter is relatively easy to measure, and using it as an indication of success is compatible with utilitarian and agency-based approaches. Taking this approach, therefore, tends to suggest that SA is only partially successful, and more research is needed to establish under what conditions and with what strategies activists can maximise their chances of success. Moreover, an intrinsic limit of this method lies in the fact that many factors could influence the performance of firms and their equity prices, and, therefore, it is not always easy to separate the effect of shareholder activism from that of other determinants.

On the other hand, if we accept the "stakeholder paradigm", SA can be interpreted as a means of expressing stakeholders' multiple points of view. SA aims to shape and foster the ethical and social responsibility orientations of business. In this case, it is not only the stock value that is at stake, but also various ethical or social values. The effectiveness of SA will therefore be assessed mainly on the basis of actual changes in corporate behaviour.

Previous studies have measured SA effectiveness in terms of the percentage of votes received by a shareholder proposal (Profitt and Spicer, 2006) or on the basis of the number of withdrawals or successfully withdrawn resolutions (Tkac, 2006; Rojas et al., 2009; Profitt and Spicer, 2006). Haigh and Hazelton (2004), for example, show how shareholder activists lack the power to create significant change as they obtain very low consensus for their proposals during meetings. This perspective is challenged by Graves et al. (2001), O'Rourke (2003) and IRRC - SIF (2002) who argue, in contrast, that even small levels of consensus may indicate a real and growing interest among shareholders, the public and the media, and could represent a first step in a public debate on specific environmental, social and corporate governance issues (U.S. SIF, 2003).

In order to throw further light on the emerging picture, it may be helpful to make the ethical theories underlying the analysis of SA and its effectiveness explicit. From what we have presented above, we may note that the 'shareholder view' tends to fit better with both utilitarianism and agency theory, while the 'stakeholder approach' is often based on deontological or social contract theory. All these theories, however, seem to lack the power to catch all the dimensions of SA, in particular, the capability of building and growing relationships over the long term. As Hoffman (1996) emphasizes, the changes obtained are often the result of a delicate process of mediation between companies and shareholders and therefore that investors are in fact in a position to influence policies if they allow for some compromise.

From an ethical point of view, a utilitarian and/or agency theory perspective, based on the prioritisation of shareholders' interests, could lead to a "value-neglect" view of the relationship between companies (or managers) and other stakeholders. As a result, any action that brings interests other than the maximization of share or company value will be assessed as failure. On the other hand, deontological or social contract theories, although being based on other values as well as economic and on a multistakeholder perspective, are limited by their focus on the individual from catching the potentiality of SA for building the "learning-based engagement with others" necessary to face "messy and pluralist settings" (Calton and Payne, 2003, p. 8 and 35).

If the responses to active shareholding are to involve real and lasting change, it is necessary to stimulate a "new corporate culture" in which issues related to CSR are perceived as a source of opportunity rather than as threats to be resisted. To see the necessity of such changes, one may need "to put on new glasses" and to adopt new ideas of what counts as effective. In the next section, we will present a virtue ethics approach as a way to evaluate SA effectiveness. From the analysis of the research so far, it seems to be emerging that if we take a long term view of success, and if we see building key strategic relationships through which deep change in corporate culture can be fostered, we may be able to understand the results of SA better, at least as regards its SRI proponents.

3. A Virtue Ethics approach to business and to shareholder activism

Virtue ethics is a relatively new but developing approach within business and financial ethics, following on the "recovery" of the idea of virtue in mainstream philosophical ethics in the second half of the twentieth century (Anscombe 1958; MacIntyre, 1981; Battaly 2010). Research papers have used or referred to virtue ethics for decades, while book-length treatments for specialists, such as Solomon (1993), have been available for over twenty years. In the last fifteen to twenty years, basic texts and manuals of business ethics have begun to include chapters on virtue ethics or to include a virtue approach in their techniques for case analysis (examples would include Goodpaster, Nash, De Bettignies, 2005, or Melé 2009). To our knowledge, however, no research so far has attempted to use a virtue ethics approach to understanding shareholder activism and its effectiveness.

The central concern of virtue ethics is the kind of people we become through what we do. Rather than evaluating them individually, actions are judged as good or bad in this approach in relation to the developing character of the individual or the developing culture of the business enterprise, if we may see business culture as analogous on the level of the group to the character of a human person (Goodpaster and Matthews, 1982; Moore, 2005, 2008). It is not a surprise, therefore, that the arrival of virtue ethics in the management sphere has raised fundamental questions about the kind of people we become in business.

Virtues are the realization of the potential of human beings to be able to achieve what is good for them and for others.

Some recent definitions of the term "virtue" or "virtues" include "praiseworthy character trait" (Audi, 2012, p. 273), "acquired human qualities, the excellences of character which enable a person to achieve the good life" (Crossan et al, 2013, p. 570, quoting Mintz, 1996), and "moral and intellectual excellences of human character and action" (Bright et al, 2014). Here we see the emphasis on a "trait" that is both "excellent" and "acquired", creating a good "character" that allows a person to "achieve the good life". Hartman (2011), in reference to Aristotle's thought, says that "human beings are social creatures by nature, so virtues are community-related traits" (p. 6); Sison et al (2012) put it succinctly when they say that "we are rational creatures and we are sociable creatures" (p. 208). We are enabled to grow in virtue as part of a community, in communion with others. Virtues develop in relation with others, including shareholder activists; the importance of dialogues between activists and companies, which have now become a major way of carrying forward SA, would be clear in virtue ethics (Logsdon and Van Buren III, 2009) and the various strategies that activists can use (Guay et al., 2004) can be seen an integrated way as part of building a relationship. Virtuous people will develop common goods between them that can also be seen as a kind of "virtuous corporate culture". A virtue ethics approach would lead us to look at the on-going relationship between activists and managers, and to see how the latter gradually internalize the external pressure towards good behaviour that they experience from the former.

To summarise so far, we can outline some key aspects of the virtues as this approach has been received in business ethics:

1. Virtues are praiseworthy or excellent, since they relate to what is good (greater human development);
2. They are acquired, and can be recognised as "traits" or "qualities" that are part of a "character": we grow in virtue by acting regularly and habitually towards good ends (those that lead to human development and to the realisation of potential for being in general);
3. As a consequence of point 2, virtues develop gradually, and in some kind of relationship with others. This will be an important aspect to keep in mind as we think about shareholder activism.
4. They help us act in good (excellent) ways;
5. They are part of living a good life: which also means that they are part of social life and of relating to others in a way that leads to happiness.

Therefore, an approach to the evaluation of SA based on virtue ethics will, at a minimum: a) take a long term view; b) focus on building a relationship, and; c) be concerned about the development of virtue, both within the business and in its relations with other stakeholders, and of a virtuous corporate culture.

A virtue ethics approach could help us to go outside the AGMs and to look at what happens day by day, year after year, to uncover a basic orientation to business that is sustainable. Virtue ethics allows us to understand activism in terms of building a relationship in which both sides are aiming to generate a common good, that is, a more virtuous business organization. Real and longstanding changes in character take time. A long-term perspective is fundamental.

Investors cannot engage with all the companies in which they invest: they have to select, simply because of time and cost constraints (Eurosif, 2003). With a virtue ethics perspective investors will chose strategic actors in the market, with which they can build deep, transformative relationships.

4. Conclusions

From this evaluation of the literature on the effectiveness of SA, it emerges that a virtue ethics approach could add to and correct existing approaches. We have argued that virtue ethics is especially helpful in understanding SA as practiced by SRIs, emphasising a long-term view and the building of a relationship, aspects which are key to these actors. In contrast, these aspects of SA are not highlighted, or are even missed, by those using utilitarian and/or agency theory approaches. These brief notes show that there is potential for further empirical work on activism, using a virtue ethics approach, both in understanding what counts as success in SA and to examine how fully applicable virtue ethics is to understanding this relationship.

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