

Shareholders' Project

**An examination of the future of
shareholder/corporation relationships in Australia.**

BACKGROUND BRIEFING PAPER

*Have you ever bought or been given shares? Do you have superannuation?
If you answered yes to either of these questions, this document concerns you....*

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PREPARED BY:
Catherine Brown, Director, and Claire Thomas, Research Assistant
Catherine Brown & Associates Pty Ltd
cb&

Project Team

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Catherine Brown, Director, Catherine Brown & Associates

Professor David Kimber, School of Management, RMIT

Dr Simon Longstaff, Executive Director, St James Ethics Centre

Barbara Sharp, Principal, Offor Sharp & Associates

Pamela Webb, New Think Global

Eva Wynn, Trustee, Education Foundation and Wynn Family Fund

Project Contractors

Project management and background research: Catherine Brown & Associates Pty Ltd;
Suite 7, Level 4, 472 Bourke Street, Melbourne 3000; Tel 03 9602 2020; Fax: 03 9602 2034;
email: cbanda@optusnet.com.au

Communications: Hill & Knowlton; Tel 03 9211 2444

Forum design and facilitation: Offor Sharp & Associates; Tel: 03 9662 4023

Survey research and analysis: Irving Saulwick & Associates; Tel: 03 9537 2192

Introduction

Australia has the highest share owning population in the world. 53.7% of Australians hold shares either directly or indirectly through superannuation or managed funds. The education of shareholders and the role of corporations in Australia is a key issue facing the community. Shareholders are becoming increasingly active in respect of their shares and the activities of the companies in which they invest. Corporations are managing the sometimes conflicting pressures of providing a maximum return on shareholder investment with emerging expectations about social and environmental investment screening, and the corporation's reputation as a good employer and community citizen.

It is timely to look closely at these competing pressures and analyse the real preferences of shareholders and the different ways in which corporations could respond, or even take the initiative. What do shareholders in Australia want?

This Background Briefing Paper has been prepared to provide information to a group of expert advisers and shareholders who are taking part in a forum to be held on 15 September 2001 at Parliament House, Melbourne. The forum will examine the future of shareholder/corporation relationships in Australia and will analyse the results of a unique quantitative survey of 1,000 shareholders. The survey will examine the attitudes of individual and institutional shareholders to a number of questions surrounding shareholders' relationships with the corporations in which they invest. A wide range of views is presented in this Background Briefing Paper.

The Shareholders' Project is supported by a panel of expert advisers who have knowledge about shareholder/corporation relationships, and by a Project Steering Committee, led by The Myer Foundation, which has been responsible for identifying the issue, choosing the methodology, developing this document and raising the funds to carry out the project.

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The Process

A large group of up to 1,000 shareholders is being polled and their views on shareholder/corporation relationships will be determined. The relevant population is people aged 18 years of age and over whom:

- Own shares in publicly listed companies, either directly or through a trust or superannuation fund that they themselves control;
- or
- Own shares in publicly listed companies by virtue of their membership of a superannuation fund that they themselves do not control.

The survey is being conducted nationally by telephone in private occupied dwellings.

Qualitative data is also being obtained from around 50 institutional investors and 50 trustees of superannuation funds. These are being surveyed by individual telephone interview lasting up to 10 minutes.

A group of more than 100 shareholders and expert advisers will convene at Parliament House, Melbourne, on 15 September 2001 to further explore the issues surrounding shareholder/corporation relationships. The Forum will include expert presentations, small roundtable discussions, the presentation of the survey results, and a moderated panel discussion of those results.

The key questions that will be examined during the survey and forum will be:

1. What do shareholders consider to be the benefits, costs or other implications of a corporation in which they invest adopting socially and environmentally acceptable practices? How does this relate to financial returns on investment?
2. Under what circumstance would shareholders more actively exercise their rights (for example, voting rights) and perhaps responsibilities in relation to the corporations in which they invest?

Whatever the outcome, the Shareholders' Project is an innovative project, which is bound to be informative and revealing of the perceptions of both individual and institutional shareholders. The Project will make a major contribution to identifying future directions in the debate surrounding corporate social responsibility and shareholder expectations and participation in Australia.

The survey is being carried out by Irving Saulwick & Associates, social researchers with 30 years experience. Offor Sharp, experts in community consultation processes, is designing and facilitating the forum. The public education and communications program is being managed by Hill & Knowlton, one of Australia's leading communications firms. St James Ethics Centre is assisting with financial administration of the project. The project manager and background researcher is Catherine Brown & Associates, which advises philanthropic and community organisations on innovative projects.

The Issue

1. The Shareholder/Corporation Relationship

Shareholders in Australia – A Snapshot

*Australian Shareholder Statistics –
Some Facts to Consider¹*

1. Australia has the highest share owning population in the world - 53.7% of the population owns shares directly or indirectly through superannuation funds.
2. 5.7 million Australians, 40.6% of the population, have direct share ownership.
3. 1.5 million Australians aged 18-34 own shares, equal to those aged 55+.
4. Australians aged 35-54 own more shares than any other age group.
5. A fifth of the Australian adult population has directly entered the share market since 1997.
6. The increase in Australian share ownership has occurred evenly throughout the country, in both metropolitan and rural areas.
7. 62% of Australian shareholders hold three stocks or less in their portfolio.
8. 42% of Australian shareholders hold a portfolio worth \$10,000 or less.
9. Foreign shareholders hold around 38% of the capital on the Australian Stock Exchange.

While the above statistics reveal that a large proportion of Australians are corporate investors, it is also apparent that many of those shareholders have narrow interests in the market. Many people became shareholders for the first time with the Telstra floats. While personal investment portfolios were previously considered to be the domain of the retiree, younger members of the Australian population are now also enthusiastically engaging in the share market.

What exactly is a shareholder?

¹ Results taken from the ASX Share Ownership 2000 survey.

The shareholder/corporation relationship is governed by the Corporations Law, which regulates corporate practice in Australia.

A shareholder is a legal person or entity that holds one or more shares in a company. The company may be publicly or privately owned. In this Poll, we are interested in examining the role of shareholders in publicly listed companies.

A corporation in this context is a legal entity that is owned by one or more shareholders with the goal of operating at a profit. This Poll is not examining other corporations that are not for profit.

Essentially, a shareholder is an owner of the corporation or company in which he, she or it holds shares. A shareholder may be another company (for example, AMP) or even a trust (for example, HESTA superannuation fund).

While many people hold shares directly in companies in Australia and overseas, many also invest in shares via a managed fund (eg BT Split Growth Fund) or a superannuation fund (eg UniSuper or the Victorian Government Superannuation Fund). All working Australians are shareholders because a portion of their income is placed into a superannuation fund for investment. This type of shareholder is known as an “indirect” shareholder.

The affairs of a company are managed by its Board of Directors. Directors have duties under the Corporations Law and Australian common law regarding the way they control the corporation. Directors’ first duty is to act in the best interests of the company and for a proper purpose (section 181(1) Corporations Law). Some of directors’ duties relate directly to the information provided to all shareholders, whether small or large, prior to an annual or extraordinary general meeting, a takeover offer or bid, or a merger.

Directors of publicly listed companies can also hold shares in those companies – so directors are also shareholders.

The role of the owners or shareholders in a corporation is blurred due to the increasing

number of senior executives and ordinary employees who own shares in the corporations which employ them. Executives (management) might hold shares or options as part of their remuneration package and other employees might have acquired shares under an Employee Share Scheme.

The motives and roles of shareholders are varied and subject to different duties and legal relationships. However, underlying all these relationships is the question of what shareholders, either as a group or as sub-groups expect of the corporations in which they invest. Is it more than a financial return? If so, *how far are you, as a shareholder, prepared to get involved in helping shape the social and environmental policies of your company/ies? And are you interested in pursuing this at all, if the financial return is adversely affected?*

How has the increase in share ownership affected corporate operations? How much impact should individual and institutional shareholders have on corporations? How much impact could they have? What are the priorities of shareholders?

These issues will be explored in more detail in the following section.

A) The Role of Shareholders

Is the primary objective of a corporation to maximise shareholder wealth? With the increase in shareholders among the Australian population, has this objective received further support?

Many shareholders are happy to entrust their money to fund managers and have little interest in their personal investing details. Some shareholders take a more active level of interest in the corporations in which they invest. Others perceive their investments as important social choices. Given the extent to which corporations seek to satisfy the shareholder, whatever the context, it is important to understand the priorities of investors.

Traditional conceptions of the shareholder/corporation relationship have focused on the goal of building shareholder

wealth. A number of people argue that a focus on maximising shareholder value in \$ terms can be achieved while still prioritising social, environmental and regional development factors. They argue that there may be other groups, as well as shareholders, who have an important stake in a company's operations. This view accepts that is appropriate for outside stakeholders to impact on corporate practice. Government regulations are another example of the external monitoring of corporations. Regulations in relation to the environment and social issues (eg, anti-discrimination legislation) have made corporations include these responsibilities in their accountability processes.

The above viewpoint has been defined as "stakeholder capitalism", "business ethics" and "triple bottom line". Many people view the emergence of these movements as challenges to the current advances made by business in balancing increased shareholder value with environmental and social concerns: "*These movements are threats in a number of ways. First, they seek to undermine the rights of individual shareholders. They seek to impose social or collective rights on corporations and to elevate these objectives to the same status as those of shareholders.*"²

Rather than responding to external stakeholder pressure from groups that may not be representative or accountable themselves, this approach argues that corporations should remain focused on ensuring greater shareholder value and work towards continually improving social and environmental practices as a part of normal corporate accountability.

Should environmental and social issues be addressed only through the regular operations of a company, at the discretion of its directors? Or is it necessary for external groups to actively pursue these issues?

The discussion about undermining a corporation's overriding duty to build shareholder wealth needs to consider the expectations of shareholders themselves – what

² Mike Nahan, "Accountability in the New Millennium: Accountability to Whom, for What and Why?", Address, Institute of Public Affairs to CPA's Congress 2000, 3 May 2000.

do shareholders actually want? The range of expectations may be diverse.

Like consumers who change their buying habits, shareholders can change their investing habits. Where they were once passive investors, they can choose to actively use their shareholder vote to influence many aspects of a company's operations. Shareholders (both small and institutional) have begun to use their shareholder voting rights more strategically in areas such as environmental protection, use of child labour, remuneration of directors and senior management, contribution to the communities in which a company operates, corporate governance and social policies.

Shareholder concerns are varied: from simply seeking greater Board transparency to demanding changes to key aspects of a corporation's operations. As an example, "research shows that both ordinary shareholders and other Australians believe the well-being of employees should rank above the drive for increased profitability".³ "Looking after employees was ranked as the most important characteristic of a good company, followed by making profits and good returns for shareholders. External responsibilities ranked third."⁴ Other shareholders, however, invest for the short term, for financial gain and enjoy taking risks when trading in speculative shares.

A recent KPMG/Resnik survey of Australian individual shareholders revealed some interesting statistics about shareholder priorities. Some of the findings included:

- 1. 20% of respondents said they would accept lower returns on investments if a worthwhile cause was being benefited.*
- 2. Commendation of a company by an environmental organisation would persuade 58% of respondents to invest in that company.*
- 3. The most important non-financial issues for shareholders were the environment, human rights, labour relations, community relations and Aboriginal rights.*

- 4. The least important non-financial issues for shareholders were alcohol, gambling and tobacco.*
- 5. Of the 46% of respondents who were aware of ethical investment funds, only 8% had supported them.*
- 6. If given a choice by their superannuation fund, 80% of respondents said they would opt for the ethical stream.*

Interestingly, the survey asked what shareholders would do, not what they currently do.

B) The Role of Corporations

Legally, corporations, via their Board of directors, have a duty to act in the best interests of the company. Companies are required to operate within their Constitution and the Corporations Law. Corporations have policies about how they will contribute to the community that are in line with the overall strategy for achieving their corporate goals.

The control of the company business is the responsibility of the Board of directors who usually act collectively. Certain responsibilities, subject to suitable controls being in place, may be delegated by the Board to a sub-group of the Board or to management. A company is a legal entity in its own right and shareholders are the owners of the company. The Board acts on behalf of shareholders to ensure that the business of the company is carried out as profitably as possible.

But how far should the role of the corporation extend? Many believe that the triple bottom line - financial, social and environmental considerations - is now the accepted approach to running a business. Finding a balance between these three issues can be perceived as the greatest challenge for today's corporation.

On the other hand, it is argued that undue emphasis on social and environmental factors can corrupt the main corporate goal, i.e., to generate profits. Proponents of this viewpoint argue that it is not the role of private corporations to specifically target issues that should be dealt with by other sectors, eg,

³"How Stakeholders are Changing the Rules", *Clemenger Report* 1998, p6

⁴ *Ibid.*, p24

government, philanthropy and non-government organisations.

*"Corporate Australia has...contributed to the environmental and social well being of the country in the most effective and appropriate way, which is by creating wealth, jobs and opportunities."*⁵

While the above comment emphasises the positive outcomes of a successful corporation, is it enough to simply assume that good business will include social and environmental benefits? How much trust do shareholders really have in company directors?

C) Corporate Governance

*"Corporate governance refers to that blend of law, regulation and appropriate voluntary private-sector practices which enables the corporation to attract and retain financial and human capital, perform efficiently, and thereby perpetuate itself by generating long-term economic value for its shareholders, while respecting the interests of stakeholders and society as a whole."*⁶

Most shareholders would agree that corporations have a responsibility to operate effectively and transparently. Ethical management of a corporation is an important part of its reputation among its customers, shareholders and the general public.

There is some scepticism in the community, however, regarding the integrity of corporate operations. Some people would argue that directors and management do not always operate in the most ethical manner.

Executive salaries, for example, are a problematic issue for many shareholders. Indeed, the Executive Officer of the Australian Shareholders Association, Tony McLean, says that "we get more complaints about executive

pay than any other issues put together".⁷ Without adequate communication of a corporation's salary policy, shareholders may perceive executive bonuses as arbitrary or inconsistent with performance. The connection between executive pay and the success of the corporation can also be weak:

*"...in too many cases, seeing senior executives reach their performance hurdles and receive their bonuses has given shareholders no indication of how their company is travelling, whether share prices will rise, or even if the company will still be in business six months later".*⁸

The idea of transparency is a key to the perception of ethical corporate governance. Indeed, for some investors, almost anything goes as long as it is disclosed. Concerns over executive pay, for example, may not be as prevalent if investors were aware of the motivations behind remuneration packages.

Transparency of operations is also essential when considering a corporation's wider social impact. If, for example, a group of shareholders became concerned about the environmental impact of a company's activities, vague records or unexplained actions would only increase their suspicion. As previously mentioned, there are a number of people who believe that social issues should be a part of normal business accountability. It is important to note, however, that this idea is dependent on quality corporate governance.

Shareholders need to trust the Board and concealment of operations only generates suspicion. Adequate disclosure of information and explanations for a chosen course of action have proven to be important priorities for shareholders.

"The investment community seems to assume that boards don't know what they are doing. Maybe the investment community would be less sceptical if companies were more up front about

⁵ Nahan, 2000.

⁶ Ira M. Millstein, Principal Advisor on corporate governance to the OECD and World Bank.

⁷ Quoted in Neil Chenoweth, "The backlash against the unearned bonus", *Australian Financial Review*, 21 April 2001.

⁸ Chenoweth.

who the directors are, how they add value and how decision-making processes work.”⁹

The recent collapses of HIH Insurance and One.Tel could be seen as examples of inadequate information being provided to shareholders – and employees and customers.

Flexibility and the capacity to respond to the changing environment is considered another aspect of effective corporate governance: *“Nothing should be sacrosanct – board papers, board agendas, meeting schedules, sub-committees, fee structures, board composition – all should be challenged, and changed if necessary”*.¹⁰

In a recent article, Henry Bosch examines the difficulties faced by an honest and diligent director who becomes seriously concerned about a governance matter: *“A very good case can be made that shareholders have a right to know about major issues of principle that affect their investment. They elect directors to represent their interests and the directors act as the auditors of management, asking detailed questions and becoming aware of the most confidential matters... In practice, the advice of dissenting directors has little chance of being heeded and the damage to their personal careers may be substantial, so the convention has developed that dissenting directors quietly fold their tents and walk away. Shareholders rarely become aware of the issues, and when they do, they usually prove reluctant to do anything about them. This is a serious defect in our system of corporate governance.”*¹¹

If the separation of ownership and control which currently exists is changed by allowing shareholders to direct Boards, or by protecting independent directors more fully, then what are the appropriate mechanisms? Would the law relating to directors' duties need to be revised?

⁹ Diane Grady, “Breaking the Boardroom Mould”, *Company Director*, September 2000

¹⁰ Grady.

¹¹ Henry Bosch, “Wake us up, before you go”, Shareholders Rights, *Shares*, August 2001 p105

D) The Role of Institutional Shareholders

It is not only individual shareholders who have demonstrated concerns beyond wealth maximisation; institutional shareholders are also becoming increasingly involved with corporate social and environmental practice. As large-scale investors, institutional shareholders have a great capacity to influence corporate operations.

For example, during the 2000 annual general meeting season, representatives from Perpetual Trustees attended many meetings to query issues of corporate governance, including executive remuneration.

In a paper entitled *Does Coordinated institutional Activism Work? An Analysis of the Council of Institutional investors*,¹² the researchers investigated the outcome of institutional activism programs during a five year period in regards to poorly performing firms. In the year following the Council's activism program, the firms showed an average share price increase of 11.6% above that of the Standard and Poors 500. “This increase is broadly consistent with the view that coordinated institutional activism creates shareholder wealth.”

Australia's financial institutions (for example, superannuation and insurance funds) are old by world standards and have an established position in our society. These institutions have power as major investors in shaping the behaviour of corporations in Australia. Some commentators have criticised Australian institutional investors for being passive and not actively representative of their own share or unit holders. How should they exercise this power – and how could they canvas the views of their unit or policy holders?

E) Employees as Shareholders

Now that 53.7% of Australians hold shares, including in superannuation funds which are major shareholders of many public companies, the distinction between management and employees is beginning to blur. Many employees are shareholders in the companies

¹² T C Opler, Ohio State University, 1995

for which they work, either directly or indirectly through their superannuation funds.

*"In the past it was a short-term interest centred around the weekly pay packet but now their [employees'] super is invested in companies such as Rio Tinto and if these companies do not prosper in the longer term then [the employee shareholders] suffer as well."*¹³

A recent Federal Government report into employee share ownership recommended that workplace, tax and corporations laws should be changed to facilitate the share ownership of blue-collar workers. While about 5 per cent of the Australian workforce were found to be participants in employee share schemes, most of those were at the executive level.¹⁴

F) Members of Superannuation Funds – The Growth of Indirect Shareholders

Superannuation is a compulsory form of share ownership for all working Australians. The superannuation guarantee scheme was introduced in 1992 and required employers to give prescribed levels of superannuation support for their employees or otherwise be liable for non-tax deductible charges.

*The total assets held by superannuation funds reached nearly \$488.9 billion by September 2000. At that time there were 217,158 superannuation funds. Superannuation savings in Australia currently comprise around 30 percent of all financial sector assets. Over 98% of funds have fewer than five members. There were 2,065 corporate funds at September 2,000.*¹⁵

Members of superannuation funds that invest in public companies are known as indirect shareholders.

The activities of superannuation funds are regulated by the Australian Prudential Regulation Authority ("APRA") which monitors prudential matters; Australian Securities and Investment Commission ("ASIC") which is responsible for consumer protection and market integrity and, more recently, the Australian Tax Office in regards to self-managed superannuation funds.

Trustees of superannuation funds owe a fiduciary duty to their members. This means that *"the trustee is expected to serve faithfully the interest of the plan's members within the terms of the trust. The standard against which the trustee's actions will be judged is a high one, always aimed at securing and advancing the members' economic interests."*¹⁶

Trustees have particular responsibility for the investment strategy of their fund and are required to invest in authorised trustee investments, avoid investing in prohibited investments (for example what are known as "in house" assets), and to cover certain matters in the investment strategy including risk assessment, diversity, acceptable levels of investment return, liquidity, membership profile (when members are likely to require their funds) and their investment powers under the trust deed. Trustees also have duties to keep members appropriately informed about the fund's investments.

In addition to these duties and responsibilities, directors of trustee companies who act as trustees of superannuation funds also have to meet their duties as directors under the Corporations Law and common law.

While, in a legal sense, superannuation funds have the sole purpose of income generation, many members may have concerns about this single-minded approach. There are, in fact, many ways in which the financial outcome can be achieved that may prove to be more acceptable to these members.

Increasingly, super funds are adopting diverse investment choices for their members. One example is HESTA's Eco Pool. This option

¹³ Susan Ryan, *Company Director*, 15 April 2000, p. 16.

¹⁴ Andrea Carson, "Blue-collar workers up for shares", *The Age*, 9 October 2000.

¹⁵ Superannuation Market Statistics, Australian Prudential Regulations Authority, Website July 2001.

¹⁶ *Managing Superannuation, A Trustees Guide*, Association of Superannuation Funds of Australia Ltd, 1997, p31

invests superannuation funds in companies with a good environmental track record, according to a 'best of sector' screening process that is combined with the usual financial tests. So far, the response to the Eco Pool has been very positive. The returns are in line with, or above, the conventional superannuation fund options. In addition, some companies have responded by attempting to improve their environmental score to warrant inclusion.¹⁷

While superannuation is not traditionally associated with individual shareholder activity, members do have the capacity to impact upon the investment of their funds. Lobbying for ethical investment fund options, or simply choosing to place your money in one, are increasingly viable possibilities for Australia's indirect shareholders.

¹⁷ HESTA Annual Report, 1999/2000.

2. Shareholder Expectations – some emerging topics for debate

A) Ethical Investment

Social and environmental issues are a real source of interest for many Australian investors. Issues that were once of marginal concern are moving to be factors in the mainstream. For example, AMP was recently the target of shareholder protest because of the involvement of one of its subsidiaries in the clearing of woodlands. *“Until recently, opposition to land-clearing would have been dismissed as the wailings of the lunatic fringe, with no relevance to the bottom line. Not now. AMP invited the Australian Conservation Foundation in for discussions.”*¹⁸

Some shareholders are expressing their concern for issues beyond wealth maximisation by choosing ethical investment portfolios. Ethical investments, also known as socially responsible investments (“SRI”), are becoming increasingly popular. In the US, the market expanded by 82% from 1997 to 1999, and is now valued at over \$2 trillion. This translates as 1 dollar in every 8 that is invested. Similar growth has occurred in the British market.¹⁹

In Australia, ethical investment is also becoming increasingly common. Mainstream fund managers like Tower, Westpac, Rothschild and AMP have recently introduced SRI fund options.

Ethical investment is not straightforward. There are differing perceptions of what constitutes ethical choices and how much emphasis ought to be placed on each of them. Ethical investing usually involves one of three processes:
Positive screening – companies are included according to specific criteria.
Negative screening – companies are excluded according to specific criteria.
Best of sector screening – companies are included that are deemed to have the best policies and practices in their industry.

¹⁸ Barbara Drury, “Shareholders want their money to behave”, *Sydney Morning Herald*, 21 April 2001.

¹⁹ Jacquie Hayes, “The Greater Good”, *The Weekend Australian*, 26-27 August 2000.

Some of issues that might be considered in ethical investment screening include –

Environmental Impact
Human Rights
Community Relations
Workplace Relations
Indigenous Issues
Gambling
Alcohol
Tobacco
Uranium Mining
Animal Rights

Today, there are so many funds competing for the ethical investment dollar that investors must be able to distinguish genuine screening from good marketing. Indeed, Tony McLean of the Australian Shareholders Association believes that ethical investing is an over-stated phenomenon:

*“I’m not convinced that ethical concerns are any more significant than they were 10, 20 or 50 years ago, except now they’re promoted by groups and consultants who stand to gain by promoting them.”*²⁰

Is this comment an accurate reflection of a marketing trend or a denial of the changing priorities in today’s society?

Obviously, the financial outcome of ethical investment is an important factor in its long-term future. Does ethical investment necessarily mean some degree of financial sacrifice?

Ethical screening means placing limits on stock selections. Some investors and fund managers are opposed to ethical investment for this basic reason – reduced share options may increase risk and inhibit returns. According to some commentators, in the relatively new SRI climate of Australia, “broad evidence that ethical, or ‘screened’, investment can hold its own against unscreened or unlimited investment is inconclusive”.²¹

On the other hand, many people believe that strategic limitations on stock selections do not have any negative impact on performance. In addition, overseas evidence has indicated that

²⁰ Drury.

²¹ Hayes.

sustainable investments can also be financially impressive. A recent study of 89 multinationals based in the United States found that “companies applying strict US environmental standards in developing countries reap more rewards on the stockmarket”.²²

Westpac Investment Management’s research supports this view: “WIM research has produced results consistent with the overseas studies and we conclude that screening of itself should not result in portfolio underperformance. Rather our experience – theoretical and practical – tells us that it is the rigour and consistency of one’s investment discipline that is critical for investment performance. WIM is of the view that environmentally screened investments have the potential to be an asset class of high return potential with a risk level similar to that of Australian shares (based on 8 years of monthly return observations to 31 December 1998).”²³

Interestingly, despite a recent survey indicating that 46% of a random sample of shareholders were aware of socially responsible investment (“SRI”) funds, only 8% had actually invested in them. There seems to be a divergence between awareness and action. The survey report suggests that education could overcome this. In addition, women and younger people were identified as groups with stronger potential interest in SRI.²⁴

B) Corporate Reputation – The Impact of Philanthropy and Sponsorship Activities

“Australian business is experiencing a transition in expectations of its social role. The social obligations of business have traditionally been met through producing goods and services responsibly, acknowledging community

*standards and expectations, with optimum returns on shareholder funds. Many companies now believe they should go beyond this.”*²⁵

Corporate reputation is increasingly important among Australia’s financially aware population. Adherence to high ethical standards enhances reputation, thus becoming a sensible business approach.

The Prime Minister’s Community Business Partnership has been established to facilitate new partnerships and to promote the successful outcomes of existing relationships.

A corporation can enhance or impact on its general reputation by its charitable or community activities. This could be via a philanthropic gift such as donation or free provision of services. It could be a strategic investment in the community which matches the corporation’s goals but still results in a tax deductible gift for the corporation.

Corporate sponsorship or cause related marketing also often support community projects but the corporation gives, financially or otherwise, to a community organisation in exchange for a commercial benefit, such as publicity.

Whichever approach is chosen, corporate community partnerships create opportunities for a corporation to contribute to the community, while still seeking to satisfy the financial needs of its shareholders.

However, a company’s community activities can be met with disapproval by its shareholders. For example, investors may object to corporate donations to certain political parties or question the value of cultural investments.

Recently, Orica came under fire from its shareholders for maintaining a highly valuable art collection when its profits and share prices were down. The question being asked related to whether it was ethical for a company to own significant cultural assets without the approval

²² Claire Miller, “Green firms reap the big rewards”, *The Age*, 16 September 2000.

²³ Linking Screened Investments to Shareholder Value, Erik Mather, Senior Manager, Screened Investments, Westpac Investment Management, 2001, p 5

²⁴ Socially Responsible Investment Research, Resnik, KPMG & Nolan Norton Institute, August 2000

²⁵ Centre for Corporate Public Affairs in conjunction with the Business Council of Australia, *Corporate Community Involvement – Establishing a Business Care*, published study, 2000, p. 11.

of its shareholders.²⁶ Again, the issue of transparency about corporate community activities is key in allaying many shareholder concerns.

C) Globalisation

“Globalisation is changing the way Australian companies have to think about themselves.”²⁷

“Where once a company’s competitors were predictable, now they come from any number of industries or countries. Where once there was little crossover between functions within a business, now companies must rely on an integrated team. Where once customers were reasonably homogenous and relatively easily satisfied, now they are fragmented and demanding.”²⁸

The global marketplace is less predictable than a distinctly national environment. When geographical boundaries are blurred, interest groups become harder to define and are more diverse. Corporate culture must adapt to international standards and function effectively beyond the isolated Australian context.

Some people believe that global business activity has diminished Australia’s financial independence, causing the country to become a ‘branch economy’ to other major corporate centres. This concern was evident in the recent BHP Billiton merger where conditions of the deal included a commitment to keep the headquarters in Australia.

For shareholders, a global marketplace means more complicated investment portfolios. Dual listed companies, for example, provide shareholders with the added challenge of having to remain aware of two different currency climates if they wish to be up-to-date with the status of their shares. On the occasion of a takeover or merger, shareholders often have to make decisions about share conversions, as was the case with the recent BHP-Billiton merger.

Rio Tinto is another good demonstration of the impact of globalisation on corporations. Rio Tinto is registered in the UK as Rio Tinto plc and in Australia as Rio Tinto Limited. Voting at general meetings follows an unusual combined voting process. The development of joint stock exchanges between countries is also going to continue to reduce the national focus of corporate financing.

The value for Australian shareholders is a difficult thing to define in an increasingly global marketplace. When the Federal Government recently blocked Shell’s takeover of Woodside, issues of national benefit were a key aspect of the debate. The idea of “national interest” was defined as “the economic or material welfare of the people of Australia”.²⁹ But how does such a definition apply to Australian investors who could benefit from increased share value after a corporate merge or takeover?

“It is as if people are saying that if we must have globalisation, deregulation and information technology, we will have it as far as possible on a human scale and, wherever we can, we will have it on our terms.”³⁰ But how will this be achieved?

3. Communication within the shareholders/corporation relationship.

How should shareholders relate to and communicate with the corporations in which they invest? What level of information should corporations provide to shareholders?

A) Shareholder Activism

According to one economic commentator, shareholders have no options if they are dissatisfied with a corporation:

²⁶ Susan Owens, “A wealth of art”, *Australian Financial Review*, 21 April 2001.

²⁷ Susan Owens, “Keepers of the corporate soul”, *Australian Financial Review*, 28 April 2001.

²⁸ Grady.

²⁹ Professor Ian Harper, Melbourne Business School, quoted in Michael Gordon, “Costello’s Conundrum”, *The Age*, 18 April 2001, p. 13.

³⁰ Dr David Morgan, CEO Westpac Banking Corporation, “Reconciling Profitability & Responsibility – An Australian Perspective on a Global Phenomenon”, 2001

*“All managements are prone to maximise their own interests rather than those of the shareholders, and the only remedy shareholders have is to sell their stock to someone who promises to manage the assets more efficiently.”*³¹

In today's financial climate, there are many ways a shareholder can communicate with the corporations in which they invest. The power to sell shares can be an indicator of shareholder dissatisfaction. Similarly, choosing to invest your money in only a certain type of company is a definite measure of approval. Once the shares are held, however, investors are able to impact upon corporate operations even further.

With increasing involvement in the share market, a recession would have greater implications on the Australian population today than it did in 1987. This financial vulnerability might be a part of the motivation of shareholder activists – individuals and groups who seek to maximise their input as part owners of a corporation.

Exercising shareholders' voting rights to impact on corporate decision making is also described as “shareholder democracy”.

*“Shareholder activism has become a major force in improving corporate performance in the US, Australia and in the UK; it is an essential element of a healthy market economy and it will become an even greater force for change in the years ahead.”*³²

The US Shareholder Action Network (whose slogan is “uniting investors for corporate responsibility”) defines shareholder activism as “a way that shareholders can claim their power as company owners to influence a corporation's behaviour. Shareholder activism consists of both dialogue and formal shareholder

*proposals, also known as shareholder resolutions.”*³³

Increased shareholder activism is a global trend. Organised activist groups exist throughout the world, specifically designed to monitor corporate practice and organise shareholder input. A common feature of all shareholder activism is the attempt to make changes from the inside. As opposed to other interest groups or stakeholders who lobby or protest externally, shareholders utilise their position within a corporation in order to effect change. Shareholder activism has been concerned with a variety of subjects, including corporate governance, investment returns, social and environmental issues.

In Australia, shareholder activism has taken many forms. Last year, for example, two shareholder resolutions were presented at the Rio Tinto annual general meeting. This activism was initiated by the union movement. In contrast, Stephen Mayne, former journalist and political candidate, is renowned as an individual shareholder activist, often buying shares just to gain access to a corporation's annual general meeting. Another form of shareholder activism exists when investors in a corporation form a group to protest against a particular issue. For example, a group of North Limited shareholders, calling themselves the Ethical Shareholders Group (“ESG”), was formed in response to the mining of Jabiluka uranium mine, near Kakadu National Park.

Shareholder activism can have an impact. For example, “shareholder concerns and activity played a part in dismantling apartheid in South Africa through divestment, and phasing out of polystyrene at McDonald's”.³⁴

However, shareholder activism can be seen as drawing negative attention to a company and hence adversely affecting the share price.

In addition, the activism of ordinary shareholders often has little chance of impacting upon a corporation where institutional shareholders are the real wielders of power. One

³¹ Norman Barry, *The Ethics of Business*, New Zealand Business Roundtable, 1999, p. 13.

³² Ian Dunlop, “Corporate Governance – Global Directions”, address to IIR Corporate Governance 2000 Conference, 29 June 2000. www.companydirectors.com.au/polsub

³³ A Handbook on Socially-Oriented Shareholder Activism, 2000, www.shareholderaction.org

³⁴ see www.ioe.international.shareholder

aspect of this perceived futility of shareholder activism relates to the processes of the annual general meeting.

B) General Meetings

High level of share ownership does not necessarily correspond with a high level of participation in corporations by shareholders. While the increase in share ownership amongst normal Australians is significant, the level of active shareholder involvement is not so striking.

*Only 41 per cent of Australian shareholders vote at annual general meetings, compared with 50 per cent in Britain and 80 per cent in the US.*³⁵

The annual general meeting ("AGM") is the traditional avenue for communication between shareholders and the corporations in which they invest. The AGM is designed to give shareholders the opportunity to confront the Board with any questions and have input in the company's key decision making.

Today, it could be said that the AGM is suffering from an identity crisis. Is it a valuable forum for social issues, a platform for minority interest activism, a key aspect of corporate accountability or a formal gesture of little genuine impact?

The real capacity of shareholders to influence a company through the general meeting process is often questioned. A recent analysis of the AMP Board meeting by Andrew White of *The Australian* confirmed that despite increased awareness and action by shareholders, shareholders are "noticeably failing to do more than provide an uncomfortable hour or two for Australia's corporate directors".³⁶ This is due to the ability of directors to hold large numbers of proxy votes to counter any attempt at voting on the floor of the meeting itself. In addition, it is rare for the holders of even a majority of issued capital to vote at general meetings.

Even during last year's Rio Tinto AGM in which a concerted effort to exercise shareholder voting power was applied, only one third of the total issued capital voted.

Issues of corporate governance are legitimate concerns of shareholders who want to ensure that the Board is acting in the best interests of the company as a whole. But at what size of shareholding does the company feel compelled to take note of shareholder views?

In Australia, a group of shareholders holding 100 ordinary shares in a publicly listed company is able to requisition an extraordinary general meeting to consider a resolution. The Companies and Securities Advisory Report 1999 recommended the legislation be changed to 5 per cent of issued capital in a company. This was also supported by the Australian Institute of Company Directors which viewed this as achieving a balance between the interest of minority and majority shareholders.³⁷

C) Communicating with Shareholders – the Impact of Technology

Communication with shareholders is a fundamental aspect of responsible corporate practice. As previously discussed, transparency of operations is an important part of shareholder satisfaction. As well as relieving investor concerns, knowledge of a corporation's practices and outcomes is necessary to any active shareholder involvement.

Last year, the Australian Stock Exchange ("ASX") and the Australian Securities and Investment Commission ("ASIC") released new guidelines for corporations to provide information to their shareholders, in line with the requirements of the Corporations Law Act: "the principles aim to ensure that the widest audience of investors have access to company information released under the continuous disclosure rules".³⁸

³⁵ Barbara Drury, "Shareholders want their money to behave", *Sydney Morning Herald*, 21 April 2001.

³⁶ *The Australian*, May 27-28, p33

³⁷ Submission to Companies and Securities Advisory Committee, AICD, 9/12/00

³⁸ *Company Director*, 17 September 2000.

*“Corporate responsibility is being redefined in a rapidly changing global environment. The information revolution, globalisation and population pressure are changing societal values, perceptions of authority and standards of behaviour.”*³⁹

The Internet is becoming increasingly important to the communication between shareholders and the corporations in which they invest.

Almost all of Australia's biggest companies (those in the ASX200 index) regularly post financial results on their websites with the majority also providing a specific investor relations section.⁴⁰ In addition, corporate websites include parts of the Annual Report and sometimes directions regarding access to information such as environmental or social audits. Online information can be updated easily and tracked by a corporation to establish the interests of its website's users.

The internet has also become a major tool for shareholder activism. Some websites, like www.crikey.com.au, are designed primarily to direct activists to relevant companies or encourage shareholder involvement. Email is a simple way for people to pressure corporations and register their opinion. Indeed, it is not uncommon for an organisation's website or email address to shut down as a result of the barrage of protest comment. The alleged bad activities of some corporations take place in remote parts of the world. The internet can also serve to bring these activities 'closer' to interested activists or shareholders.

Internet communication has had an impact on the annual general meeting process. Where once a shareholder would be required to be physically present at an AGM or organise a proxy in advance, electronic voting has changed these long established traditions. Internet access to AGMs assists the speed at which information can be received and acted upon. On the other hand, electronic voting can lessen the impact of the meeting. In the US, where online participation is becoming increasingly popular, the ongoing existence of AGMs is being

³⁹ Ian Dunlop, "Towards a code of ethics", *Company Director*, September 2000.

⁴⁰ Katrina Nichols, "Online results the rule not the exception", *Australian Financial Review*, 8 May 2001.

questioned as all the heat has been taken out of the traditional meeting.⁴¹

As well as being a fundamental tool in the distribution of information to shareholders, the Internet has changed the nature of share market involvement. Indeed, it has altered the face of the whole share market process. With the onset of online broking, the idea of share investment has become more realistic to many ordinary Australians.

*“Brokers...used to wear loud jackets and scream their orders on the floor of the stock exchange, but these days...all you really need is a computer screen and a telephone.”*⁴²

Geography no longer matters and anyone can trade. The changes that have occurred with the Internet have made a remote idea seem realistic. There has been significant recent growth in Internet trading with ASX CEO, Richard Humphry, predicting that if the trend continues, "we're going to see the majority of shares traded via Internet brokers".⁴³

Access to online trading is a contributing factor in the increase in individual share ownership. The growing use of the Internet, however, is not without its problems. There are obvious "social ramifications [with] the enormous job losses involved with the digitalisation of white-collar functions".⁴⁴ In addition, people disenfranchised from technology will only become further alienated from share market participation.

D) Triple Bottom Line Reporting

Some corporations, particularly those like Shell and BP that operate in overseas markets where more information about social and environmental practices is expected, are

⁴¹ Andrew White, "Approximate Justice", *The Weekend Australian*, 27-28 May, 2000.

⁴² Cath Dwyer, "Shareholder Nation", Morning Show, Triple J, 30 April 2001.

⁴³ www.abc.net.au/triplej/morning/shareholdernation

⁴⁴ Richard Humphry, "Open Briefing – Australian Stock Exchange CEO on Outlook", www.asx.com.au/asxir, 29 February 2000.

⁴⁴ Robert Gottlieb, "Listen to three wise chiefs", *The Weekend Australian*, 23-24 September 2000.

beginning to adopt triple bottom line reporting frameworks.

development of corporate community involvement and shareholder education.

As mentioned previously, this means reporting information to shareholders about three areas of a corporation's activities: financial results, environmental performance and social contribution.

Last year, Senator Hill, Federal Environment Minister, said that "triple bottom line accounting is Australia's next big challenge after the GST. He told an economic development conference recently that the next challenge after tax reform was to accept such an accounting system which put a high value on social and environmental impacts."⁴⁵

Whether this should be a legislative requirement or industry driven is the subject of debate.

4. The Need for an Examination of Shareholder/corporation Relationships

This Background Briefing Paper touches on a wide range of issues surrounding shareholder/corporation relationships that remain unresolved. Very little data is available which examines the attitudes of shareholders themselves, both from the perspective of individual shareholders (direct and indirect) and institutional shareholders (including the trustees of superannuation funds).

The quantitative survey of 1,000 individual shareholders and survey of institutional shareholders will provide the first robust data on this issue in Australia.

The survey results and forum discussion will provide a balanced debate about the expectations of shareholders and the possible responses from corporations and government policy makers.

The Project Steering Committee anticipates that this research should be the platform for future

⁴⁵ *Sydney Morning Herald*, June 26, 2000, Andrew Clennell.