
Effective shareholder engagement: the factors that contribute to shareholder salience

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1 Introduction

Institutional investors are increasingly becoming active owners through voting their shares and engaging in dialogue with companies. As of 2009, the UN-backed Principles for Responsible Investment (PRI), which contain commitments to active ownership, had over 600 signatories, representing more than USD 18 trillion in assets under management. The majority of these signatories engage in dialogue with investee companies to some extent, either directly or as part of broader investor collaborations, to influence corporate behaviour (PRI Initiative 2007, 2008, 2009).

This article seeks to determine which factors contribute to shareholder salience in improving the environmental, social and corporate governance (ESG) performance of investee companies, and the relative importance of these factors.

2 Analytical framework

Mitchell, Agle and Wood's (1997) theory of stakeholder salience was chosen as the underlying theoretical framework for the analysis of shareholder engagement. These authors explore the maze of definitions of agency, stakeholder and institutional theory and propose a simple and coherent model of stakeholder salience. They develop a descriptive model of *stakeholder salience*, defined as the degree to which company managers give priority to the claims of various stakeholders (including those of their shareholders). They identify three overarching attributes that determine the degree to which managers pay attention to stakeholder demands: power, legitimacy and urgency. The attribute of power mirrors Scott's (2001) regulative pillar (one of the core drivers of corporate change within institutional theory), though Mitchell *et al.* (1997) define it more broadly, stating that a stakeholder has power "to the extent it has or can gain access to coercive, utilitarian, or normative means, to impose its will in the relationship" (1997, p. 865). Mitchell *et al.* (1997) take Suchman's (1995) definition of legitimacy as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (1995, p. 574). Legitimacy is central to Scott's (2001) normative pillar within institutional theory, and can also be seen to include the cultural-cognitive pillar, in that once a practice gains widespread legitimacy within the community involved, it becomes "the way things are done". Mitchell *et al.* (1997) see these two attributes – power and legitimacy – as overlapping and interacting. Both are

required in order for the stakeholder claim to be salient in the eyes of the company managers. Urgency is the third of Mitchell's *et al.* (1997) attributes and represents the "degree to which stakeholder claims call for immediate attention" (1997, p. 864). This is based on the premise that urgent matters demand and get attention. Agle, Mitchell and Sonnenfeld (1999) find evidence that the application of urgency is essential to maximise shareholder salience. They find that "although shareholder power, legitimacy, and urgency are all correlated with shareholder salience, we note that for this sample of large public firms, urgency is the best predictor of shareholder salience ... it is the extra push of shareholder urgency that really gets CEO attention" (1999, p. 520).

Mitchell *et al.* argue that stakeholder salience is positively related to the degree to which the three attributes of power, legitimacy, and urgency are "perceived by managers to be present" (1997, p. 873). Agle *et al.* (1999) conducted a survey of 80 CEOs in the US and found support for this theory. Ryan and Schneider (2003) take Mitchell's *et al.* (1997) theory on stakeholder salience and apply it to the 'new' reality of large institutional shareholders with massive power in the marketplace and the alignment of shareholder power with stakeholder power (through the ownership of pension funds by millions of citizens). On the basis of power and legitimacy, they find public pension funds are the most salient stakeholders of the listed company. With respect to urgency however, Ryan and Schneider (2003) find that active fund managers (i.e. stock pickers) exhibit a greater degree of urgency in their interactions with companies than do passive shareholders because of their trading activities, and the resulting urgency of their claims as perceived by company managers.

In this article, each of Mitchell's *et al.* (1997) overarching drivers of stakeholder salience – power, legitimacy and urgency – is analysed and further subdivided into sub-attributes and mapped onto the various shareholder engagement practices or characteristics. This mapping process led to the development of a number of propositions that were then tested through three case studies.

Power is categorised – using Etzioni's (1964) framework – into **coercive power** (through the use of formal shareholder governance powers), **utilitarian power** (the power to reward or punish through financial means) and **normative power** (expressed through actions that affect the company's reputation). The following table shows Etzioni's (1964) three types of power and some of the sources of this power relevant to shareholder engagement.

Table 2.1 Sources of shareholder power

| Level of analysis | Sources of shareholder power |
|-------------------|--|
| Coercive | <ul style="list-style-type: none">▪ Use of formal shareholder rights through resolutions▪ Replacement of directors or CEOs▪ Legal proceedings to enforce shareholder rights▪ Successful lobbying for regulation |
| Utilitarian | <ul style="list-style-type: none">▪ Provision or withdrawal of capital or other resources from companies (investment, divestment) |
| Normative | <ul style="list-style-type: none">▪ Public or private statements, shareholder resolutions or other activities that affect the company's or individual managers' reputations |

From this, the following are proposed:

- Proposition 1: In successful engagements¹, the shareholder request is backed by an implicit or explicit threat of the use of formal shareholder rights (Coercive power)
- Proposition 2: In successful engagements, the shareholder request is backed by an implicit or explicit threat of divestment (Utilitarian power)
- Proposition 3: In successful engagements, the shareholder request is accompanied by public or private activities that have the potential to affect the reputation of the target company or its managers (Normative power)

Legitimacy, drawing on Wood (1991), is further divided into **individual legitimacy** (relating to the credibility of the engagement practitioners meeting with the companies), **organisational legitimacy** (driven by the credibility of the organisation in the market) and **societal legitimacy** (based on the legitimacy of the issue in the eyes of the community). A fourth level of analysis of legitimacy – **pragmatic legitimacy** – is proposed, focusing on the legitimacy of the shareholder's argument *from the perspective of the company*: i.e. the business case. This draws on Suchman's (1995) notion of 'pragmatic legitimacy' which rests on 'self-regarding utility calculations' of the audience – in this context, the company managers at the receiving end of shareholder requests. While the business case that is put to companies will affect the legitimacy of the shareholder in the companies' eyes, the *strength of the arguments themselves* as perceived by the company is sufficiently important to constitute a separate level of analysis within 'legitimacy'.

¹ Successful engagements in these propositions are loosely defined as engagements that result in changes in corporate behaviour in line with the shareholders' requests, or commitments by the company to that effect

The following table combines Wood's (1991) and Suchman's (1995) categorisations of legitimacy and proposes sources of legitimacy that may contribute towards shareholder salience.

Table 2.2 Sources of shareholder legitimacy

| Level of analysis | Sources of shareholder legitimacy |
|-------------------|---|
| Individual | <ul style="list-style-type: none"> ▪ Credibility, expertise, experience and status of the individuals engaging with the company |
| Organisational | <ul style="list-style-type: none"> ▪ Legitimate claim on the company (e.g. large shareholding, high-risk stake) ▪ Alignment between shareholders' interests and those of the company (shareholder has the best interests of the company at heart) ▪ Perception that the shareholder organisation is a credible and respected member of the investment community ▪ Consistency of messaging from different parts of the shareholder organisation |
| Pragmatic | <ul style="list-style-type: none"> ▪ The shareholder has a strong argument for why the proposed action is in the interests of the company ▪ The shareholder provides new information to the company |
| Societal | <ul style="list-style-type: none"> ▪ The shareholder embodies or reflects a position widely accepted in society ▪ Existence of norms or codes of conduct ▪ Supportive political and policy environment |

The following are proposed:

- Proposition 4: In successful engagements, shareholder representatives are highly credible, evidenced by seniority, experience, expertise and the ability to build trust (Individual legitimacy)
- Proposition 5: In successful engagements, the shareholder institution is seen as 'mainstream', aligned with the interests of the company, and internally consistent (Organisational legitimacy)
- Proposition 6: In successful engagements, the shareholder has a strong business case, including providing the company with new information on emerging issues (Pragmatic legitimacy)
- Proposition 7: In successful engagements, the shareholder request has strong societal legitimacy, and the shareholder can make use of standards or norms as a basis for engagement (Societal legitimacy)
- Proposition 8: In successful engagements, the shareholder is engaging within a supportive political and policy environment (Societal legitimacy)

In the propositions above, societal legitimacy was further divided into two propositions to reflect the difference between general support from society as reflected by NGOs or consumer movements, and the related but distinct societal legitimacy that comes from public policy makers and the political and regulatory environment.

Urgency is the third of Mitchell’s *et al.* (1997) attributes and represents the “degree to which stakeholder claims call for immediate attention” (1997, p. 864). They state that “urgency, with synonyms including ‘compelling’, ‘driving’, and ‘imperative’, exists only when two conditions are met: (1) when a relationship or claim is of a **time-sensitive** nature and (2) when that relationship or claim is important or **critical** to the stakeholder” (1997, p. 867).

Mitchell’s *et al.* (1997) attribute of urgency is more problematic than the other two attributes from the instrumental perspective of a shareholder conducting an engagement with an investee company. The time-sensitive nature of the attribute is clear – i.e. deadlines and time pressure tend to focus the minds of managers. However, criticality, as defined, reflects the *subjective* importance the investor places on the claim. From an instrumental shareholder perspective, it is unhelpful to suggest that “you will be more influential if you care more”. It is proposed therefore, that this factor be interpreted as the presence of *shareholder behaviour* that illustrates a *resolve or determination* to address the issue of concern. In the context of shareholder engagement therefore, it is proposed that criticality exists where there is a high level of *intensity* in the engagement, demonstrated through assertiveness, persistence and the application of resources.

The table below expands the two sub-components of urgency and identifies sources of shareholder urgency.

Table 2.3 Sources of shareholder urgency

| Level of analysis | Sources of shareholder urgency |
|-------------------|---|
| Time-sensitivity | <ul style="list-style-type: none"> ▪ Shareholder resolutions at AGMs ▪ Benchmarks with deadlines for response ▪ Use of other forms of deadline to create time pressure |
| Criticality | <ul style="list-style-type: none"> ▪ Assertiveness of tone ▪ Persistence ▪ Willingness to apply resources |

The following are proposed:

- Proposition 9: In successful engagements, the engagements are time-sensitive (Time sensitivity aspects)

- Proposition 10: In successful engagements, the shareholder is assertive and persistent, and expends resources (Criticality of stakeholder demand)

There are a number of other factors that do not fit neatly into one of Mitchell's *et al.* (1997) attributes, yet are likely to moderate, positively or negatively, the effects of all three of Mitchell's attributes, and are important from an instrumental shareholder engagement perspective. These include the extent of **coalition-building** activities by the investor, the **relative size of the investor and the company**, and the **values of the managers** of the company, the latter of which was elaborated in (Agle *et al.* 1999).

The first of these moderating variables is related to relative size of the shareholder *vis-à-vis* the company, and its stake in the company. Presumably, if a shareholder has a large stake in the company, or is itself a large shareholder in the market, it is a more powerful economic actor in relation to the company, and would have more power and legitimacy, and therefore, salience. It would also have more governance power, related to its larger stake in the company.

The second is coalition building among shareholders, and working with NGOs and policy makers. Coalition-building is very much related to the size question, as a coalition of shareholders is, in effect, a pooling of their power and legitimacy. Because size of the shareholder or coalition of shareholders enhances all three of Mitchell's *et al.* (1997) attributes, it is proposed that these factors positively moderate power, legitimacy and urgency, rather than reside within any of them.

The third moderating factor – the values of company managers – comes from the other direction – the subjective attitudes of managers towards the shareholders and their requests. Again, this factor is likely to cut across Mitchell's *et al.* (1997) attributes and moderate shareholder salience independently from the attributes or characteristics that the shareholder itself possesses. This moderating factor was identified and applied by Agle *et al.* (1999) when they tested Mitchell's *et al.* (1997) through surveying company CEOs.

Adding these three factors, the following are proposed:

- Proposition 11: In successful engagements, shareholders have a high degree of relative economic and governance power over the firm
- Proposition 12: In successful engagements, the shareholder builds coalitions with other shareholders and stakeholders

- Proposition 13: In successful engagements, managers' values are broadly aligned with the premise of the investor request

The table below sets out these factors and maps them against the concrete shareholder engagement characteristics and attributes to be tested in the case studies.

Table 2.4 Factors likely to affect shareholder influence

| | Power enhancing | | | Legitimacy enhancing | | | Urgency enhancing | | |
|--|-----------------|-------------|-----------|----------------------|----------------|-----------|-------------------|------------------|-------------|
| | Coercive | Utilitarian | Normative | Individual | Organisational | Pragmatic | Societal | Time sensitivity | Criticality |
| ★ indicates the main sub-attribute relevant to that investor practice or characteristic +/- indicates the presence of attributes and the expected sign of influence (positive or negative) | | | | | | | | | |
| Power-oriented | | | | | | | | | |
| 1. Use of shareholder rights: shareholder resolutions, votes against management, director elections | ★ | + | + | | - | | | + | + |
| 2. Use of economic power: divestment (or investment) | | ★ | + | | | | | + | + |
| 3. Use of the media and/or public statements/peer pressure; public shareholder campaigns; threats to reputation | | | ★ | | - | | | + | + |
| Legitimacy-oriented | | | | | | | | | |
| 4. Credibility of the individuals: seniority, experience and expertise; ability to develop trust and collegiality | | | | ★ | + | + | + | | |
| 5. Status of the engaging organisation: degree to which shareholder is perceived to be 'mainstream'; perceived alignment of interests between the shareholder and the company; organisational alignment and consistent messaging | | | + | + | ★ | | | | |
| 6. Strength of the business case: validity of the argument; evidence; extent of new information provided to the company; maturity of the issue | | | | + | + | ★ | + | | |
| 7. Strength of the societal case: social and cultural context; existence of legitimising standards, norms and principles | | | + | | | + | ★ | | |
| 8. Political/policy context: supportive political environment; regulatory momentum | + | + | + | | + | + | ★ | | |
| Urgency-oriented | | | | | | | | | |
| 9. Time-sensitivity: deadlines, benchmarks | | | | | | | | ★ | + |
| 10. Intensity of private engagement activities: assertiveness and persistence | | | | | - | | | + | |
| Moderating influences | | | | | | | | | |
| 11. Relative economic and governance power: size of the stake, investor and firm | + | + | + | + | + | | | | |
| 12. Coalition building: leveraging other investors, NGOs and policy makers | + | + | + | | + | | | | + |
| 13. Values of managers: degree of alignment with investor request | | | | | + | + | | | |

3 Research design

The research uses qualitative case studies of the shareholder engagement practices within three leading institutional investor organisations, two in the UK (Hermes and Insight Investment) and one in the US (Calvert). These were chosen because of the size of their engagement teams and reputations as leaders in the field. They also represent a variety of approaches and styles of engagement. The research method allows for an in-depth analysis of leading practice, rather than attempting to capture a statistically-valid snapshot of shareholder engagement activities or processes across the sector. The unit of analysis is the 'engagement', which focuses either on a specific shareholder-company dialogue or a thematic shareholder-sector or issue dialogue.

Despite the qualitative nature of the study, a simple rating system of one, two or three stars was developed for evaluating the strength of support for each proposition across each of the cases studied. This allows an aggregation of results across the cases and engagements to provide an indication of the relative importance of the various influences identified in the propositions. These ratings were determined by the author and based on responses to specific questions put to the relevant practitioners seeking to determine support or otherwise for the propositions in specific contexts, as well as analysis of documentary evidence.

4 Analysis of cases

Hermes is predominantly a corporate governance engager², with a direct goal of improving the financial performance of companies by improving some aspect of governance or strategy performance, often through influencing the board of companies. Insight Investment, while also a large mainstream investor and very financially oriented, has an additional mandate to seek improvements in corporate behaviour on environmental and social issues, ultimately with the goal of improving long-term financial performance. However, the direct links between many of Insight's engagement activities and financial returns to the portfolio are not as clear as with Hermes. Insight engages on a range of environmental and social issues for their own sake, even where the potential material impact to Insight's portfolio would be

² Readers should note that Hermes has considerably increased its engagement on environmental and social issues since this case study was conducted in September 2005.

difficult to demonstrate. Insight's corporate governance work, however, is similar to Hermes' in style and substance (though not as well-staffed), and indeed the two organisations have worked together on issues of common concern. Among the largest clients of both Hermes and Insight are their mother institutions, British Telecommunications Pension Scheme and HBOS respectively. The major difference between Hermes and Insight in this context appears to be the degree to which their engagement is driven by financial criteria, and, resulting from that, Insight's greater willingness to engage on thematic environmental and social issues across a number of companies, contrasting with Hermes' approach of focusing on company-specific, and primarily corporate governance, issues.

Calvert is a relatively small retail fund with an explicit social and environmental mandate (though it the largest SRI fund). It is seeking to sell to a vast number of retail customers of socially-responsible mutual fund products, through a large network of financial advisors. Its shareholder advocacy work is driven not only by Calvert's inherent social commitment, but also by the need for market differentiation within the SRI sector. Examples of successful advocacy campaigns are used repeatedly in Calvert's marketing materials. Calvert also uses a financial rationale for its environmental and social activities on the basis that 'good' companies are best equipped to prosper financially through better managing emerging issues.

Table 4.1 below is a summary of the results of the cases and lays out the degree of support for each of the propositions from each of the cases. Each proposition, representing a source of shareholder salience, is also mapped against the various level of analysis of Mitchell's *et al.* (1997) attributes.

| | | | | | | | |
|---------------------------------|-----|---|---|-----|-----|-----|-----|
| Calvert | ★ | | ★ | | ★ | ★ | |
| Political/policy context | | + | + | + | | + | + |
| Insight | ★★ | | | | ★ | ★★ | ★★ |
| Hermes | ★★ | | | | | ★★ | ★★ |
| Calvert | ★ | | | | | ★ | ★ |
| Urgency-oriented | | | | | | | |
| Time-sensitivity | | | | | | | + |
| Insight | ★ | | | | | | ★ |
| Hermes | ★ | | | | | | ★ |
| Calvert | ★ | | | | | | ★ |
| Intensity | | | | | - | | + |
| Insight | ★★★ | | | | | | ★★★ |
| Hermes | ★★ | | | | | | ★★ |
| Calvert | ★★★ | | | | | | ★★★ |
| Moderating influences | | | | | | | |
| Relative size | | + | + | + | | + | |
| Insight | ★ | | | ★ | | ★ | |
| Hermes | ★ | | | ★ | | ★ | |
| Calvert | | | | | | | |
| Coalition building | | + | + | + | | + | + |
| Insight | ★★ | | | ★★ | | ★★ | ★★ |
| Hermes | ★★ | | | ★★ | | ★★ | ★★ |
| Calvert | ★★★ | | | ★★★ | | ★★★ | ★★★ |
| Values of managers | | | | | + | + | |
| Insight | ★★★ | | | | ★★★ | ★★★ | ★★★ |
| Hermes | ★★★ | | | | ★★★ | ★★★ | ★★★ |
| Calvert | ★★★ | | | | ★★★ | ★★★ | ★★★ |

Figure 4.1 below shows the average ratings for each of the propositions across all three cases.

Figure 4.1 Support for propositions across all three cases

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The following section takes each proposition and summarises the overall results, drawing on lessons learned from the cases.

4.1 Power-related factors

4.1.1 Use of shareholder rights

Insight's thematic engagements did not make use of formal shareholder rights. On corporate governance issues, there was a greater use of voting, but rarely the filing of shareholder resolutions. Hermes frequently used voting (but rarely shareholder resolutions) to send signals to management, and there was strong evidence that the threat of a vote against management was an important motivator for companies to comply with requests. But much of Hermes' use of shareholder rights was subtle, and the threat implicit – though, in a number of cases studied, the threat to vote against management was quite explicit. Of the three cases, Calvert made the greatest use of formal shareholder rights, with the filing of shareholder resolutions (or threat to do so) an integral part of its engagement strategy.

There are a number of possible reasons for these differences. Regarding Insight's thematic engagements based on cross-sector benchmarking exercises, the strategy is not to directly press for specific changes of the type that would be the subject of a shareholder resolution. The goal is to provide a framework for improving corporate performance across a sector and, at the launch of each of these benchmarking reports featuring leaders and laggards, provide a modest normative incentive to improve. Shareholder resolutions were seen as an inappropriate tool for this type of engagement. In addition, these benchmarks are very much legitimacy-oriented, with relationships built up over multiple years. In this case it is concluded that the use of shareholder rights undermines legitimacy, and this can damage the positive, trust-based approach implicit in the benchmarking process.

Like Insight, Hermes itself rarely files shareholder resolutions, though there were many occasions where it votes against management (often relating to remuneration reports). Hermes' and Insight's reluctance to use shareholder resolutions indicates the importance they place on maintaining their legitimacy with companies (and their view that legitimacy-oriented engagement is indeed effective).

Calvert, however, uses shareholder resolutions routinely as a tool to gain management's attention and move an issue forward. This case demonstrates that resolutions can be very effective and need not harm legitimacy, particularly over the longer term. Filing a resolution can bring a firm to the table, allowing Calvert staff to then build relationships and develop legitimacy where none may have existed previously. There is considerable evidence that company management will take significant steps to accommodate investor demands in order to avoid resolutions going to the vote.

The three cases (and indeed direct quotes from interviewees) support the view that there is a cultural difference between the US and the UK on the issue of filing shareholder resolutions, with this tool being much more common in the US due to weaker shareholder rights leaving shareholders with fewer options, as well as a more confrontational corporate culture.

Calvert appears to be able to make use of the shareholder resolution process as a normal part of its interaction with companies, without necessarily damaging its legitimacy. In fact, the withdrawal of a shareholder resolution based on the company's commitment to establishing a long-term dialogue is a sophisticated way of building the 'socialising infrastructure' to allow the establishment of legitimacy, trust and strong relationships. That said, in some cases, companies saw the filing of a resolution as a hostile act, which resulted in Calvert losing legitimacy and being unable to make any progress with those companies.

Overall, there is strong support for the proposition that engagement efforts can be assisted by the judicious use (or threat of use) of shareholder rights. But their use is certainly not a prerequisite to successful engagement, and has the potential side effect of undermining organisational legitimacy.

4.1.2 Divestment

The threat of divestment is not a lever that was used in any of the engagements studied. There may be cases where divestment or threat of divestment by large investors could be a driver for shareholder salience³, but, in these particular cases, it was not.

Hermes is largely passively managed, so divestment is not seen as an option for them.

Insight has a separation between its fund management decision-making on the one hand and its voting and engagement activities on the other. Insight is explicit in its preference for

³ See, for example, the divestment of Walmart by the Norwegian Government Pension Fund (Ministry of Finance Norway 2006)

engagement over divestment as a way of addressing environmental and social issues. While Calvert does divest from companies that do not fulfil its social and environmental criteria, it does not use the threat of divestment directly with companies it is seeking to change. Often the companies with which Calvert engages are considered 'good' companies overall and are not at risk of being excluded, but have some key areas in which they can improve. One would expect Calvert to make greater use of the threat of divestment for those companies that are on the borderline of being excluded from their index, and therefore from their investible universe.

4.1.3 Actions that affect reputation, etc.

The clearest example of the use of normative power is 'going public' and making strong media statements to put pressure on companies to agree to shareholder demands. The case-study organisations rarely, if ever, use the media to push directly for changes in company behaviour. All three cases indicated that 'going public' damages legitimacy and should be avoided if possible. Responses from the Hermes case affirmed companies' distaste for shareholders using the media to make a point. With Insight's environmental and social engagements, the media were not used as a tool to pressure companies directly. However, in their governance work, this approach was taken on occasion. This may reflect the maturity of the corporate governance debate and the confidence that investors feel to go 'into the trenches' where they see management taking action that damages shareholders' interests. Calvert avoided direct criticism of companies with which it was engaging, as it felt this would undermine its relationship with the company. Calvert does, however, use the media regularly to raise awareness of the issues themselves (climate change, human rights, etc.).

The evidence points to two conclusions regarding the use of negative publicity generated by shareholders: companies will indeed take steps to avoid it (normative power contributes to salience); and negative public statements emanating from the shareholder will undermine the relationship between shareholder and company.

While avoiding the use of the most negative and confronting forms of normative power, all three organisations applied normative power in more subtle ways, and there is strong evidence that overall, the use of normative power was an important contributor to shareholder salience. Although Insight does not actively court the media, its level of transparency is likely to result in a degree of normative pressure being applied to companies that are named as the targets of engagement and featured in Insight's reports. Insight staff

emphasised that normative power need not always be negative, and that giving positive feedback to companies on good work is an effective and under-utilised practice.

Perhaps the most sophisticated and clever use of normative power is evidenced in the sector benchmarking activities conducted by Insight. These benchmarks introduce an element of competition and peer pressure among companies. Because these processes constitute robust and objective assessments of sustainability performance across a sector, and do not involve direct demands (apart from participation), they largely eliminate the harm to legitimacy that more aggressive approaches may risk. They also provide an opportunity for subtle, yet powerful, reputational levers to be applied to companies through the public release of the results. Being judged against peers is an important motivator, particularly when the results are viewed and the process is endorsed by senior government ministers.

Calvert clearly applies normative power as a routine part of its strategy. Companies often see the 'tick of approval' from the SRI industry as a reputational asset worth seeking. Inclusion or exclusion from the Calvert Social Index is likely to have reputational impacts for some companies. However, Calvert prefers to build trust over the long term, and recognises the damage that media statements can have on an engagement. The indirect use of normative power through leveraging peer pressure is another important finding. Calvert has observed that when an industry leader, such as Dell, takes the lead on an issue like computer take-back and recycling, the rest of the industry follows.

Another finding is the importance of the reputation of *individuals* within the company as a lever for shareholder influence. There was strong evidence that targeting (or at least 'playing upon') the reputations of individual managers can be an effective avenue for influencing the entire company.

Given the lack of coercive and direct utilitarian avenues of power available to most investors in most cases, the predominant form of power that investors can apply is normative power, which generally involves actions that affect or threaten to affect the company's or its managers' reputations. While the evidence does not point to the use of normative power as being essential, it is clearly a useful tool.

4.2 Legitimacy-related factors

4.2.1 Credibility of the individuals

At the individual level, there is a range of attributes that could contribute to legitimacy in engaging with companies including personal credibility, experience, seniority, specialised

knowledge, contacts and professional background. In all three cases, the engagement staff were relatively young – with the majority being in their late 20s or early- to mid-30s. Most of Insight’s investor responsibility team have NGO backgrounds, yet there was no evidence that their backgrounds or age undermined their legitimacy in engaging with companies. The high level of legitimacy awarded to Insight’s staff by companies is due in part to their high degree of expertise and specialised knowledge in the areas under discussion. Hermes also has a predominantly young team, but with more mainstream financial sector backgrounds such as financial journalism and corporate governance analysis. Hermes also sends very senior representatives to some engagements, including a former CEO of a listed company, illustrating that seniority and experience is indeed seen as important. Insight also employs a veteran corporate governance expert, with decades of experience in the field. Calvert’s social analysts (who also do engagement) are recruited specifically for their environmental and social expertise and research ability. Financial background was not seen as essential, but it was acknowledged that it is becoming more so.

There were important differences in how the individuals from the three teams were likely to be perceived by companies, but these did not necessarily translate into more or less legitimacy. Certainly, Hermes’ staff were tasked with discussing the issues of greatest financial and strategic concern to the boards and senior management of the companies and in that sense, expertise in that area would enhance individual legitimacy. However, Insight’s and Calvert’s staff were able to build legitimacy on a broader range of issues through their expertise in those areas and their ability to develop trust and personal relationships.

Overall, there was strong evidence in support of the proposition that the credibility and reputations of the individuals conducting the engagements is a reasonably important factor.

4.2.2 Perceived as mainstream, interests aligned, internally consistent

There was strong evidence for the proposition that these factors did enhance organisational legitimacy and therefore shareholder salience. There were important differences between the three cases, with Hermes likely to be perceived as the most mainstream, with Insight following and then Calvert, with its explicit social mandate and small size likely to result in it being seen as a niche fund with a social agenda and therefore having relatively less legitimacy. The differences in organisational legitimacy represent differences in style between the three organisations, with Hermes aligning itself very much with the concerns of company boards, and Calvert, on the other end, focusing almost exclusively on the social and

environmental performance of companies. Insight and Hermes are also likely to gain considerable legitimacy simply from their size in the market.

Hermes made the greatest efforts to ensure its organisational legitimacy was protected and enhanced, through being careful not to engage on issues that are not seen as relevant to the company's financial prospects. Hermes' reward for this level of legitimacy is the regular invitations to 'go inside' a firm to view and discuss confidential board-level matters. This, in itself, reflects very high levels of organisational legitimacy unavailable to most other shareholders.

Calvert is clearly different from both Insight and Hermes in that it is a small fund, proudly SRI-oriented, and engages almost exclusively on environmental and social issues. Interestingly, Calvert is able to access a different type of organisational legitimacy *because* it is an SRI fund, but only with those companies that see the SRI 'tick of approval' worth pursuing. For other companies, Calvert is unlikely to have the legitimacy that comes with the large assets and mainstream market perceptions of the other two funds. However, it appears that Calvert is able to *build* legitimacy during its engagements due to the level of expertise and professionalism applied to engagements over a number of years. The goal for small funds such as Calvert should be therefore to get a 'foot in the door' and use that to build strong relationships with companies and their staff over the longer term.

4.2.3 Strong business case

The source of *pragmatic* legitimacy in the context of shareholder engagement is the 'business case' for taking action – from the company's perspective. It is not surprising that the strength of the business case was found to be the most important of the legitimacy-oriented contributors to shareholder salience. There was very strong evidence in all three cases that the business case is vital to the success of the engagement. There was also strong evidence that providing the company with new information on emerging issues (as a way of building the business case) contributes significantly to the prospects for success. Insight and Calvert both contribute considerable amounts of new information to companies during the engagement process by providing tools, best practice guides and advice.

Hermes is the most financially-oriented of the three engagement operations, and the targeting decisions were based in financial criteria rather than environmental and social. Therefore the business case is somewhat easier to make, given that most targeted companies had poor financial performance to start with, and Hermes' engagement was explicitly attempting to address it. Responses from companies that Hermes engaged with

indicated that the companies prefer engagement on what one called 'sensible issues' (i.e. financially- or strategically-relevant), and it is likely that the weaker the business case, the greater the risk that the company will perceive the issue as not 'sensible', thereby risking the shareholder's organisational legitimacy. Despite Calvert's social agenda, the business case is still a major consideration in its targeting decisions, because it recognises that if it cannot make a strong business case, then the engagement will fail.

The more an investor can provide practical tools, frameworks and 'how to's' for companies to address issues in a cost-effective way, the greater the likelihood of the company taking action. One approach used by Calvert is to start with a simple request, such as a feasibility study and a commitment to dialogue. The initial request is not necessarily onerous for a company to undertake, but allows the shareholder to get 'in the door' and build trust.

These cases confirm that the business case is probably the most important factor in the success of engagement, and therefore shareholders should spend considerable time and resources in building that case.

4.2.4 Strong societal case

The *societal* case is often seen as the most obvious source of legitimacy of a stakeholder claim. The societal case is represented by, for example, the strength of moral support for an issue within society, often reflected by ethical codes, norms or principles. However, the evidence suggests that the appeal to moral, ethical or broader societal arguments was not considered a major contributor to shareholder salience.

Insight draws on the societal case in many of its documents, but not in its direct discussions with companies. It appears that while societal principles and norms may foreshadow regulation and inevitable change in corporate behaviour, they are not particularly useful in themselves as tools within the engagement process. A societal norm must be related back to the pragmatic legitimacy of the claim, through identifying reputational risks to the company, regulatory momentum, or other consequences to the company of not being aligned with that norm.

Hermes, apart from the one occasion where they used the OECD Guidelines for Multinational Enterprises as a tool for engagement, does not normally draw on norms-based arguments or frameworks. Calvert is driven by the societal case and its targeting is based on where it can create the greatest good for society. However, while it does raise the societal case and make moderate use of various norms and codes, its primary focus – in its

interactions with companies – is on how societal trends and attitudes will affect the financial performance or other aspects of company operations.

4.2.5 Supportive political environment

Where there is a supportive political environment for an engagement, there is strong evidence that it can indeed enhance shareholder salience. Insight has been the most successful in working directly with policy makers on engagement, using them to enhance the normative impacts of one of their sector benchmarks (involving a Government Minister in the launch) and to fund another benchmark directly. While most of Hermes' engagements were not backed in any direct sense by policy makers or public sector organisations, the examples of Hermes' engagements that did involve participation of government officials demonstrated the importance placed on the political environment by companies. Calvert worked with the Treasurer of the State of Connecticut (who is also the sole trustee of that State's pension scheme) to enhance the legitimacy of an engagement, and also with regulators on other matters of concern.

Policy-maker involvement in engagement can take a number of different forms including actively joining with investors to push voluntary improvements in company performance, endorsing the work of investors through launching benchmarks and the resulting reports, or directly funding the engagement itself (or its research aspects).

4.3 Urgency-related factors

4.3.1 Time-sensitivity

In the three cases, time-sensitivity was seen as only moderately relevant to the success of engagements. It is acknowledged that the benchmarking and shareholder resolution/voting processes involved deadlines that can be leveraged to focus the attention of managers. However, there was no strong evidence that the time-sensitivity factor was an important driver of shareholder salience in the context of engagement. Interestingly, Hermes' staff felt that in many cases, they actually needed time to work through the issue with the company, and that real change rarely occurred in the lead up to an AGM. However, it was also acknowledged that there are opportunities for shareholders to intervene successfully during moments of crisis for the company.

It is likely that most shareholder engagement – particularly relating to environmental and social issues – works to longer timeframes than those envisioned by Mitchell *et al.* (1997) in their characterisation of urgency. Very few of the shareholder requests require 'immediate attention' in the 'crisis management' sense referred to by Mitchell *et al.* (1997). Insight's

benchmarks are slow, methodical and process-driven activities, conducted over multiple years. Calvert's multi-year dialogues indicate that major changes to corporate practices take time, and it is an incremental process.

That said, the time-sensitive nature of the shareholder resolution process is nevertheless likely to focus the attention of management on the problem and therefore may be a useful tool from time to time.

4.3.2 Intensity of engagement / criticality

Criticality is Mitchell et al.'s (1997) model was modified for this context to reflect the level of intensity of engagement. On assertiveness, all three cases support the use of a calm, professional and business-oriented communication style and tone with companies. However, there is also a thread running through the cases around the need to be firm, transparent and direct, and to 'up-the-ante' where necessary. Because of the nature of the Insight sector benchmarks, the tone was very much process-oriented rather than request-oriented, and therefore it may not have required the degree of assertiveness that other direct shareholder requests may require. Hermes' tone tends to be more 'questioning' than 'demanding', indicating their strong preference for legitimacy-based interaction. There was a willingness to 'up the ante' where necessary, backed by evidence of some 'robust' conversations. Calvert's tone is professional and business-like, but it too is willing to escalate the rhetoric where necessary. It was noted that being overly-assertive can undermine legitimacy, as it adds an adversarial aspect to the interaction, rather than keeping a spirit of working together for mutual benefit. Therefore, assertiveness – when taken too far – can be salience-decreasing because of the harm to organisational legitimacy.

All three cases demonstrated a great degree of persistence, with many engagements continuing over multiple years.

All three organisations applied significant resources to their engagements, through the allocation of staff time to company dialogue and, particularly in the case of Insight, the commissioning of third party research.

Another practical tool for increasing the intensity of an engagement is the filing of shareholder resolutions. Shareholder resolutions are inherently attention-grabbing, and demonstrate to the company that the shareholder is willing to expend considerable time and resources on the issue (as well as leveraging normative power). Of the three cases, Calvert files the most shareholder resolutions, by a considerable margin. Again, this reflects

the cultural context in the US, but also may reflect Calvert's limited ability to gain the attention of management without such action.

4.4 Moderating factors

4.4.1 Relative size: size of the stake, the shareholder and the company

The size of the stake was not found to be as important as might be expected. That said, if the size of the stake means a shareholder is one of the larger shareholders, this status will bring with it additional salience.

The case studies indicate that the total size of the shareholder organisation (assets under management) is likely to have a greater bearing on organisational legitimacy and therefore salience than the stake in the company at that particular time (unless the stake is particularly large). For Insight, size of the stake didn't appear to be important, whereas Insight's overall size in the market was felt to be important to organisational legitimacy and therefore shareholder salience. This was affirmed in the Hermes case, where their reputation in the market (organisational legitimacy) was felt to be more important than size of the stake. The Calvert case shows that even a small investor with an insignificant stake in economic or governance terms can effect significant change within these large companies. One company response in the Hermes case indicated that managers only have time to have detailed discussions with a small number of shareholders, so in that sense, being one of the *larger* shareholders is probably important in gaining a share of that limited access to board-level representatives (depending on how many other shareholders are taking up management's time).

It was suggested that smaller companies, particularly when dealing with governance issues, may be more amenable to change because of the formal leverage and the greater ease with which a shareholder can pull together a coalition in cases where there is a smaller shareholder register. The point was also made that small companies are less used to engagement by investors and may therefore be more responsive.

The lesson is that while relative size clearly can have an impact on salience, small funds should be confident that they too can exert influence, even on large companies, through maximising their other points of leverage.

4.4.2 Coalition building

There was strong evidence that building coalitions, not only with other investors but also with NGOs and policy makers, does contribute to the salience of shareholder claims. The

cases contained numerous examples of the successful use of coalitions between investors, NGOs and governments. That said, there were numerous cases where no other stakeholders were involved and the engagement nevertheless appeared to be successful. Insight's governance work was conducted, on many occasions, in collaboration with other large investors, but not in the cases of the environmental benchmarks studied. Hermes is very much involved in investor collaborations, particularly on governance issues. It was felt that coalitions are particularly useful in regions where a shareholder has only a small geographical presence and it must rely on local investors, both to understand the local context as well as provide legitimacy in that market. Coalition-building is perhaps most important and most evident with Calvert. Because of its modest size, Calvert needs to gain the support of large investors (most often public pension funds) to ensure its shareholder resolutions receive respectable votes in favour, and therefore add to the legitimacy of the claim. In many cases, they also need the support of other SRI investors and partners to share the workload involved in the most intense and long-running engagements.

Limitations of coalitions were also highlighted. There is considerable overhead involved in investor collaboration. There is also the issue of sharing credit, where engagement outcomes are used as a marketing asset. Another challenge is competitive pressures and the 'free rider' problem, where one shareholder expends resources to engage with the company, resulting in benefits for all shareholders.

Coalitions with NGOs can be useful, contributing significant intellectual resources, and increasing the potential for the application of normative power. There are also some examples of effective coalitions with policy makers. Insight's engagement on the CHaSPI⁴ process was conducted with a UK-government agency, the Health and Safety Executive. The potential benefits of working in collaboration with policy makers to promote better corporate practice is a key finding of this study, and it is suggested that investors and researchers explore this strategy further.

4.4.3 Values of managers

Like the business case, the values of managers are universally seen in these cases as a very important contributing factor to the success of an engagement. Insight felt this issue could be one of the most important factors. Calvert claimed the leadership of the firm as the number one variable in its willingness to work with social investors. Examples were given

⁴ UN Government's Corporate Health and Safety Performance Index

where an issue progressed quickly, once a new chairman or CEO with more closely-aligned views took over. This factor can be particularly important where supportive individuals within the company are having difficulty moving an issue forward internally, and the shareholder can lend support to that individual's efforts. This finding supports the characterisation of the firm as a forum for competing stakeholder interests, including internal stakeholders. Similarly, Insight found that an *unsupportive* individual in a key position can stop and engagement in its tracks.

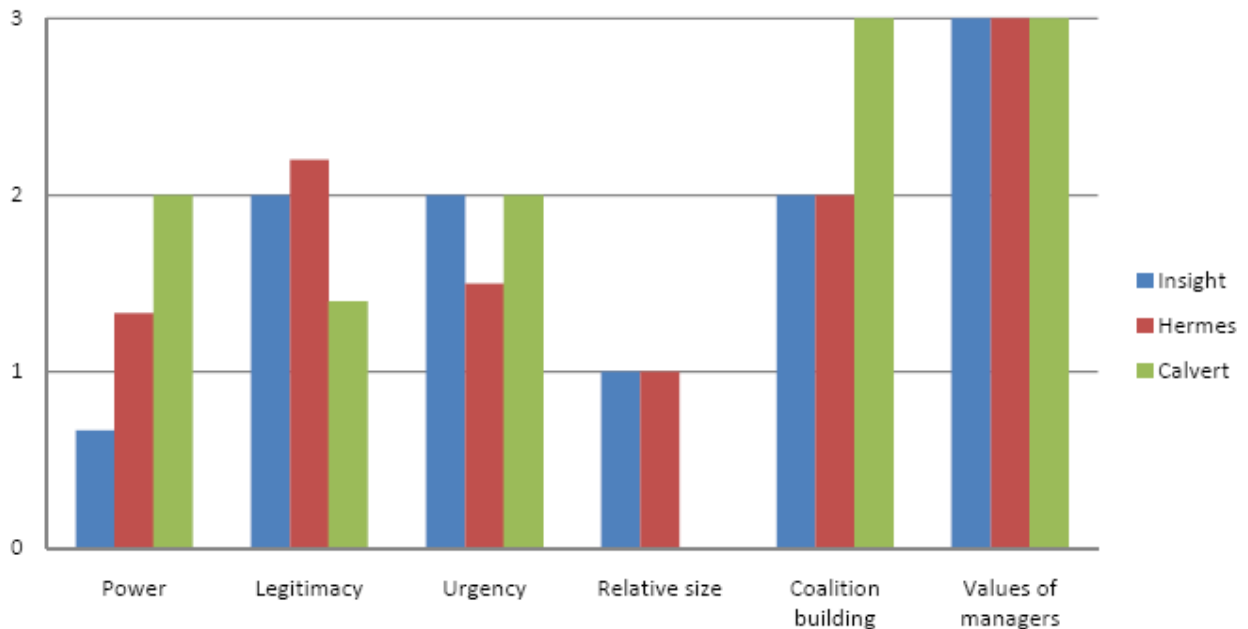
It was noted that managers' values are very much connected with managers' *personal* reputations, and that this can be an important point of leverage. One targeting strategy suggested is to write to new CEOs and chairmen when they start to determine the willingness of the new person to move forward on particular issues, and then target companies accordingly. Another strategy could be to seek out CEOs or board members who have made previous public commitments to sustainability and good governance, and then hold that person to those sentiments.

In addition to having values that are aligned, it was also seen as important that the company and the individuals involved have some level of knowledge and understanding of the issue in order to take it forward. This would seem to contradict the idea that new information will necessarily be well received. The truth lies somewhere in between, in that the provision of new and emerging issues is a driver of salience, but must still be somewhat within the paradigms of the individuals within the firm. If ideas are perceived to be too 'radical', then they are likely to be dismissed out-of-hand and are therefore unlikely to be salient.

4.5 Assessing the relative importance of the various factors

Figure 4.2 below illustrates support for the propositions in each case, grouped by attribute.

Figure 4.2 Support for propositions, grouped by attribute



From this, we can see that the three cases have different emphases when it comes to power and legitimacy. Insight and Hermes draw less upon power than does Calvert (due mostly to Calvert’s use of normative pressure through shareholder resolutions), but the large funds draw more on legitimacy (due to their size and mainstream status). All three engage intensively, with Hermes being slightly more ‘low-key’ than the others, based on its preference for behind-the-scenes engagement. Relative size was not considered important. Coalition-building was important for the large funds and very important for Calvert. The values of managers were seen to be very important to all three.

From a practitioners’ perspective, these findings lend support to the notion that the targeting process (driven by an assessment of which managers have aligned values) is the most important aspect to get right. Building coalitions is also very important. However, investors cannot easily change their own size (which was the driver of legitimacy that led to the high scores for this factor). So apart from taking steps to build coalitions (and perhaps engaging with smaller companies), the size challenge is not easily addressed. A commitment to undertake intense engagements with an appropriate level of assertiveness and persistence is important, while ensuring that legitimacy is enhanced as much as possible (particularly relating to the business case). Power is applied as a tool where legitimacy-based attempts fail.

5 Summary

The study supports, with qualifications, Mitchell's *et al.* (1997) model of stakeholder salience based on the stakeholder's possession of power, legitimacy and urgency, moderated by the values of the target company's managers. The definition of legitimacy is enhanced to include the legitimacy of *what a shareholder says* (the strength and substance of the arguments), not just *who they are* (the shareholder's reputation and credibility in the market). Urgency is modified to include a sense of intensity of engagement, which not only includes time sensitivity, but also the persistence, assertiveness and resources applied. Added to the model are moderating factors around relative economic size and coalition building.

The study confirms that shareholders are indeed most salient when there are high levels of power, legitimacy and urgency and the target company managers have values that allow for the accommodating of the shareholders' concerns. However, it is concluded that all three of the overarching attributes need not be present to achieve high levels of salience. The study suggests that within the engagement practitioner community, there is a strong preference for legitimacy-based engagement in the first instance, with an appropriate degree of intensity, and power being applied only after legitimacy-based options have been exhausted. This adds a temporal dimension to the stakeholder model, in that the attributes are not drawn upon at the same point in time, but applied sequentially as the engagement escalates.

It is concluded that the business case and the values of the target company managers are the two most important factors contributing to salience.

It is hoped that the exploration, modification and expansion of Mitchell's *et al.* (1997) stakeholder model in the context of shareholder engagement will provide additional explanatory power for those seeking to improve corporate ESG performance through leveraging the influence of perhaps the most important stakeholders of the firm: its owners.

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