

SHAREHOLDER RESOLUTIONS AND CSR

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Definition

A shareholder resolution is a form of shareholder activism through which shareholders make a proposal to a company regarding a particular issue that they need the firm should address. This proposal should be voted in the shareholder general meeting. If the proposal passes, it serves as an advice to the board of directors in setting the strategy and management of the company. Activist shareholders seek to influence managers to change the strategic priorities and the behaviour of the firm. Lately, activist shareholders have been paying greater attention to corporate social responsibility (CSR). This is demonstrated by the significant increase in the number of resolutions about social, environmental and corporate governance aspects since the 1970s. By submitting a resolution covering CSR topics, shareholders try to promote and incentivize CSR practices by pressing managers and making them aware of their demands. Nowadays, shareholder resolutions on CSR are mostly common in anglosaxon countries, particularly the United States (US), where the protection of shareholder rights is higher. In this country, the Security Exchange Commission (SEC) Rule 14a-8 regulates the process of submitting a resolution. Companies must respond to all shareholder resolutions by choosing among three options: (i) Managers can omit a proposal on legal grounds before the general meeting; (ii) the proposal can be included in the proxy statement to be voted in the general meeting, and (iii) managers can engage with the proponents to negotiate an agreed withdrawal prior to the general meeting.

Synonyms

Shareholder proposal

Introduction

A shareholder resolution is a proposal that a shareholder or a group of shareholders make to the board of directors of public companies. By means of a resolution, shareholders show their dissatisfaction with how the firms is being managed and try to use their power to influence the way in which managers are running the company. The filling of a shareholder resolution is a type of shareholder activism. Activist shareholders have several mechanisms

at their disposal, which may be classified according to the frequency of their use, as well as to their privacy (Yamahaki and Frinas 2015). Specifically, a shareholder resolution is an extraordinary and public form of shareholder activism. It is the most relevant form through which shareholders exert direct pressure on companies. Shareholder resolutions are particularly common in countries with an anglosaxon corporate governance system.

The filling of resolutions has become an important mechanism through which shareholders and investors try to foster CSR practices in their firms. Activist shareholders fill resolutions to challenge the legitimacy of the firm's behavior and the way in which it is currently managed. At the same time, they also try to improve the corporate social performance of their firms. Resolutions may cover a diverse set of policies and topics related to corporate governance, as well as social and environmental concerns. Nonetheless, there are specific topics that are salient within each field. For instance, social resolutions usually focus on labour and human rights, international operations, product responsibility or healthcare. Within the environmental area, climate change (e.g. GHG emissions, energy) and animal protection highlight among other issues. Finally, corporate governance related resolutions are mainly concerned with transparency and external reporting, compensation, and diversity in the board of directors. Corporate governance resolutions are usually more common than social and environmental ones. Shareholder resolutions seek to indicate the investors' concerns and to raise managers' awareness about these issues by suggesting the need for a change and solve them (David 2007). In so doing, activist shareholders try to pressure firms to engage in CSR activities (O'Rourke 2003).

Some companies are more prone to be subject to shareholder CSR-related resolutions than others. Investors target firms with low CSR performance to signal the ineffectiveness of managers in improving the social responsibility of the firm (David 2007). Shareholders also focus on large companies because they are more visible and operate in more different environments; hence, they are more likely to suffer from social and environmental issues that must be addressed (Eding and Scholtens 2017, Rojas et al. 2009). Additionally, the presence of responsible shareholders in the ownership structure of a firm is related to its likelihood of receiving a CSR proposal (Eding and Scholtens 2017).

Once a firm receives a resolution, there are three possible outcomes: the company can try to omit the resolution on adequate grounds, shareholders may decide to withdraw it before being voted, or the resolution can be included in the annual proxy statement to be subject to voting in the annual general meeting. Shareholder resolutions are non-binding recommendations. Those that pass are only advisory; hence, they may not be effectively implemented. However, regardless of the result, shareholder resolutions are useful mechanisms to raise awareness about CSR issues because they can have an internal and an external impact eventually. Shareholder resolutions help to increase the attention of managers and society about social and environmental problems. By means of being included in the annual proxy statement, these issues are made known to other investors and stakeholders of the firm, thereby increasing the pressure on managers. Additionally, some resolutions reach the general public because, if they are too relevant, they may be covered by the media. It is also noteworthy that a resolution may have a spillover effect on firms

operating in the same industry. If these companies observe that industry peers receive a resolution, they might proactively adjust their behavior before being subject to one themselves.

Historical evolution and current stage

The history of shareholder resolutions dates back to 1942. In that year, the Security Exchange Commission (SEC) allowed United States (US) shareholders to fill proposals to their firms through resolutions for the first time. However, the SEC prohibited the inclusion of social policy issues in the proxy statement on grounds of the “proper subject” test, included in the rule 14a-8 of the Securities Exchange Act in 1948 (Proffitt and Spice 2006). This situation changed in 1969, when a court authorized a group of activist shareholders of Dow Chemical, known as the Medical Committee for Human Rights, to present a resolution asking the firm to stop producing napalm, which was being used in the war of Vietnam (Ryan 1988). This moment represented the starting point of the submission of CSR-related shareholder resolutions. The Dow Chemical case led to the revision and adjustment of the “proper subject” test in 1976. This modification officially permitted the inclusion of social and environmental issues in the proxy statement, although other CSR-related resolutions had already been filled since the Dow Chemical milestone (Rojas et al. 2009).

During the 1970s, religious associations were the predominant group of investors filling CSR resolutions. Religious investor groups were pioneers in submitting social proposals because they had a moral motivation and a long-term perspective (Proffitt and Spicer 2006). Several organizations that grouped and organized religious investors appeared in that decade to help them in the process of filling resolutions. The Interfaith Center on Corporate Responsibility (ICCR) founded in 1971, highlighted among the rest and it still exists today. Despite being a key precursor, shareholder resolutions filled by religious investors in the 1970s received little attention as these groups were small. It was not until the 1980s that the relevance of CSR resolutions increased as other investors followed the lead of religious groups. In this decade, pension funds, institutional investors and NGOs started to make CSR proposals through resolutions (Gillan and Starks 2007, Proffitt and Spicer 2006, Sjöström 2008). These investors often collaborated with religious groups and they jointly sponsored resolutions on CSR (Dunn 2013).

Nowadays, resolutions are a common practice of CSR activist shareholders and more social issues are being included in proxy statements. Shareholders that own significant stakes in companies are paying increasing attention to social and environmental problems and urging managers to address them (Proffitt and Spicer 2006). Around 1,000 resolutions related to social and environmental issues were filled in US listed companies between 2014 and 2016 (SIF Foundation 2016). Some large well-known companies have received these resolutions, such as Home Depot, Cisco, Microsoft, Google or Yahoo (Guay et al. 2004, Sjöström 2010). Religious groups are still relevant players in organizing the filling of resolutions. As a matter of fact, ICCR is one of the most important associations of activist shareholders, and it tracks the filling of CSR resolutions in US. This organization has around 300 members with a total portfolio of \$100 billion (Goodman et al. 2014).

The process and outcomes of shareholder resolutions

Filing shareholder resolutions is a common practice in anglosaxon states. By allowing shareholders to make proposals and to indicate deviance from what they consider an adequate running of their firms, it shows a high level of shareholder protection in countries with a common law corporate governance system. Among these countries, US is the most active. The SEC Rule 14a-8 regulates the process of filing shareholder resolutions. The resolution should comprise a 500-word proposal. An investor needs to own \$2,000 in shares during at least 1 year to fill a resolution. Social or environmental resolutions are normally co-sponsored by several shareholders with the same objective. Activist investors usually lobby and form coalitions to increase the relevance and impact of their proposals (Rojas et al. 2009). This is important given that a resolution needs to be firmly supported to succeed. The practice of joining other investors when submitting a proposal is especially common among small shareholders. Several organizations, such as the abovementioned ICCR, help shareholders to organize, share information, and coordinate resolutions. Activist shareholders also engage with other stakeholders, beyond other investors, to increase the social legitimacy of their proposal. For example, NGOs are important advisors when preparing resolutions. Sometimes, they even pose their own resolutions by acquiring stakes in targeted firms or by engaging with shareholders that allow them to use their votes at general meetings (Guay et al. 2004). They try to promote change and push shareholder activism to address CSR issues.

Shareholders have to submit the resolutions at least 120 days before the release of the company's proxy statement. Firms must respond to all resolutions, regardless of the stake owned by the shareholders posing the proposal. Companies may choose between three responses: (i) omitting the resolution if it is not adequately presented; (ii) including the proposal in the proxy statement to be voted in the general meeting; or (iii) negotiating a withdrawal with the proponents before the general meeting. Each option indicates a different attitude, sensitivity and responsiveness to shareholders' demands. Firms should study these options to decide their course of action because they have advantages and disadvantages (Rehbein et al. 2013).

The most strongly opposing and least responsive action that managers could take against a CSR resolution is formally omitting it with the permission of the SEC. This option is considered a failure because it clearly indicates that the company is not willing to consider or discuss the proposal. To get the permission, the company should prove that the resolution failed to satisfy the requirements for its submission or that it violated the proxy rules. SEC Rule 14a-8 also allows firms to legally omit resolutions if the subject matter is not considered proper. For example, if the issue is not relevant (it does not affect 5% of the corporate business) or if it is related to personal grievances. The company should start the omission process no later than 80 days before filing the proxy statement and it should send the opposing declaration to the resolution proponents at least 30 days prior to the release of the statement. If the SEC agrees with the firm, the resolution may be excluded from the proxy statement. If the firm omits the resolution without permission, the SEC will proceed with enforcement actions against the company, such as the annulment of the general meeting.

If managers do not openly oppose the resolution or if they fail to get the SEC permission to omit it, the proposal must be included in the proxy statement and be voted in the general meeting. The firm must send the proxy statement to all shareholders that are entitled to vote so that they know in advance the matters that will be discussed. Management makes recommendations on what shareholders should vote. Managers normally oppose most CSR resolutions and usually make a statement justifying their positions and advising shareholders to vote against them (Gillan and Starks 2007, Rehbein et al. 2013). Managers tend to oppose resolutions because (i) they do not want to see their power diminish or (ii) they consider that the proposals are unfeasible and/or detrimental for business (David 2007, Rehbein et al. 2004). Therefore, most social and environmental proposals fail (Proffitt and Spicer 2006, Goodman et al. 2014). When this happens, the resolution could be resubmitted in the following year if it reached a minimum threshold of supporting votes (3% in its first year, 6% in its second and 10% percent in its third and subsequent years). If the proposal is approved, it may not have any substantial effect on corporate behaviour. Passed resolutions are non-binding and only serve as advice to the board of directors. So, if managers opposed the proposal, it may only lead to symbolic rather than substantial changes in corporate policies or actions, or it may even end up in not being considered at all.

Finally, managers can opt to settle a negotiated withdrawal with the resolution proponents before the annual general meeting. In contrast to the two prior alternatives, negotiating a withdrawal is a private way of handling a proposal (Semenova and Hassel 2018). This option is considered the most responsive corporate action because it initiates a dialogue between managers and proponents with the aim of negotiating a win-win agreement that satisfies both parties (Dunn 2013). Negotiating a withdrawal shows that the firm seriously considers the CSR resolution and that it is committed to comply and implement the proposal, at least to some extent (David 2007). The negotiation process is then an attempt to adjust the competing interests of both parties to decide a common set of environmental and/or social issues that satisfy them. The firm is willing to accept some of the terms of the proposal and adapt some changes, while activist shareholders may soften their demands. Although a settled withdrawal represents the most positive corporate response because it normally implies that some measures will be taken (David 2007, Uysal 2014), it may sometimes represent a bad outcome. In some cases, shareholders might decide to withdraw a resolution if they regard that they will not get the sufficient support in the general meeting (Rojas et al. 2009).

If the shareholders that propose the resolution are not satisfied with the firm's response (i.e. it was omitted or did not get enough votes), they still have a last call. In some cases, the shareholders that filed the resolution might regard that the issue addressed in the proposal is so important that they may not be willing to continue investing in the company and they could take the exit option: sell their stock and use their voice to publicly claim that this decision is driven by the reluctance of the firm to address a CSR proposal (Goodman et al. 2014). This situation is the most harmful because it has negative effects for both, shareholders and firms. The former find that their demands have not been considered and feel betrayed; while the latter may see that its behaviour is publicly scrutinized.

Companies analyse each resolution individually and they decide the action that they will take considering the filler (Dunn 2013). Some proponents are more salient and powerful; hence, they may be able to negotiate a withdrawal. For instance, and in contrast to individual investors, mutual and public pension funds are more likely to get a commitment from the management to implement their proposals (Rojas et al. 2009). It is key for firms to take into account the demands of large activist shareholders to guarantee the access to financial resources (Dunn 2013). The topic of the resolution is also an important determinant of the firm's response. Negotiated withdrawals are more common when the resolution deals with an environmental or social issue, than with corporate governance (Dunn 2013). For example, Rojas et al. (2009) found that proposals related to energy, human rights, international labour, or equal employment are more prone to be negotiated and withdrawn. These authors also observed that these topics are usually covered in the resolutions filled by the most influential investors. Thus, there seems to be a topic-shareholder relationship that reinforces the success of the resolution. Finally, some firm characteristics are also important factors in explaining the likelihood of a resolution being negotiated. Companies with low levels of CSR performance (Clark and Crawford 2012) or that have been previously subject to a resolution (Reid and Toffel 2009) are more likely to negotiate a withdrawal.

Whatever the response and outcome, shareholder resolutions are useful mechanisms to increase awareness about CSR, because it helps to direct the attention of managers, other stakeholders and other companies to environmental and social concerns, which may not be considered otherwise. Regarding management, CSR resolutions incentivize problem-solving decisions and foster an internal analysis of the firm (Proffitt and Spicer 2006). Managers must assess whether the issue is relevant for the company and decide whether or not to omit the resolution, recommend a negative vote, or negotiate a withdrawal. CSR resolutions may also have an impact on other stakeholders, beyond shareholders. Due to the public attention of some shareholder proposals, employees, customers, suppliers, or NGOs could take notice of the issue that the resolution addresses. Consequently, these stakeholders may contribute to exerting additional pressure on firms to adapt their policies (David 2007, Rehbein et al. 2013). Finally, there could be a spillover effect to other firms (Rojas et al. 2009). Companies that operate in the industry of a firm being targeted with a resolution may have a proactive attitude. These companies could try to adapt their own behavior if they fear that they could be challenged with a similar resolution from their shareholders in the short-term.

Cross-references

- See [Shareholder activism](#)
- See [Corporate governance](#)

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