ESG Now Podcast

“Are Shareholders Turning Against ESG?”

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Michael Disabat...: What's up, everyone? And welcome to the weekly edition of ESG. Now where we cover how the environment, our society and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato. And this week, we discussed if shareholders have turned their backs on ESG. Thanks as always for joining us. Stay tuned.

Every proxy season, the efforts that shareholders have been making to challenge companies to change or improve certain aspects of their business bubbles to the surface. And we get to see what's going on. We get to see where shareholders desires, conflict with companies wishes so much that one of the parties would rather go public about it, than work together behind closed doors to get to a happy consensus. Shareholder proposals are a big deal, especially in the US because we love our drama and it's fun to see what people want to change in the corporate world, especially for MSCI ESG Research for us because a majority of shareholder proposals concern ESG topics and issues. There are proposals to change how a board is structured for a company to disclose more honest diversity and equity inclusion or its climate priorities. The E, and the S, and the G are always there, and since part of the proxy season has just ended, I decided to call up my colleague, Harlan Tufford, who covers all things governance and ask him to dish on how the season turned out.

And he is going to take us through why support for ESG shareholder resolutions are dropping, what some of the typical but newer proposals are being pushed for in the market? And also, a crop of proposals with a very new intent that are starting to pop up in the financial world. This is a very mysterious popup indeed. But first I wanted Harlan to give a broad overview of what happened this proxy season and why it matters.

Harlan Tufford: So over the last three years, we've seen a big jump in the number of proposals relative to prior years and really strong support for many of those proposals. But in 2023, I think we're walking back some of that trend compared to this time last year, we've seen about a 25% drop in the overall number of shareholder proposals going to a vote. And that's being driven in large part by fewer proposals related to governance and social issues. Proposals on shareholder rights have always been among the most prominent in the US, and proposals on key social issues like human rights have also been quite common. Both of these are down in volume in 2023 to date, with a year-over-year decrease of about 29% and 33%, respectively. Climate is one area where proposal volume's still pretty strong, 45 so far this year, 46 last year at the same time of year. But we are seeing changes in the types of proposals that are going to a vote.

So this year there's an even number of proposals urging companies to set greenhouse gas emissions reduction targets and proposals related to broader questions of transition risk and climate strategies and opportunities. In contrast, last year, there were far more proposals that were really focused on setting targets and across all these proposals for the ones going to a vote, the support level's down. We're seeing an overall average support of about 23% for shareholder proposals. And last year, that was 31% and that drop is actually stronger for climate proposals than it is for governance or social.

Michael Disabat...: Oh my God. Now mind you, 25% to 30% support is still pretty good when it comes to shareholder proposals, but that's still noticeable dip there. And also, to note, success for a shareholder proposal is getting over 50% of shareholder votes, which then means in the US, the company has to seriously think about enacting the proposal. But this decline that Harlan mentions, what does it mean for the support for the common ESG oriented shareholder proposals that we've seen over the years is apathy setting in on ESG? I asked Harlan.

Harlan Tufford: So looking at shareholder proposals is a bit like looking at an iceberg, where the proposals that go to a voter are just the tip of the iceberg and there's this whole mass of withdrawn proposals underneath it. We don't always see, we don't always know about... the shareholder proposals are kind of cool that way. Unlike the formal engagement mechanisms, other formal engagement mechanisms like voting against directors and proxy contests and things like that. Shareholder proposals can allow an investor and a company to build consensus without necessarily having that public confrontation. So when investors first submit a proposal, they'll often follow up on it with meeting with the company to discuss why they submitted their proposal and whether the company can make some kind of commitment, otherwise address the investors' concerns and really get to the core of what prompted the proposal. And if they can do that, there's a good chance the investor will withdraw that proposal.

And there's evidence to suggest that this happens a lot, companies don't usually have to disclose the proposals that are withdrawn, so they're quite hard to study. But we did look at the withdrawn proposals of which were aware from public disclosures between January of 2017, and August 2022, and we found that a majority of all US shareholder proposals related to environmental issues, 58% were withdrawn before they went to a vote. So the fact that we're seeing fewer proposals this year on ESG issues does not necessarily mean that investors are deprioritizing those issues. It could mean that companies kind of, the inverse is happening. Companies are increasing their prioritization of these issues. They're responding to investor concerns at an earlier stage on the engagement spectrum and giving investors a reason either to withdraw the proposal or just never to submit it in the first place.

And this framework, it may go some way to explain why proposals this year are getting lower support on average. Many of the proposals going to vote may represent proposals where investors and issuers couldn't find that compromise. And so, investors may find these proposals too onerous and too prescriptive to support.

Michael Disabat...: Yeah. It might not be an active defiance. It might be the main streaming of ESG concerns at companies. So now we have harder shareholder proposals that companies and investors have to vote on because the easier ones are gobbled up. For example, one of the more common climate proposals was for companies to set a decarbonization target. And if we look at data across our coverage on whether companies have set up a target and publicly disclosed on that target, we see that as of May 2023, 44% of listed companies have set a decarbonization target up eight percentage points from seven months earlier. So it seems like those were maybe the easier ones to get through. More companies have adopted them and now the harder, more detailed ones are coming up against a more hesitant shareholder group. So, all those that Harlan just talked about, those are the common ones, the ones that we've been seeing for a number of years. What about the new? There are also new shareholder proposals on the docket this year that Harlan has been seeing regarding drug pricing and labor rights.

Harlan Tufford: So we've seen a brand new type of proposal break out this season related to pharmaceutical patents. These proposals are asking boards to report on how extended patents on exclusive medicines kit impacts product access for customers. And there's a really clear focus with these proposals, I think on high prices for prescription drugs in the US and we see seven of these so far at pharma and biotech companies in the US and they've gotten an average support of about 20%, no successes so far, that's the norm. And the highest we've seen was 30% supported American company, all of these proposals, almost all of them coming from faith-based investors, one from a secular nonprofit. So that's one, I think we'll be watching to see how it develops, whether we see more of those next year. Another interesting one type of proposal is on collective bargaining. And this isn't totally new. We saw the first of these last year in '22 and '23 total, we've seen six of them. And these are proposals looking at workers' right to organize and how companies are really approaching issues around workers' rights and labor.

And again, most of these have received around over 30% support, I should say, well above the kind of 25% average for social proposals. And this year, we saw the first of these proposals actually get majority support at Starbucks with just scraping by at 51%. And this proposal, like many of the others, was urging boards to commission an independent third-party assessment of how Starbucks is adhering to its commitments on workers' rights and in connection with international labor standards. And I think that success at Starbucks could be a bit of a wake-up call for other companies that are facing some scrutiny around their labor practices and whether or how they're communicating with workers about their right to organized.

Michael Disabat...: Well, these are new. They still ask the same thing of companies as the last two decades of shareholder proposals have. They ask companies to better oversee, for example, the externalities from their businesses and the communities that they interact with an impact and to incorporate more practices that are consistent with the expectations of sustainable investing advocates and to deal with the risks that might be voiced by those advocates. But there is a different sort of proposal that are coming into the market that have become more prominent in recent years and they deserve a discussion. So here is Harlan to give you it.

Harlan Tufford: So between 2018 and 2021, we began to see a small number of proposals from a small group of investors that differed significantly from the norm. And some people have been calling these proposals anti-ESG proposals, but I think a more accurate term would be contrarian proposals. And I say that because while these proposals tend to address topics that are very typical of US shareholder proposals, things like climate change, employee diversity initiatives, the resolutions, what's actually being requested of the company in these proposals, it is almost the diametric opposite of what we usually see in shareholder proposals. A good example, in 2019, an organization called Burn More Coal, submitted a proposal at Exelon Utility that requested disclosure on the cost and benefits to shareholders and other parties from the company's voluntary environmental activities. And the proposal was prompted by the company's decision to divest from coal, in the proponent argued that Exelon's reduction in CO2 emissions is not an obvious benefit to anyone or anything, a quotation.

So this proposal, which is skeptical of the need to act on climate change, is in really stark contrast to the more than 200 other proposals. We've seen voted over the last seven years, which have asked companies to do more on climate or discuss the risks of not acting on climate.

Michael Disabat...: These are contrarian relative to the past majority of proposals that we have seen. The ISS, the Institutional Shareholder Services organization, that is one of the leading organizations that looks at shareholder proposals and collates them for the marketplace, said at a conference recently that they would be highlighting these proposals in their proxy voting recommendations reports, which was a pretty big deal at the conference. But it's curious to hear that because how are they actually going to do that? It isn't like proposals have a label on them that state this is a common type of proposal, or this is the new type of proposal with a new agenda attached to it. So, I asked Harlan about that. I asked how is this possible that the ISS, that others can actually get these type of proposals together? And he added an interesting point near the end about the different support that these proposals are getting.

Harlan Tufford: While it's not required, most companies do publicly disclose who filed each of the shareholder proposals in the proxy. And because we track that, we can track the proponents of these contrarian proposals who I will call the contrarians for the purpose of this. And these investors aren't only putting forward contrarian proposals. The contrarians are also putting forward proposals on really bread and butter governance issues as sort we see every proxy season. For example, we've seen several proposals from contrarians that called for greater disclosure on companies lobbying and political spending activities. We've also seen them file proposals calling for the separation of the chair and CEO roles. These two proposals are the first and third most common type of proposal over the last seven years, and they typically receive really strong support from shareholders. Lobbying disclosure, proposals average about 32% support and independent chairs average, 31% support. However, when contrarians submit these proposals, they aren't fairing as well as those submitted by other investors.

In fact, the average results for both of those proposal types when they're filed by a contrarian are about 10% less than the average for proposals submitted by other investors from 32 or 31 to 22 or 21.

Michael Disabat...: The reason also might be because the context provided by these contrarians on their own platforms, mind you, when lobbying for these proposals, focus on a political agenda for why they're making these proposals. And I don't mean they allude to it. I mean, politics is mentioned directly in the contextual language. And this sort of stark partisanship, it might be slowing investor support for what are normally, as Harlan said, "Bread and butter proposals." It might be that we're seeing a push for the shareholder democracy landscape to join what some of the other nonpartisan landscapes in the US have been forced to join in recent years, the political spectrum. And we might be seeing voting for proposals that begin to be split along partisan lines in the near-term future.

And that's it for the week. I wanted to thank Harlan for discussing the news with an ESG twist. I wanted to thank you so much for listening. If you liked what you heard, don't forget to rate and review us. It really helps puts us up on those podcast lists so more people can find us. And if you want to hear myself or Bentley or any of our other hosts that are upcoming every week, then subscribe wherever you get your podcasts. Thanks again and talk to you soon.

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