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Book Review

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BOOK REVIEWS

The University Portfolio and Social Responsibility

THE ETHICAL INVESTOR: UNIVERSITIES AND CORPORATE RESPONSIBILITY. By John G. Simon, Charles W. Powers & Jon P. Gunnemann. New Haven and London: Yale University Press, 1972, Pp. x, 208. $9.50 (paper, $2.95).

Justice Louis D. Brandeis characterized the modern corporation as "the master institution of civilized life."[1] In light of the actual and potential impact of such an institution, it is hardly surprising that concern over the proper scope of corporate activity and responsibility for its conduct dates almost as far back as the origins of the corporation itself.

In the late nineteenth century, this concern over corporate activity in the United States focused primarily on enactment and enforcement of the antitrust laws. In the early years of the twentieth century, courts were occasionally forced to deal with social issues raised in shareholders' derivative actions, but the cases were few and far between. Systematic analysis of the problems of corporate responsibility did not really get under way until the publication in 1932 of *The Modern Corporation and Private Property*, by Adolph A. Berle and Gardiner Means. The fundamental purpose of this seminal and prophetic book was to demonstrate the distance between the legal theory of corporate control and the realities of corporate life in the United States. Today most minority shareholders who seek to instill a sense of social responsibility in corporate managers acknowledge the continued existence of the gap documented by Berle and Means and the futility of attempts to reassert shareholder control. The objective of these shareholders is to persuade; their method is to arouse public opinion and bring to bear on corporate management the full weight of all favorable pressures that can be generated, including the considerable leverage which institutional investors can potentially exert.

It is no secret that the percentage of shares of common stock of

1. Liggett v. Lee, 288 U.S. 517, 565 (1933). Justice Brandeis was quoting from T. VEBLEN, ABSENTEE OWNERSHIP AND BUSINESS ENTERPRISE 86 (1923).

American corporations held by institutions of one sort or another has risen dramatically in recent years, although there are few, if any, major corporations of which institutions own a majority of the stock.[2] To speak of "institutional investors" in the context of the corporate responsibility debate, however, is to say very little because there are so many different kinds of institutions, each type subject to differing legal, moral, and political constraints and pressures. At one extreme are banks and mutual funds, whose freedom to take any action that might adversely affect the return to trust beneficiaries or investors is rigidly circumscribed. On the other end of the spectrum are foundations whose charitable purposes are so broadly defined as to give their managers virtually complete freedom to advance social causes at the expense of portfolio performance. The churches, universities, and other single-purpose charities fall between the two extremes and find themselves caught between the legal obligation to maximize investment return and a countervailing desire to respond in some way to the will of their constitutents and to the needs of society. In *The Ethical Investor*, Messrs. Simon, Powers, and Gunnemann have limited themselves to an examination of the problems of the university as an institutional investor, but every institutional investment manager who takes the problem of corporate responsibility seriously should find the book valuable.

Much of the initial awareness that universities may have a significant role in attempts to instill a sense of social responsibility in corportate management come as a result of student activism. The concern of college students for the solution of social problems is not new. What is new about the concern of the current generation of students, which may be dated very roughly from the Greensboro sit-ins in 1960,[3] is its breadth, depth, and scope. Very simply, more students have deeper feeings about many more problems, and the problems themselves are of unprecedented technological and sociological complexity. As early as 1960, students were aware of at least some of the implications of corpo-

2. During the period 1960-69, the estimated share volume of institutional investors on the New York Stock Exchange rose from approximately 360,000,000 shares (28% of the total public volume) to nearly 2,300,000,000 shares (more than 50%). SECURITIES AND EXCHANGE COMM'N, INSTITUTIONAL INVESTOR STUDY REPORT, H.R. DOC. No. 92-64, 92nd Cong., 1st Sess. 2167-68 (1971).

3. On February 1, 1960, 4 black college students from Agricultural & Technical College of North Carolina attempted to obtain service at a F.W. Woolworth Company's lunch counter in Greensboro, North Carolina. N.Y. Times, Feb. 5, 1960, § 1, at 12, col. 3. Four days later a number of white college students joined the protest, which then spread to S.H. Kress & Company. N.Y. Times, Feb. 6, 1960, § 1, at 20, col. 1. Finally, on July 25, segregation ended at the lunch counters of the Woolworth and Kress stores when the manager of each store agreed to begin service on an integrated basis. N.Y. Times, July 26, 1960, § 1, at 1, col. 8.

rate activity, as evidenced by the Greensboro sit-ins having touched off picketing at the northern outlets of the retail store chains involved.[4] Not until the Kodak controversy in 1967,[5] however, was the anger and frustration of students directed against their own colleges and universities, which as institutional investors were thought to be somehow implicated in corporate conduct. Another important change occurred in 1970 when the leaders of Campaign GM made the first serious attempt to organize and coordinate efforts to force shareholder action on campuses across the country.[6] Since 1967, university trustees have found themselves asked to make many complex "investment" decisions of a very new sort. The issues have included apartheid and other forms of racial discrimination in South Africa,[7] strip mining,[8] pollution control,[9] the manufacture

4. N.Y. Times, July 26, 1960, § 1, at 1, col. 8.

5. FIGHT (Freedom, Integration, God, Honor—Today), a militant black organization formed by the late Saul D. Alinsky in Rochester, New York, deadlocked with Eastman Kodak over a proposed program to hire and train 600 blacks in December 1966. In March 1967 FIGHT purchased 10 shares of Eastman Kodak stock. FIGHT then mailed 700 letters to various clergymen and civil rights groups urging them to contact fellow stockholders to protest Kodak's action in a controversial "contract agreement" between Kodak and FIGHT. N.Y. Times, April 7, 1967, § 1, at 1, col. 7. At the annual stockholders meeting, FIGHT was unsuccessful in forcing Kodak to honor any previous "agreements"; nevertheless, Kodak subsequently hired a black advertising public relations firm and emphasized its intention of recruiting and training additional blacks.

6. Campaign GM was formed by Ralph Nader. Its announced goal was to make General Motors more responsive to the public. Nader's colleagues on the project purchased 12 shares of GM stock. Subsequently they proposed the following 3 shareholder resolutions: first, to expand the Board of Directors of General Motors from 24 to 27 and include 3 representatives of the general public; secondly, to establish a shareholders' committee for corporate responsibility; thirdly, to have the corporation undertake no business activities that were detrimental to the health, safety, or welfare of United States citizens. N.Y. Times, Feb. 8, 1970, § 1, at 44, col. 1. All 3 of these resolutions were defeated soundly at the annual stockholders meeting, but GM subsequently took action consistent with those resolutions. N.Y. Times, May 23, 1970, § 1, at 15, col. 1. For an extensive analysis of the first 2 phases of Campaign GM by a law professor who participated in the project see Schwartz, *The Public-Interest Proxy Contest: Reflections on Campaign GM*, 69 MICH. L. REV. 419 (1970); Schwartz, *Towards New Corporate Goals: Co-Existence with Society*, 60 GEO. L.J. 57 (1971).

7. N.Y. Times, Aug. 23, 1972, § 1, at 1, col. 1 (World Council of Churches voted to liquidate its financial stake in all corporations doing business with South Africa); N.Y. Times, Aug. 19, 1972, § 1, at 33, col. 3 (investigation of role of black workers in United States corporations' subsidiaries located in South Africa indicates that only about 10% are attempting to improve the lot of black workers). *See also* Unterhalter, *The "Polaroid Experiment" in South Africa—A Progress Report*, 6 VAND. J. TRANSNAT'L L. 109 (1972).

8. *E.g.*, Natural Resources Defense Council v. TVA, 340 F. Supp. 40 (S.D.N.Y.), *rev'd* 459 F.2d 255 (2d Cir. 1972) (action to enjoin TVA's involvement in strip mining; reversed because New York was not a place of proper venue); Lomayaktewa v. Morton, Civil No. 974-71 (D.D.C., filed May 14, 1971) (attempt to invalidate Interior Department's approval of a lease of Hopi tribal lands on Black Mesa for strip mining coal). For a discussion of this case see 1 E.L.R. 65171 (1971).

9. Illinois v. City of Milwaukee, 406 U.S. 91 (1972) (holding that there is a federal common law of pollution control); Washington v. General Motors, 406 U.S. 109 (1972) (action by 18 states against the Nation's 4 major automobile manufacturers alleging conspiracy to impede research and development of automotive air pollution control devices).

of antipersonnel weapons,[10] and discrimination in hiring.[11]

Initially there was considerable confusion and irritation, and, on a number of campuses, outright confrontations over issues of corporate responsibility threatened to halt normal academic activity. Nearly every major institution ultimately responded by appointing a committee to study the problem and to make recommendations for the establishment of procedures to ensure that responses to future requests for institutional action would be orderly and thoughtful. The most comprehensive study to date is the subject of this review, a report to the Yale Corporation which grew out of an interdisciplinary seminar on corporate responsibility led by the study's authors in 1969-70.

The scope of the report is rather limited. It does not, for example, purport to examine the vast range of possibilities for institutional investment in activities such as low-income housing construction, that are directed toward the accomplishment of social goals rather than maximization of investment return. Moreover, the authors assume at the outset that in a complex industrial society there can be no such thing as a "clean" portfolio.[12] Their principal concerns are whether the university as shareholder should try to influence the behavior of corporations, whether it may legally do so, the range of possible action, and the nature of the decision-making process.

A more fundamental question is whether corporations have any real social responsibilities. If not, then it is a moot point whether an institutional investor can be implicated, in any meaningful sense, in corporate conduct. The authors conclude that corporations do have an obligation to avoid and correct social injury—but only to the extent that the societal harm is caused by the corporation itself. They call this negative injunction a "moral minimum." Affirmative duties may play an important role for individuals, but they have no place in the corporate moral scheme. This distinction is extremely useful as an aid to the analysis of corporate responsibility problems. Consider, for example, the familiar statement that the sole purpose of corporate existence is the

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10. State *ex rel.* Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1971) (shareholder's attempt to inspect munition manufacturer's shareholders list to communicate with other shareholders regarding his opposition to the corporation's production of war materials). For a discussion of this case see 25 VAND. L. REV. 425 (1972).

11. Wall Street J., Jan. 31, 1973, at 1, col. 3, (EEOC charges NBC with discrimination against women in its hiring); Wall Street J., Dec. 14, 1972, at 4, col. 3 (EEOC charges Mobil Oil Co. with discrimination against women in its hiring); Wall Street J., Aug. 24, 1972, at 8, col. 2 (class action filed charging 32 firms with discrimination against women in hiring).

12. A devastating critique of the "clean portfolio" concept may be found in Malkiel & Quandt, *Moral Issues in Investment Policy*, HARV. BUS. REV. 37 (March-April 1971).

maximization of profit.[13] Attempts to accomplish objectives that are incompatible with profit maximization are, according to the profit advocates, definitionally impossible. Moreover, they frequently assert that the corporation is singularly unfit to promote the general welfare and will probably fail in its attempt. These arguments, with several variations, simply have no relevance to the problem of corporate responsibility in the limited Simon-Powers-Gunnemann sense. Similarly, in discussions of highly competitive industries in which harmful practices are widespread, it is often argued not only that it is unrealistic to expect individual firms to adopt measures that put them at a competitive disadvantage but also that the resulting social injury from unemployment might well be worse than that resulting from the pollution. Applying the moral minimum criterion, one can admit all of this and nevertheless find fault with corporations in such an industry. The pollution is "self-caused" to the extent that the industry has not taken steps to find solutions, and individual firms may be faulted for failure to encourage industry-wide action.[14]

Having made a case for corporate responsibility, the authors must still make a case for university shareholder action. Invoking a complex tripartite principle called, for reasons at once obvious and utterly unfathomable, "the Kew Gardens principle"—an allusion to the celebrated Kitty Genovese murder which took place in Kew Gardens, Queens, in 1964—they conclude that universities do have an obligation to act. In the final analysis, this principle boils down to nothing more than "if you are in a position to do anything which will prevent or eliminate social injury (whether or not self-caused in any usual sense), and nobody else is going to do anything about it, you ought to do whatever you can, no matter how futile the effort may appear."

This is one of the major weaknesses of the book. The Kitty Genovese-Kew Gardens metaphor is no more than a metaphor, and yet the authors rely heavily upon it; the rigorous analysis to which other concepts are subjected is temporarily abandoned. One wishes that the problem of proximate cause had not been passed over so lightly, and that the authors had taken this occasion to examine in some depth what it means to be an "investor." Surely the swapping of pieces of paper on the New York Stock Exchange is not the equivalent of an injection of

13. *See, e.g.*, M. FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962). Whether one adds the innocent-sounding phrase "in the long run" makes an enormous difference in the thrust of this argument. *Cf.* Rostow, *To Whom and For What Ends Is Corporate Management Responsible?*, in THE CORPORATION IN MODERN SOCIETY 46 (E. Mason ed. 1959).

14. *See* J. SIMON, C. POWERS & J. GUNNEMANN, THE ETHICAL INVESTOR: UNIVERSITIES AND CORPORATE RESPONSIBILITY 109 (1972).

venture capital, the purchase of a new equity issue, or the purchase of bonds from an underwriter. Furthermore, the authors failed to recognize the possibility that a valid reason for university action may be pure political necessity; the alternative to university action may be a mob outside the president's door—or worse.

Whether universities in fact have the capacity to influence corporate behavior is a very real and fascinating issue, and one that has figured prominently in corporate responsibility discussions. The authors believe that universities can be influential so long as they remain shareholders; divestment of a stock is viewed as a desperation move to be made only after all other tactics have failed. They identify and discuss twelve possible devices available to the shareholder, ranked in approximate order of aggressiveness. Declining to invest in the stock of a corporation is obviously the least aggressive "action;" divestment is hardly better. The acquisition of shares for purposes of initiating shareholder action is ruled out as wholly inappropriate (a decision required by the adoption of the moral minimum approach) but the authors do go so far as to approve engaging in or even initiating litigation to enjoin harmful activity under specified conditions. Between these extremes, the book points out a wide range of possible actions designed to influence management, either by direct communication, through the proxy machinery, or by implication, through a combination of the two. It is interesting and initially somewhat curious to note that making public pronouncements in connection with other forms of shareholder action is viewed as the most aggressive tactic, outranking even litigation. On reflection, however, this judgment may well be correct. The fundamental issue would seem to be whether universities and other concerned institutional investors can affect the cost of capital to a given corporation. Looking at the question from the point of view of raw market power, the answer for any major corporation is probably negative, but when considerations of adverse publicity are factored in, this answer would seem to be in doubt.

The ability of institutional investors to affect the cost of capital would appear to be a fertile field for empirical analysis. In any given case, it may be difficult to determine a clear cause-and-effect relationship between external events and the movement of stock prices because of the number of variables involved, but perhaps one could obtain some meaningful results on an aggregate basis.[15] A correlation of changes in

15. One may only speculate whether, for example, the price behavior of General Motors stock over the past 2 years may have been less favorable than pure business or economic considerations would warrant. If this were the case, it might indicate that Campaign GM had deferred

bond rating with shareholder activity might further indicate that minority shareholders can have a significant influence on the cost of capital. Until such studies are undertaken, however, one can only guess at the economic effects of efforts to reform corporate conduct.

The ultimate product of the Yale seminar is a set of suggested guidelines the purpose of which is to: "establish criteria and procedures pursuant to which the university will respond to requests from members of the university community that the university take into account factors in addition to maximum economic return when making investment decisions and when exercising its rights as a shareholder."[16] The guidelines themselves are reasonably brief, and the criteria they establish are general because the authors envision a case-by-case development of a concrete body of precedent which will provide guidance for future decisions. Hypothetical cases are given to illustrate the operation of the guidelines.[17]

The guidelines recommend that the president and trustees of the institution appoint a committee or council drawn from all walks of university life. This group is to respond to requests (it is definitely *not* to be a roving commission), establish facts on the basis of evidence, and make recommendations for action to the trustees, who in turn are asked to indulge a presumption in favor of the council's recommendations.

The pattern of organization suggested by *The Ethical Investor* is the same one actually adopted, with minor variations, by nearly every university which has grappled with the problem. The committees or councils that have been established as a result have been left, by and large, to establish their own procedures, and more importantly, to define their real function. As a result, they undoubtedly will go through protracted identity crises. Perhaps this is unavoidable, but the authors of *The Ethical Investor* could have been more explicit about the way in which the investment council should approach the decision-making—or rather, recommendation-making—process itself. One's initial impression is that such a body is supposed to function in much the same way as the staff of an administrative agency, with the trustees cast in the role of the commissioners.[18] Undoubtedly there are significant differences

numerous potential purchasers. Similar findings for Gulf and other companies subjected to heavy shareholder pressures would certainly tend to reinforce such a conclusion.

16. J. SIMON, C. POWERS & J. GUNNEMANN, *supra* note 14, at 171.

17. One may take issue with the proposed handling of some of the cases, and it will be a rare lawyer who cannot posit slightly more complex factual situations that would make the decisions difficult. This is not a very telling criticism. The "common law" technique proposed by the authors does permit decisionmakers over a period of time to sharpen their rules and their techniques of application.

18. The Securities and Exchange Commission perhaps offers a useful analogy.

between these relationships, but the adoption by an investment council of some working assumptions based on such an analogy might lend a certain coherence to the council's work and minimize frustration.

One significant practical problem which is alluded to only in passing is that of the expense and time which must be invested in factfinding if the forthcoming recommendations for action are to have a sound basis. To give an example, a recent effort by Harvard University to gather sufficient facts to permit the Harvard trustees to make an informed decision on the University's ownership of Gulf Oil stock involved many weeks of full-time work by a presidential assistant, including a trip to Angola.[19] Clearly not even a major university can afford to incur expenses of this magnitude on a regular basis, and for a small institution such thorough investigations are out of the question. To solve this problem, a number of educational institutions and foundations have recently established the Investor Responsibility Research Center.[20] The Center will be operated on a membership basis; the cost of membership will be determined by the size of the institutional portfolio. Its functions will be to keep its members abreast of developing corporate responsibility issues and to publish factual background papers on issues involving companies whose stocks are widely held by institutional investors. To the extent that the Center or some similar institution succeeds, university corporate responsibility committees and councils will be able to serve a useful purpose. Messrs. Simon, Powers, and Gunnemann have demonstrated conclusively that neither the issues nor the procedures can be significantly simplified if the results of university inquiries are to be meaningful, but it is equally clear that volunteer committees cannot sustain the burden of fact finding; it is more than enough to ask for analysis of the facts and for recommendations.

The Ethical Investor is, despite its flaws, as thorough and comprehensive a treatment of the problems of universities and corporate responsibility as might be desired. It should be required reading for university trustees, and it offers many valuable insights to the general reader. Although it may appear that student and faculty interest has diminished somewhat during the past two years, it is nearly a certainty that this has been more the result of an intelligent and sincere response by university administrators and trustees than of any profound change in the climate of opinion. If the universities continue to respond in a

19. *See* Farber, *Gulf and Angola*, HARVARD UNIVERSITY GAZETTE, Oct. 6, 1972.
20. *See* Wall Street J., Dec. 14, 1972, at 14, col. 4.

thoughtful and reasonable way, they can make an enormous contribution to the cause of social justice, and they need not suffer in the process.

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