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The Politicization of Social Responsibility

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Editor's Note: **Todd Gormley** is a Professor of Finance at Washington University in St. Louis, **Manish Jha** is an Assistant Professor of Finance at Georgia State University, and **Meng Wang** is an Assistant Professor of Finance at the University of South Florida. This post is based on their recent **working paper**.

Our paper analyzes whether institutional investors' votes on environmental and social proposals, commonly referred to as socially responsible investing (SRI) proposals, differ with which political party currently controls the government of the firm's headquarters state. We find that institutional investors are less likely to back these proposals for firms headquartered in states governed by Republican leaders. This reduced support concentrates in recent years when political rhetoric around corporate social responsibility (CSR) became more polarized and among larger institutions and firms, which tend to attract more attention from politicians.

Motivation and Background

The growing political polarization in the United States has placed companies and investors in a difficult position, especially regarding environmental and social issues. While Democratic politicians frequently push for corporate actions related to equity, human rights, and environmental sustainability, Republican leaders often criticize such efforts. Institutional investors, who must vote on shareholder proposals tied to these sensitive topics, are increasingly navigating a landscape where political pressures vary significantly across US states.

There are several reasons to believe institutional investors might alter their votes based on state-level political leadership. State governments influence firms' profitability through policies, tax breaks, and contracts. Politicians can retaliate against companies that engage in activities that contradict their political priorities, potentially harming a firm's local business operations. Investors, aware of these risks, might be less inclined to support SRI initiatives that conflict with local political views. Additionally, investors might seek to avoid provoking local politicians, who could use state-controlled assets or media influence to pressure the institution.

Data and Methodology

To assess the potential impact of state-level politics on investor voting, we analyze a comprehensive dataset of institutional investors' votes on every shareholder proposal from January 2006 to June 2021. We focus on SRI-related proposals because polls consistently show that Democrats are more likely to prioritize issues promoted in such proposals during our sample (e.g., sustainability, human rights, equity, political contributions, etc.). We use high-dimensional fixed effects to control for various factors that could influence voting patterns. We include meeting-level fixed effects to control for firm- and time-specific factors; institution-by-month-by-SRI fixed effects to account for institutions' monthly tendencies to support SRI proposals; and industry-by-month-by-SRI fixed effects to control for variations in support for SRI proposals across different industries.

Our primary analysis tests whether institutional support for SRI proposals is lower in states led by a Republican governor. We focus on the governor's political party because governors are the state's top executive, with the power to affect local firms through state-level appointments (e.g., treasurer or comptroller), legislation vetoes, and proposed budgets. We also conduct several robustness tests, including examining states where one party controls both the governorship and the legislative bodies, and using alternative proxies for firms' exposure to state politics.

Main Findings

Our findings reveal a clear and significant relationship between state-level politics and institutional investors' voting behavior. Specifically, institutional support for SRI proposals is 4.1 percentage points lower for firms headquartered in Republican-led states, representing a 13% decline relative to the average support level across the sample. Moreover, the association between state-level politics and SRI voting has become more pronounced recently. The negative correlation between Republican governorships and SRI support was statistically significant during President Obama's second term (2013-2016) and became even more pronounced during the Trump administration (2017-2020). Before 2013, the association was weaker and not statistically significant.

We also find that the observed correlation between political leadership and SRI voting is greater for larger firms and institutions, which are more likely to attract political and media attention. Additionally, the decline in support is more pronounced for firms and institutions with significant media coverage and when the institutional investor holds a substantial ownership stake in the firm.

Within-State Shifts and the Likelihood of SRI Proposals' Passage

The observed shift in investor support for SRI proposals also occurs within states following changes in political leadership. When a state has a Republican governor, institutional investors are ten percentage points less likely to support SRI proposals than when that same state has a Democrat governor. This decrease corresponds to a 30% reduction relative to the average support level. These shifts occur for both types of political transitions: from Democratic to Republican and vice versa.

We also observe within-state shifts in the likelihood of SRI proposals' passage. In our sample, eight percent of SRI proposals are within ten percentage points of passage, suggesting that the governor's political affiliation could play a key factor in determining whether SRI proposals pass. Consistent with that possibility, we find that when a state has a Republican governor, SRI proposals are 17 percentage points less likely to pass than when that same state has a Democrat governor.

Possible Mechanisms and Investor Motivations

There are several mechanisms by which politics might influence investor votes. One possibility is that investors tailor their SRI votes to avoid misalignment between the firm and the political views of the state's workers and consumers. Alternatively, investors might directly care about the political influence of the newly elected leaders. In support of the latter mechanism, we find no evidence that the observed within-state shift in investor support is smaller when the political transition coincides with a closer election or a minor state-level change in the popularity of each party.

Several investor-related motivations could drive the observed differences in SRI votes. One possibility is that institutions adjust their votes for self-interest reasons. Tailoring votes might help avoid retaliation from local politicians, who can divest state-controlled assets from those institutions or use their influence to bring unfavorable media attention to the institution's voting stance. A second possibility is that institutions adjust their votes for fiduciary duty reasons. Pushing a firm to take actions that run counter to local political views could result in investor losses if local politicians cut the firm's state-level subsidies or tax incentives. Distinguishing between these motivations is challenging, and many of our findings are consistent with both possibilities. However, we find evidence that fiduciary duty motives play some role in the observed differences. The observed differences in votes are bigger in states that spend more of their GDP on business subsidies.

Implications and Contribution

Overall, our research contributes to the growing literature on the intersection of political partisanship and economic decision-making. Prior studies have shown that political affiliation can influence individual economic choices and corporate behavior. Our paper extends this line of inquiry by providing evidence that external political factors, particularly state-level politics, might also matter for companies' shareholders. These shifts in investor behavior, which have intensified in recent years, suggest another important mechanism by which increasing political partisanship is likely affecting the choices and governance of companies.

Moreover, our findings provide insights into the broader relationship between politics and institutional investor engagement. While various factors might drive institutions' SRI choices, including self-dealing, attracting socially minded investors, and supporting politically aligned managers, our results suggest that state-level politics also matter. This observation aligns with research highlighting how political appointments and pressure can shape public pension funds' investment decisions and voting behavior. Our findings suggest that state-level political influence extends even to private institutional investors not directly controlled by state governments.

Lastly, our results have implications for firms' CSR activities. Previous research has emphasized the role of stakeholders, legal liabilities, and judicial decisions in shaping corporate social and environmental actions. Our findings suggest an additional consideration firms might face when pursuing CSR activities—a lack of investor support when local politicians oppose such activities.