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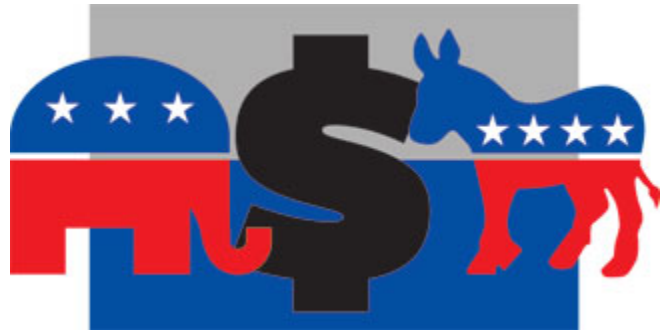
Corporate Political Donations: Ties That Bind

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Corporate Board Member

by John R. Engen

By now, most corporate leaders are at least vaguely familiar with Target Corp.'s ill-fated dalliance in the arena of financing election campaigns. During the 2010 Minnesota gubernatorial race, the big Minneapolis-based retailer gave \$150,000 to MN Forward, a pro-business fund-raising group that supported Republican candidate Tom Emmer.



Target officials say they liked Emmer's free-market economic policies, but the conservative politician also opposed gay rights. Word of the contribution, from a company that has long worn its support for equal opportunity in the workplace on its sleeve, ignited a firestorm of protest from the gay and lesbian community.

A loose alliance of activists staged boycotts and picketed Target stores around the country, and in a separate protest, but related to the company's troubled political connection, earlier this year pop music icon Lady Gaga widely publicized her pullout of an exclusive marketing deal with the retailer. Target officials met with protesters and some riled investors. They offered mea culpas and eventually beefed up the company's political spending policies and oversight. But the damage to the retailer's progressive reputation had already been done.

Prior to the contribution, Target had a perfect 100 on the Human Rights Campaign Foundation's Corporate Equality Index, which measures workplace treatment of gays and lesbians. After getting docked 15 points because of the expenditure, its score stands at 85, about middle of the pack.

At this June's annual meeting, 10 of the 12 shareholder questions for Chairman and Chief Executive Gregg Steinhafel were about the contribution and Target's response. "Does anybody have a question relating to our business that's unrelated to political giving?" an exasperated Steinhafel asked at one point. "I'd love to hear any question related to something else."

There was nothing illegal about what Target did. Indeed, in 2010, the U.S. Supreme Court affirmed the standing of corporations as "persons," with First Amendment speech rights. Money passes for speech nowadays, and that means companies are free to give as much as they want to nonprofit political front groups, or even offer more direct support to candidates (as long as they're not working in concert with their campaigns)—straight from the corporate treasury.

But as the fallout illustrates, just because a company can make political contributions might not mean

that it should—at least not without a strong oversight process in place.

“If you’re just doing a business analysis of what this did to Target’s reputation, it wasn’t a very smart thing to do,” says Timothy Smith, senior vice president and director of environmental, social, and corporate governance shareowner engagement with Walden Asset Management, a \$2 billion fund in Boston that owns shares in Target.

Walden sponsored a shareholder resolution calling on Target’s board to perform a “comprehensive review” of its political giving process. The motion was withdrawn after the retailer improved its contribution review policies and gave a board committee direct oversight of future expenditures.

“We’re not saying, don’t make political contributions,” Smith explains. “What we’re saying is, if you’re going to make these kinds of contributions, do it with your eyes open. You need to be willing and able to stand up and explain why it’s in the best business interests of shareowners.”

For boards already struggling with a backbreaking list of external demands, political spending is quickly emerging as another topic that demands attention. Politics is a bare-knuckled, elbows-flying kind of endeavor. At a time of growing partisanship, every statement of political support can generate backlash from customers and investors who don’t agree with the company’s views—or, as in Target’s case, the views it implicitly (or unintentionally) winds up supporting.

“When you engage in political spending—and that’s campaign contributions, trade association payments, independent expenditures—it carries reputational risks that need to be thoroughly assessed,” says Bruce Freed, president and founder of the Center for Political Accountability (CPA), a Washington, D.C., nonprofit created in 2003 to promote transparency of corporate contributions.

An entire mini-industry of public watchdogs and investors has emerged that carefully monitors companies’ contributions, looking for signs that companies might not be walking the talk of their values with their political dollars. Proxy advisory firms consider such information part of the evaluation criteria for their voting recommendations, mostly as part of a broader risk management review. More investors are weighing those risks, too, as part of their allocation decisions. They’re demanding both better board oversight and better disclosure from companies to limit potential damage to their investments.

The issue is hot enough that The Conference Board recently published a 52-page handbook about corporate political contributions and this summer is launching a committee to examine best practices more closely.

In the 2010 mid-term elections, trade groups, unions, and nonprofits reported spending more than \$305 million, or four times what they paid out in the 2006 mid-term elections, according to an analysis by the Center for Responsive Politics in Washington, D.C., a nonpartisan research group that tracks Federal Election Commission filings.

Nonprofit groups formed specifically to support political candidates or causes—usually organized under IRS Section 527 or as 501(c)(4) entities and known for producing advocacy and attack ads for or against candidates—told the FEC they spent \$137 million in 2010, a 25-fold jump compared to four years earlier. The total is thought to be much higher, but no one knows for sure, as many nonprofits don’t report their spending to the commission at all. (Some states, including Minnesota, have tougher disclosure laws, which is how Target’s MN Forward contribution came to light.)

Much of the funding for those nonprofits comes from corporate political action committees, which individual companies set up to support causes and candidates that will serve their interests best. These corporate PACs get the bulk of their funding from employee contributions, have separate boards, and are considered well regulated.

Far touchier are contributions like Target's that come straight from the company till. In the Supreme Court's 2010 decision in *Citizens United v. Federal Elections Commission*, the justices, by a 5-4 margin, explicitly permitted unlimited, anonymous political spending by private organizations, including corporations and unions.

It opens the floodgates to more corporate money in politics," Freed explains.

No one is saying corporations shouldn't be players in the political process. Companies have plenty of strategic and business reasons to support candidates and political groups, and many directors feel obliged to pull every lever at their disposal to boost shareholder returns.

"It would be a mistake" for a board to ban contributions to political groups like MN Forward, says Richard Kovacevich, former chairman and CEO of Wells Fargo & Co. who retired from Target's board at the end of 2010.

"It's very important that businesses get together, put their funds together, and support those candidates who have similar [views] about how we get this country growing," Kovacevich adds.

Indeed, a 2008 academic study of 819,000 campaign contributions over a 25-year period by more than 1,900 corporate PACs found a "strong correlation" between political giving and the firm's stock price.

"As you give more, your performance goes up, and you see a 2% or 3% effect on your stock price," explains Michael Cooper, a finance professor at the University of Utah's David Eccles School of Business and an author of the study. His advice to boards: "Keep giving. The more you give to powerful people in politics, the better you do economically and with your stock price."

The trick is to move carefully and be smart. Target is far from the only company to get burned by a political contribution. Retailer Best Buy and 3M Co., the industrial products maker, are both headquartered in the Twin Cities and caught flack for giving \$100,000 each to the same group as Target.

In 2005, Wal-Mart Stores gave \$300,000 to a committee seeking to defeat an anti-big-box-store proposal on the ballot in Flagstaff, Arizona. The group ran full-page newspaper ads that featured Nazi supporters burning books, with the caption, "Should we let government tell us what to read? Of course not. So why should we allow government to limit where we can shop?" The ads sparked an outcry among veterans and Jewish groups, upset at comparisons between Nazi Germany and a local proposition, and the Bentonville, Arkansas, retailer was forced to apologize.

In 2004, Merck & Co., the Whitehouse Station, New Jersey-based pharmaceutical giant, gave \$1,000 to Samac Richardson, a pro-business candidate for the Mississippi Supreme Court who also ran on an anti-gay marriage platform and once boasted to a white audience that he was "one of us." The contribution led to a story in *Time* magazine, which listed Merck among 18 companies "that gave money to judicial candidates whose conservative views clashed with [its] progressive policies." The next year, Merck began disclosing its political expenditures. "It was administrative," says Charles Grezlak, PhD, Merck's vice president for government affairs and policy, explaining the company's

earlier reticence. “It takes time and effort to disclose.”

There are other, more serious, stories, like the one about the eight out-of-state companies—including the likes of retailer Sears, Roebuck and Co.; Westar Energy, a Topeka, Kansas, power company; and Tulsa natural gas firm Williams Cos. Inc.—that were charged with making illegal contributions during the 2002 election to a group called Texans for a Republican Majority. The group allegedly funneled the money to the Republican National Committee, which then transferred it to candidates for the state House of Representatives, in violation of state campaign finance laws.

The companies reached individual settlements with prosecutors, including Sears’ agreement to give \$100,000 to fund a series of programs on “corporations in American democracy” at the University of Texas, disclose political contributions on its website, and sign off on a statement acknowledging that “the historical basis for the Texas prohibition against corporate political contributions is that they constitute a genuine threat to democracy.”

Governance wonks say such embarrassments can be avoided by laying down a firm set of principles to govern political expenditures, making sure those rules are adhered to, and posting a list of recipients on the company website. Shining a brighter light on political spending, the thinking goes, forces companies to be more careful about where the money goes in the first place.

“We’d probably be better off if the companies we’re invested in didn’t get involved in the political process at all, because they would reduce the risk of those expenditures to zero,” says Shelley Alpern, vice president and director of social research and advocacy at Trillium Asset Management Corp. in Boston.

Barring that, “they should disclose that political spending honestly and comprehensively,” Alpern adds. “It’s the shareholders’ money, and we should know where it’s going.”

More boards are buying into the concept. Sixty of the S&P 100 companies now have acceptable board oversight and disclosure policies around such expenditures, according to the CPA’s Freed. The list includes such big names as Microsoft Corp., Midland, Michigan-based conglomerate Dow Chemical Co., and insurer Aetna Inc., which publishes a 16-page report on the political spending of both the company and PAC each year.

A small number of companies, including computer maker International Business Machines Corp. of Armonk, New York, and Colgate-Palmolive Co., the New York-based consumer goods company, have policies that prohibit spending corporate money on elections.

Others, including Nike Inc., the Portland, Oregon-based athletic shoe marketer; computer-maker Apple Inc. of Cupertino, California; and PG&E Corp., the San Francisco-based power company, have withdrawn fully or partially from the U.S. Chamber of Commerce, at least in part because the group’s outspoken opposition to federal health care reform and climate change regulation clashes with their corporate values. The chamber, which does not disclose its donors and is presently opposing a proposed executive order that would enhance disclosure requirements for companies that seek federal contracts, did not respond to questions supplied to it for this story.

In a statement, the chamber complains the order would require a business seeking even the smallest federal contract to disclose the combined giving of the company and its insiders if the amount is more than \$5,000. The group fears the information will be used to “undermine current procurement laws,” which emphasize factors like price and quality of past work.

Frustrated with the lack of nonprofit disclosure, activists are pressing givers. As of mid-June, shareholder resolutions demanding better disclosure and oversight of political spending had been put to a vote at 32 U.S. companies—many of them with CEOs who sit on the chamber’s board—and garnered at least 30% support (considered a good showing) 17 times, says Freed. Eight resolutions were withdrawn after the companies reached an agreement with the shareholders.

A nonbinding resolution won 53.3% of the votes cast at Sprint Nextel Corp.’s annual meeting in May. (Sprint disputes that the resolution won a majority, noting that including abstentions, only 41% of total votes were cast in favor of the measure.) At Chicago-based commercial printer R.R. Donnelley & Sons Co., a similar resolution captured 48.7% of the votes, while 44.1% of shareholders at State Street Corp., the big Boston money manager, supported stronger disclosure requirements.

3M’s board opposed a resolution calling for a “comprehensive report” of political spending practices, including an itemized report of expenditures and the titles of decision makers, as “unnecessary and burdensome.”

The company already has a policy requiring that “political activities ... comply fully with applicable state and federal laws,” and discloses all contributions above \$50,000 to nonprofit groups, the board’s opposition statement read. “In order to advocate the company’s and stockholders’ interests, we must actively participate in the political process.”

The resolution received 32% of the shareholder vote.

To critics, this movement has the feel of a bunch of liberal do-gooders trying to leverage the corporate governance process to deny management the ability to invest in candidates whose stances could boost shareholder returns.

Shareholder resolutions to introduce greater transparency are “another attempt by self-styled ‘reformers’ to force companies to reveal their membership in trade associations that may engage in some political speech,” wrote Sean Parnell, president of the Center for Competitive Politics, an anti-campaign finance reform group, in a recent blog.

Clearly, boards need to do some soul-searching on this one, but first they need to educate themselves.

According to a 2008 survey conducted for The Conference Board and the CPA by Mason-Dixon Polling & Research, 73% of 255 board members polled wrongly believed companies must report all of their political contributions, while 38% believed political spending requires board approval (it doesn’t).

When Elaine Eisenman, dean of executive education at Babson College in Babson Park, Massachusetts, and a director at DSW Inc., the Columbus, Ohio-based shoe retailer, tried to introduce political spending as an agenda item at a recent local Women Corporate Directors meeting, “we had absolutely no support for it as a topic.” Directors “aren’t sensitized enough to the issue to understand the implications.”

It’s not unusual for board members to have no idea which groups, causes, or candidates are recipients of their companies’ largesse. Target’s board, for instance, didn’t vote on the company’s contribution to MN Forward. “I’m not even sure if, when the contribution was made, anyone on the board knew anything about it,” says Kovacevich. “If we went into detail on every contribution, that would be all the board did.”

Directors have no fiduciary duty, per se, to oversee political contributions, says Paul DeNicola, director of The Conference Board's Governance Center and Directors' Institute. And they don't need to monitor individual expenses. But given the risks, there's a strong argument to be made for better oversight and disclosure.

Many boards delegate the oversight task to a committee, though the assignments vary. For some, it's with governance, while others place it under the purview of audit or risk management. They also have been tightening controls—centralizing political giving, for instance, so the mid-level manager in Peoria doesn't write a small check to a group that later comes back to bite the corporation.

Rather than simply taking management's word for it, directors are asking tougher questions: Should their companies give money to political campaigns or groups at all? If they do, should those gifts be disclosed? Who makes the final decisions on political giving? How do we ensure the spending doesn't stray from our values? What sort of oversight is required? Is there a response plan if something goes wrong?

"It's important for a board to get away from partisan considerations and think about [political contributions] as a governance and business question," says Alan Rudnick, a Richmond, Virginia-based partner at Masters-Rudnick & Associates LLC, a law firm that specializes in governance issues. "You want to make sure the process makes sense and the right controls are in place."

Microsoft's approach is considered a model. It starts with a set of nine principles that guide the software company's political participation. The principles say, in essence, that it's critical for a global player with big concerns about trade policy, intellectual property rights, and the like to be a player in the political process. The company's MSPAC, funded by employees, gave \$6.9 million to lobbying firms last year. All political expenditures are disclosed, and there are bans on certain types of spending, including contributions to so-called 527 organizations. Microsoft will not contribute to the types of advertising-based efforts deemed legal in the Citizens United ruling. It also will not reimburse employees "directly or through compensation increases" for PAC contributions.

The company also engages in political spending from the corporate treasury, but the numbers are disclosed and relatively small, and the dollars get spread around in an inoffensive way. Of the \$500,000 in total, the Democratic Governors Association (\$110,000) and the Republican Governors Association (\$100,000) were the two biggest recipients.

Finally, an employee committee weighs all potential corporate contributions and makes decisions based on what's best for the company. The board's governance committee sits down with the general counsel's government affairs staff twice a year to review contributions.

"This is the right thing to do. It's the easy thing to do. And it fits with how we manage Microsoft," says Dan Bross, the company's senior director of corporate citizenship. "I quite honestly don't understand the resistance I see from some companies. It rings hollow to me."

At Merck, a 15-person government affairs and policy department vets political spending recommendations with an eye for potential trouble spots. A candidate might be pro-business or be a big supporter of pharmaceutical research, for instance, but "there might be another issue he supports that makes it questionable whether we should support him or not," Grezlak says.

A corporate contributions committee with representatives from various Merck business units and headed by the company's general counsel reviews the department's recommendations. If an expenditure

is approved, a check is mailed—not presented in person—to the candidate. “It’s better perception-wise” to depersonalize the contribution and create distance from the candidate, Grezlak says.

The board’s committee on public policy and social responsibility gets an annual report on the spending, which “summarizes the contributions and talks about some of the recent decisions we’ve made,” Grezlak adds. Last year, Merck gave about \$500,000 from the treasury to various candidates—figures that are displayed on the company’s website.

Merck, which endured some bad publicity for giving \$1,000 to a controversial Mississippi judicial candidate, has been pleased with the amount of feedback it has received on its political expenditures. “Since we began disclosing, we haven’t gotten one comment,” Grezlak says. “The mystery is gone.”

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