

Corporate Engagement – A short guide: How shareholders are exercising their rights to influence the behaviour of companies

Introduction

On 14 February 2014, a conference was held in Paris to discuss corporate engagement, or how shareholders can exercise their rights to influence the behaviour of companies.

The aim of the conference was for leading practitioners of engagement in the UK and France to explain what they had achieved thus far, and for engagement practices in both regions to be compared and contrasted. Participants were able to draw encouragement from what others were achieving and to envisage how more might be achieved through engagement in future.

The conference was hosted by HSBC and held in their offices in Paris and organised by (the) Forum pour l'Investissement Responsable (FIR-French SIF), in conjunction with WHEB.

This paper serves as a follow-up to the conference, attempting to highlight some of the key insights which were expressed, as well as drawing on our wider experience following decades of company engagement.

Engagement – definition and history:

Corporate engagement is, in essence, the practice of shareholders entering into discussions with company management in order to change or influence the way in which that company is run.

The focus of engagement strategies in recent years has been on remuneration of senior management, and in particular around the issue of performance-related pay. But engagement often tackles issues of corporate governance more generally, including board structure and composition. Transparency and reporting are also issues of concern, as are environmental issues.

Engagement can be pro-active, attempting to anticipate future issues which may damage the long-term profitability of a company, or reactive, where investors express their concern in the wake of a problem or following unfavourable media coverage.

Corporate engagement has come a long way in the last decade. Originally something that was carried out by 'ethical' or 'socially responsible' investors, a number of mainstream investors now engage regularly with company management.

In the UK, engagement received an important boost with the introduction of the Stewardship Code in 2010. This code was intended to enhance the quality of engagement with asset managers and was specifically intended to 'help improve long-term risk-adjusted returns to shareholders'. Shareholder engagement is also central to the UN Principles for responsible investment and legislation supporting greater shareholder engagement is also being developed in France.

**Engagement in France & UK
What can we learn from each
other?
Speakers at the 14 February seminar:**

Introduction: an 'Entente Cordiale'

- Simon Howard, Chief Executive, UKSIF
- Pierre-Henri Leroy, CEO, Proxinvest & FIR-French SIF Board Member

The engagement landscape in the UK:
Seb Beloe, Partner, WHEB Listed Equity

Investor engagement: Challenges and opportunities
Yo Takatsuki, Senior Analyst, F&C

Comparing and contrasting of French and UK engagement
Natacha Dimitrijevic, Associate Director Continental Europe, Hermes EOS

Action and vision of a leading French pension fund
Philippe Desfossés, CEO, ERAFP

Engagement – why do it?

All the speakers at the Paris conference agreed that engagement is important, both as something that investors are increasingly demanding of their fund managers, and as a way of adding value to the investment process. The speakers touched on their motivation for engaging with companies which included:

1. **Making the voice of shareholders heard.** Shareholders are the true owners of companies, not company management. Shareholders should feel able to exercise their rights (or have them exercised on their behalf by an institutional investor) and to make their voices heard. Companies should be run for the benefit of shareholders, not for management.
2. **The investing public is increasingly keen on engagement.** Investors in funds (be they pension funds or other vehicles) like to know that engagement is being carried out on their behalf. This puts the responsibility on fund management companies who are carrying out engagement to report to their investors on the engagement that they are carrying out (see 'Further Resource's below on reporting).

3. **Companies with strong ESG performance tend to outperform¹.** The financial performance of companies is improved if their environmental, social and governance (ESG) performance is better. It therefore makes sense for investors interested in maximising returns to ensure that management is addressing, and improving, key ESG issues.



4. **Promoting deeper understanding of companies.** Investment managers who engage with the companies in which they invest are likely to understand them in greater depth and so are more able to make good, long-term investment decisions. By engaging with management, investors can get a better sense of the quality of that management team.
5. **Mitigating risks and reducing volatility.** Insightful engagement, as part of the investment process, can encourage management to identify and mitigate risks. In turn that should help to reduce share price volatility.
6. **Combating the trend of short-termism.** The markets generally have only a short-term investment horizon – which is likely to undermine value over the longer term. Investors who engage with their companies are likely to be long-term in their outlook and can counter-balance these trends.

¹ See for example: Deutsche Bank, 'Sustainable Investing: Establishing Long-Term Value and Performance, June 2012 and Eccles R., Ioannou I. and Serafim G., 'The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance, Harvard Business School, 9 May 2012

Seven steps to engagement success

Based on the insights shared during the seminar, we've distilled seven steps for successful company engagement:

- 1. Clarify why you are engaging.** Being clear about why you undertake engagement will help define the methodology used to prioritise engagement activity. For example, if the focus is on mitigating risks, then develop a system that identifies high ESG risk businesses. If the motivation is primarily in responding to client demand, a more appropriate methodology might involve surveying clients to determine what the engagement priorities should be.
- 2. Be respectful and collaborative.** Building respectful and collaborative relationships is essential in executing successful engagements. Identifying and framing engagements as centred on a shared interest in the long-term health of the business is critical to securing the interest and support of senior decision-makers in businesses.
- 3. Be flexible on tactics.** Context and culture are critical in delivering effective engagement and this can vary enormously depending on the nationality of the company and its executives, capital structure, history of the business and relevant political and regulatory frameworks. Different tactics need to be deployed to match these different circumstances. This may involve engaging collaboratively or individually, focusing engagement on different people within the businesses (e.g. Board Directors, CEO, Chairman of Board Committees, operational specialist etc.) and initiating engagement through formal channels (e.g. shareholder resolutions) or informally through direct correspondence.
- 4. Challenge the status quo.** Engagement is usually about change and encouraging companies to do things differently. This requires investors to challenge the status quo and push management to alter their perspective.

“Companies with active, interested and involved stakeholders are more likely to achieve superior, long-term returns than those without.”

Hermes
- 5. Have specialist knowledge.** Many asset managers and owners have not been systematically trained in understanding ESG issues, and for many, structured engagement is also a novel idea. Companies too may be unused to engaging with investors on these issues. Specialist knowledge and support is needed on both sides to ensure that the opportunity for successful engagement is maximised.
- 6. Network with stakeholders.** Other stakeholders can often be useful allies in supporting effective engagement. This might take the form of specialist expertise among consultants or non-governmental organisations, or may involve commercial players such as customers or regulators to help frame an engagement effectively.
- 7. Don't give up!** Finally, and perhaps most importantly, engagement is rarely successful quickly. Being long term in approach helps both in managing expectations and in capitalising on the value of engagement. Most engagements are measured in years rather than months and realising the benefits of engagement through reputational or operational improvements will take place over a similar time frame.

What next for engagement?

Driven by domestic regulations as well as international frameworks such as the UN Principles for Responsible Investment, more and more asset managers and owners are 'signed up' to systematic engagement. For some though, this is likely to be 'in name' only. This approach however is unlikely to be tenable for long as regulators and asset owners step up their monitoring of engagement implementation and impact and practitioners themselves are required to report to clients and other stakeholders on their activities.

There is also likely to be more analysis of the value that engagement creates. To date there has been relatively little academic work done to test claims that engagement underpins superior risk-adjusted returns (see resources below). This will change as asset owners and managers look to ensure that these activities add value. There will also be efforts to explore how the value of long-term investing as an adjunct to engagement can be encouraged through for example, greater voting rights, increased dividends and/or 'loyalty' shares.

There will also be better measurement and reporting of impact. Leading asset managers are already reporting on their activities to clients and the wider public and in some cases efforts are also made to establish and quantify impact. The sophistication with which this is done will continue to improve as the market deepens and broadens.

Finally, engagement is still an area that is thinly resourced by most asset managers and owners. Practitioners are innovating in order to address this through; for example, the development of collaborative engagement fora such as the UN-PRI's Clearinghouse or the Association of British Insurer's Investor Exchange which are intended to improve the effectiveness of engagement. Further innovations aimed at extracting greater value from existing resources can be expected both in collaborative engagement and through more effective targeting of engagement activity.

Further resources

The following tables provide a resource for further research on shareholder engagement.

Academic Studies	Weblink
Bauer, R., Clark G., and Viehs M. (2013) The Geography of Shareholder Engagement: Evidence from a Large British Institutional Investor	http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2261649
Dimson E., Karakas O., and Li X. (2013) Active Ownership	http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
Bolton P., and Samama F. (2012) L-Shares: Rewarding Long-Term Investors, ECGI - Finance Working Paper No. 342/2013.	http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2188661
The 'Washing Machine': Investment Strategies and Corporate Behavior with Socially Responsible Investors	http://sebastienpouget.com/wp-content/uploads/2014/01/SRI6Jan141.pdf
Practitioner Reports	
F&C	http://www.fandc.com/corporate/about-us/responsible-investment/
Hermes EOS	http://www.hermes.co.uk/eos/en-gb/literature/engagementandvotingreports.aspx
WHEB – Governance and Engagement Reports	http://www.whebgroup.com/investment-strategies/listed-equity/fund-governance/engagement-and-voting-records/
Collaborative Engagement Fora	
UN-PRI Clearinghouse	http://www.unpri.org/areas-of-work/clearinghouse/
Association of British Insurers Investor Exchange	https://www.abi.org.uk/~/_media/Files/Documents/Publications/Public/2014/investment/Collective%20engagementnt%20ABI%20investor%20exchange.ashx
UK Investment Management Association Investor Forum	http://www.investmentfunds.org.uk/current-topics-of-interest/investor-forum/
CorDial, Forum pour l'Investissement Responsable – French SIF	http://www.frenchsif.org/isr/nos-actions/cordial/