Responsible Investment Association Australasia

FACT SHEET
CORPORATE ENGAGEMENT & SHAREHOLDER ACTION

# INTRODUCTION TO CORPORATE ENGAGEMENT & SHAREHOLDER ACTION

To divest or engage? It's been a hotly debated discussion for many years, with many responsible investors stating a preference to stay invested in companies favouring corporate engagement and shareholder action over divestment to improve the behaviour of companies. But what exactly is it? How does it effect change in company behaviour and how do we know if it's working?

Corporate engagement (together with shareholder action) has become one of the most often used tools in the suite of responsible investment approaches and yet it remains one of the least understood.

In both Australia and New Zealand, responsible investors cite corporate engagement as one of the top three responsible investment approaches used and more often than not, engagement is a twin approach that supports environmental, social and governance (ESG) integration.

At its best, corporate engagement consists of an investor using their ownership of a company to influence that company's behaviour on important environmental, social and governance (ESG) issues. The aim is to improve corporate performance in particular ESG areas, and ultimately to ensure that the company continues to succeed in business, to be a more sustainable business and consequently become a better investment.

## What is corporate engagement and shareholder action?

Investing in a company gives an investor ownership rights over that company, and corporate engagement is about responsibly exercising those rights to shape the behaviour of the company.

Often referred to as a part of active ownership or stewardship practice, an investor (as a shareholder) has responsibilities to oversee the sustainability of the companies they are invested in, and an active program of engagement is an important element of this.

Globally, it is increasingly understood that to be a responsible investor in a company, a program of engagement, together with thoughtfully directed voting (or proxy voting) activities, are required. These requirements are captured in many markets in the form of stewardship codes: a set of practices that asset managers and asset owners sign up to on behalf of their beneficiaries (voluntarily in Australasia but mandatory in many other jurisdictions). In this manner, corporate engagement has become an essential part of a comprehensive responsible investment practice –effectively it is about being a responsible owner of the companies that are being invested in.

Corporate engagement may be conducted through direct engagement such as direct communications with senior management or boards, filing or co-filing shareholder proposals and voting or proxy voting in alignment with comprehensive ESG guidelines.

Furthermore, corporate engagement is not solely an activity by investors in listed companies, but is also increasingly practiced by others including bond investors in corporate debt, as well as sovereign debt.

It can be useful to think of a spectrum of activities that constitute corporate engagement. These include:

- A basic enquiry to a company that seeks further information from them e.g. a written communication or private meeting seeking information or disclosures at board, executive, senior management or investor relations levels;
- A direct engagement that aims to shift corporate behaviour e.g. private meetings with executive management or board directors, presenting clear requests; building coalitions for joint meetings; joint investor letters; or investor statements that articulate investor expectations;
- Corporate advocacy such as shareholder resolutions for change e.g. filing resolutions, voting in support of ESG related resolutions, calling extraordinary general meetings, board director nominations (or voting against director nominations). Corporate advocacy can also be done in collaboration with other investors, to strengthen voice and to increase the likelihood of success;
- Divesting of a company – the eventuality when no success has been delivered via the corporate engagement steps above. This would include a communication to the company explaining why the divestment was made.

The full suite of these engagement activities is increasingly being used by responsible investors as a means of improving a company's performance and management.

## Why is corporate engagement important?

Companies that manage ESG issues typically perform better over the long term. Responsible investors have an active interest in engagement that ensures the company continues to manage these ESG issues well and proactively.

Traditionally, ethical investment has entailed investors simply avoiding investing in companies that are seen to do harmful activities (negative screening). For many, this remains an important strategy that sends a loud signal to certain companies or industry sectors (such as tobacco, coal mining, pornography, and weapons manufacturing) that their company is part of an industry acting outside of expected norms of behaviour and ethics.

In principle, negative screening and divestment reduce the capital available to certain companies and industries and is often cited to drive stigmatisation of an industry sector on ethical grounds (i.e. tobacco manufacturing produces products that are addictive and can kill people). It is a strategy that is increasingly not just used by ethical investors but also major institutional investors who have exclusions in place across their portfolio – such as for tobacco producers.

However, by excluding or divesting a company from an investment portfolio, there is a greatly reduced opportunity to then influence change in that company. Being an investor in a company provides a unique position to flex that ownership muscle to put forward the case for change.

Also, when considering broader issues such as climate change, relying solely on a divestment strategy is unlikely to tackle the climate emergency. To align with the Paris Agreement towards a net zero economy by 2050, all sectors of the economy will need to transition, and all companies have a role to play in that transition. This extends beyond stopping the mining, extraction, production and use of fossil fuels, and many companies will need to shift their focus away from dirtier activities towards lower carbon activities. Most large investors will hold investments in companies that need to be influenced to transition at a faster rate than they otherwise would, and corporate engagement can influence and hasten activity. This applies to many other issues, such as avoiding modern slavery in supply chains, managing biodiversity impacts, and the fair and appropriate payment of taxes among others.

Many investors will also conduct corporate engagement ahead of making an investment in a company, signalling the importance of different ESG factors in deciding whether and what quantum to invest.

## How are investors using corporate engagement?

A comprehensive corporate engagement strategy is generally set up with clear objectives, target companies, a time bound process, a carefully articulated set of asks (e.g. disclosures, better information, changed behaviours), monitoring of progress against those objectives, and meetings. Furthermore, an investor's voting activities are an important tool in the tool kit to support engagement activities, and can be used to vote in support or against an ESG resolution, and to add strength to an engagement process.

Leading practice in corporate engagement by investors includes the public disclosure of reports on engagement activities and outcomes, and disclosure of voting records by the investor. While engagement reports may not disclose every meeting held or every company engaged, they will often cite the key themes targeted and addressed, and provide insights into progress against objectives. An engagement strategy is usually supported by a clear set of escalation options if progress is not achieved, or responses by a company not adequate. Ultimately, an investor has at the end of that escalation process, the option to divest.

## Examples of corporate engagement

Contemporary engagement themes include increasing gender diversity in leadership positions; strengthening climate change disclosures and action, such as setting emissions reductions targets; limiting damaging lobbying activities; improving labour rights protections, reducing risks of the use of modern slavery practices; establishing industry standards for mine tailings dams; and improving the sustainability of palm oil production and plantations.

Examples of where corporate engagement has been successful include:

- NZ Super Fund convened a group of global investors to pressure social media companies to prevent streaming and distribution of objectionable content, as a direct result of the Christchurch massacre in 2019. The Christchurch Call brings together over 100 investment organisations managing US$7.5 trillion in an engagement with Alphabet, Facebook and Twitter. It calls on governments and tech companies to eliminate terrorist and violent extremist content online.

- In the wake of a mass shooting in El Paso in 2019, Calvert Research and Management and other US investors successfully pressured Walmart to cease selling assault weapons and ammunition in Walmart Stores.

- Following the spate of mine tailings dam collapses across 2019, an international group of investors, led by the Church of England Pension fund engaged members of the mining sector to lift standards of safety in tailings dam management to avoid future collapses. This work resulted in new minimum standards being adopted by the International Council on Mining and Metals.

- Extensive engagement by investors of carbon exposed companies has started to improve disclosures and strengthen action on climate change. Areas of successful engagement include: miners and fossil fuel companies committing to net zero emissions by 2050; greater disclosures of climate risks through scenario testing; large miners leaving global industry bodies who have lobbied against practical climate change action; and some record votes by investors in support of climate change resolutions, including over 50% voting in support of a resolution for better climate risk transparency at the Woodside AGM in early 2020.

## Corporate engagement and proxy advisory services

There are various organisations in Australia and New Zealand – such as the Australian Council for Superannuation Investors, CGI Glass Lewis, ISS, Ownership Matters and Regnan – which help institutional investors manage their relationships with the companies they are invested in, from engaging with companies on behalf of investors to influence positive ESG performance, to providing research and analysis on issues which feature in shareholder resolutions, to providing proxy voting recommendations.

The Australian Centre for Corporate Responsibility provides retail and individual shareholders with the opportunity to engage in advocacy with companies, by putting forward shareholder resolutions on issues such as climate change and human rights.

## Further resources

- RIAA measures and monitors leading practices by responsible investors in Australia and New Zealand in our annual Responsible Investment Benchmark reports. Our Super Study unpacks the engagement practices of the top 50 super funds in our region.
- How ESG Engagement Creates Value for Companies and Investors – PRI
- Walk the Talk: On Engagement and Proxy Voting – an Australasian Perspective – ISS

**ABOUT RIAA**

The Responsible Investment Association Australasia (RIAA) champions responsible investing and a sustainable financial system in Australia and New Zealand. RIAA is dedicated to ensuring capital is aligned with achieving a healthy society, environment and economy.

With over 300 members managing more than $9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand.

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