# LOCAL LEADS, BACKED BY GLOBAL SCALE: THE DRIVERS OF SUCCESSFUL ENGAGEMENT

BACK

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One of the central tenets of responsible investment is engagement with investee companies. This is enshrined in the PRI's Principle 2, "We will be active owners and incorporate ESG issues into our ownership policies and practices," and it is practiced by more than 85% of PRI signatories with listed equity holdings. The PRI encourages and facilitates collaborative engagement, yet robust evidence of its effectiveness in driving corporate change and creating value for investors remains elusive.

Our detailed study, summarised here, provides the first detailed, global evidence of the impact of collaborative engagements. We find that successful engagements improve profitability at target companies, and we identify the key characteristics that lead engagements to be successful.

Our findings provide a business justification for investors to engage with investee companies, and suggest a model of the best way to go about it.

**Table 1: PRI coordinated engagements by region 2007–2017**

| Geographic region | No. of dialogues | No. of targets | No. of countries |
|---|---|---|---|
| Developed Europe ex-UK | 551 | 277 | 16 |
| Emerging and Frontier | 403 | 264 | 37 |
| Other developed ex-US | 314 | 193 | 8 |
| US | 291 | 163 | 1 |
| UK | 112 | 67 | 1 |
| **All regions** | **1,671** | **964** | **63** |

**Table 2: Successful PRI coordinated engagements by broad theme 2007–2017**

| Engagement theme | No. of dialogues | No. of successful dialogues* | Mean (median) days till success* |
|---|---|---|---|
| Environmental | 750 | 209 | 622 (610) |
| Social | 176 | 85 | 1,122 (1,168) |
| Governance | 75 | 63 | 1,069 (1,126) |
| UNGC reporting** | 670 | 71 | 485 (393) |
| All themes | 1,671 | 428 | 738 (730) |

*Information on whether or not an engagement was successful is available for 1,016 of the 1,671 engagements.

**Engagements that address reporting on the application of the UN Global Compact principles.

The PRI coordinated 1,806 collaborative engagements between its launch in 2006 and the current time. Of these, 1,671 involved companies for which market capitalisation data is available in the fiscal year before engagement. Engagement is through a process of dialogue, defined as a sequence of interactions between an investor and a company on a specific issue.

Over the period covered by our sample, these dialogues involved 225 investment organisations (asset owners, investment managers and engagement service providers) from 24 countries, and 964 target companies from 63 countries (Table 1). The database also includes information on the strategy and success rates for each engagement. Success rates have been defined by PRI professionals based on a set of criteria and scorecards defined at the beginning of each project (Table 2).

## EFFECTS AND CHARACTERISTICS OF SUCCESSFUL ENGAGEMENT

After engagements have concluded successfully, we find target companies experience improved profitability, as measured by return on assets, and increased ownership by the lead investor who conducted the dialogue on behalf of the coalition.

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Unsuccessful engagements experience no change in return on assets or in shareholding.

Two key features make collaborative engagements more or less likely to succeed:

First, leadership is decisive. In collaborative engagements, success rates are elevated by about one-third when there is a lead investor heading the dialogue on behalf of the coalition, and success rates are particularly enhanced when that investor is headquartered in the same region as the target firm. For maximum effect, coordinated engagements on ESG issues should have a lead investor that is well suited linguistically, culturally and socially to influencing target companies.

Secondly, the scale of investor influence is important. Success rates are higher when participating investors are more numerous, when they own a bigger proportion of the target company and when they have more total assets under management. This is especially important when investors are engaging across national boundaries.

Supporting investors are crucial: they should ideally be major institutions that have influence because of their scale, ownership and geographic breadth.

## WHICH COMPANIES GET TARGETED?

Engagements tend to be with the largest firms in their respective industry and country. These firms offer the biggest bang for the buck when investors are dedicating resources to active ownership. We compare each target firm with a control group of companies from the same country and industry, with as close a market capitalisation as possible.

Investors tend to target more mature and liquid firms, and those where there is higher institutional ownership, which can strengthen the power of the engagers' voice. Targeted companies tend to have lower stock-return volatility, higher profitability, and larger market capitalisation. Non-US companies are more likely to be targeted if their shares trade not only in their home market, but are made readily available to US investors through ADRs – American depositary receipts (Table 3).

PRI-coordinated engagements are heavily directed towards the manufacturing sector, followed by infrastructure, and wholesale and retail trade. Apart from agriculture, for which there are few initiatives, engagements in an industry group involve companies located in at least 12 and up to 52 different countries, depending on the industry (Table 4).

**Table 3: Difference between target firm and matched control group in pre-engagement***

| Firm characteristics | Average difference | t-statistic | No. of observations |
|---|---|---|---|
| ADR firm indicator | 0.35 | 30.13 | 1,587 |
| Shareholding of institutions | 0.28 | 29.03 | 1,587 |
| Shareholding of independent institutions | 0.24 | 27.27 | 1,587 |
| Shareholding of pension funds | 0.04 | 25.32 | 1,587 |
| Shareholding of mutual funds | 0.06 | 22.24 | 1,587 |
| Stock return volatility | -0.04 | -22.13 | 1,563 |
| Return on assets | 0.08 | 16.68 | 1,584 |
| Market capitalisation (US$ billion) | 35.38 | 15.63 | 1,587 |

*Abbreviated table. Differences between targets and matched controls omitted when absolute value of the t-statistic is below 15.

**Table 4: Successful PRI coordinated engagements by broad theme 2007–2017**

| Industry sector | No. of dialogues | No. of targets | No. of countries |
|---|---|---|---|
| Manufacturing | 795 | 451 | 52 |
| Infrastructure | 231 | 141 | 35 |
| Wholesale and retail trade | 193 | 92 | 31 |
| Mining | 189 | 97 | 24 |
| Financial | 120 | 79 | 34 |
| Services | 73 | 61 | 21 |
| Construction | 34 | 24 | 12 |
| Non-classifiable | 34 | 17 | 13 |
| Agriculture | 2 | 2 | 2 |
| All sectors | 1,671 | 964 | 63 |

## LESSONS FOR INVESTORS WORLDWIDE

Our earlier research, which can be viewed at www.tinyurl.com/ActiveOwn, analysed a major investor's engagements with US firms between 1999 and 2009. We found that dialogue involving a group of like-minded investors was instrumental in increasing the success rate of engagements on environmental and social (E&S) issues: after successful E&S engagements, companies experienced favourable stock market returns, better accounting performance, improved governance, and greater institutional ownership. That paper was the first to demonstrate the value of engagement, but did so only from a US viewpoint. Our new, innovative study expands the evidence to a global canvas, and turns attention to collaborative engagement as a crucial tool for responsible investors worldwide.