

# Making a Positive Impact: The State of ESG Advocacy and Engagement

by Julie Fox Gorte, Ph.D., Senior Vice President for Sustainable Investing

Shareholder advocacy and engagement comes in many flavors. Most shareholders approach company ownership passively: they buy and sell shares, and they vote their proxies. A few shareowners also engage companies directly, either one-on-one, or through group engagements, and occasionally through the mechanism of a shareholder proposal. This type of engagement is collectively known as *shareholder activism*, but that term is also used to broadly describe the activities of hedge funds and other so-called activist funds that take large positions in firms with the specific intention of changing their policies or behavior, with a specific and often short-horizon financial return as the objective.

What I'm going to talk about here, and what we do at Pax World, is *not* that kind of activism: sustainability advocacy and engagement is aimed at longer-term outcomes, and specifically targets environmental, social and governance (ESG) factors. The goal is to improve companies' profiles through sustainability.

This type of engagement is gaining prominence. The US Forum for Sustainable and Responsible Investment reports that between 2014 and the first half of 2016, 176 institutional investors and 49 investment managers collectively controlling over \$2.5 trillion in assets under management filed or co-filed shareholder resolutions on ESG issues.<sup>1</sup> For the 2016 proxy season,<sup>2</sup> over half of the 370 shareholder proposals filed concerned two issues: environment (33% of all proposals filed) and political activity (26% of all proposals filed), according to the Sustainable Investments Institute.<sup>3</sup>

## KEY TAKEAWAYS

- » Sustainability advocacy and engagement is aimed at long-term outcomes and specifically targets ESG factors.
- » We engage with companies because we believe that improving companies' sustainability profiles makes them better investments, and helps them perform better in the long run.
- » Shareholders can be a powerful force affecting companies' strategies and performance – this work is making a difference.

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<sup>1</sup> The Forum of Sustainable and Responsible Investment, "Report on US Sustainable, Responsible and Impact Investing Trends 2016," November 2016.

<sup>2</sup> A proxy season is the term applied to the season in which most publicly traded companies hold their annual shareholder meetings. Over half of these meetings occur in spring, which is loosely referred to as "proxy season" in the United States.

<sup>3</sup> Heidi Welsh, "Proxy Season Forecast: Social and Environmental Proposals in 2016," Sustainable Investments Institute, February 16, 2016.



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Though we do not have reliable figures on the extent of engagement beyond these statistics, it is quite likely that the extent of engagement on ESG issues is much larger than this. Major asset managers such as State Street Global Advisors, BlackRock, Morgan Stanley, and others report that they engage with companies or directors regarding climate change, particularly with regard to risk. The Principles for Responsible Investment hosts a clearinghouse in which many investor signatories engage with companies on a wide variety of ESG issues, including fresh water access, the impact of hydraulic fracturing, climate risk disclosure and greenhouse gas emissions, tax responsibility, sustainable protein, and more.

Investors who devote time and resources to engagement on sustainability issues likely do it not to be gadflies, but because they believe, as we do at Pax, that improving companies' sustainability profiles makes them better investments, and helps them perform better in the long run.

There is abundant evidence that companies that do better on sustainability metrics also perform as well as or better than their peers financially. It is more difficult to assign a financial outcome to an engagement that, in many cases, may last for years, but at least one effort to examine the impact of this kind of ESG engagement shows that activism on material issues is associated with superior financial performance.<sup>4</sup>

More good news: When we look at shareholder proposals, it is clear that support for well-crafted ESG proposals is going up, with vote counts rising from around 14-15% a decade ago to over 20% in recent years. Moreover, the number of proposals that achieve votes in favor of 20% or more has doubled over the past decade.<sup>5</sup>

While a favorable vote of 20% might seem underwhelming, it is useful to understand that at many companies, the insiders own significant percentages of outstanding shares, and almost always vote with management. Combined with the fact that many of the largest shareholders of many companies are index funds that have a blanket policy of opposing most, if not all, shareholder proposals, a vote total of 20% or more is often seen as a constituency worth paying attention to, and many companies do.

Shareholders can be a powerful force affecting companies' strategies and performance; however, achieving significant change can be a slow process. The investors that have strong advocacy programs are long-term investors, and we know that even slow progress is still progress. Board diversity is an excellent example of this. A few investors, including Pax, have been working to achieve greater diversity on boards of directors for decades, and those efforts have begun to achieve notable success.

A recent article on the Harvard Law School Forum on Corporate Governance and Financial Regulation website noted that 2016 was a "breakout year" for gender diversity in the U.S., and noted that "momentum toward gender parity on boards is building, particularly in the top tier of public corporations."<sup>6</sup> The California teachers' pension fund CalSTRS wrote to 125 companies

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<sup>4</sup> George Serafeim, "Shareholder Activism on Sustainability Issues," Harvard Business School, July 25, 2016.

<sup>5</sup> Heidi Welsh, "Proxy Season Mid-Year Review: Social, Environmental & Sustainable Governance Shareholder Proposals in 2016," Sustainable Investments Institute, August 15, 2016.

<sup>6</sup> David A. Katz and Laura A. McIntosh, Wachtell, Lipton, Rosen & Katz, "Corporate Governance Update: Prioritizing Board Diversity," Harvard Law School Forum on Corporate Governance and Financial Regulation, January 30, 2017.

whose boards were all-male urging greater efforts to advance gender diversity, and 35 of them did appoint female board members.

At Pax, we have voted against or withheld proxy votes from all board slates with fewer than two women for several years, and each time, we have written to the companies explaining the reason for our votes. This has resulted in several productive dialogues with companies, as have the shareholder proposals we have filed urging companies to assure in their Nominating Committee Charters that every board search include diverse candidates. We have been able to successfully withdraw every shareholder proposal we have filed on board diversity, and several of the companies have subsequently added women to their boards.

Progress toward greater board diversity is still slow—it inches up a few percent each year, but while it is increasingly rare to find a large company with no women directors, there are still plenty of smaller companies with all-male boards. But the topic is no longer a fringe issue. The fact that companies with better gender diversity in the ranks of decision-makers (board and management) tend to perform better financially is well established.<sup>7</sup>

Would progress have happened without investor engagement? It's impossible to know; we can't test a counterfactual argument. But what we do know is that investor efforts to advance board diversity have coincided with a period of progress in the gender diversity of boards. That is the way advocacy and engagement works.

And that is why we continue to move forward with these efforts—it *is* making a difference.

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<sup>7</sup> See PaxEllevate.com for a collection of studies linking gender diversity and corporate performance: <http://www.paxellevate.com/resources/gender-research>

## Pax World Management LLC

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