

Making the case for the common good

[Print](#)

By Mike Scott

Published: September 7 2008 20:48 | Last updated: September 7 2008 20:48

Engagement is one of the main tools in the armoury of active institutional investors – but how effective is it and does it need to evolve to remain relevant?

Engagement is “about entering into a dialogue with the companies we invest in, with regulators and other important stakeholders to bring about actions that are in both parties’ interests”, says Karina Litvack, head of governance and socially responsible investing (SRI) at F&C.

Although a relatively new activity, engagement has been a success, Ms Litvack says. “Ten years ago, companies did not have available the information investors needed to work out the risks to their investments, or thought that the issues we were raising, such as corruption or environmental management, were not their concern. That has changed dramatically.”

There are some areas of engagement where the arguments have been won, such as health and safety, where there is virtually universal recognition that failing to deal with the issue will have a material impact on company performance.

Corporate governance is another key focus for the engagement community. Partly this is because the importance of good corporate governance to investor returns is well recognised and partly because the structure to engage, through annual meetings, is well established.

“Corporate governance, with its focus on protecting shareholder rights and value, is the way in [to engaging on other issues],” says Ian Burger, director of investment management at Newton.

However, according to Penny Shepherd, chief executive of the UK Social Investment Forum, “an increasing range of issues is seen as material”. One of the most obvious examples of this is climate change. “People used to question whether climate change would be material to investments. Now the idea that it will have an impact is not significantly challenged.”

Climate change is one of a range of issues that show up the limitations of engaging with companies, according to Rory Sullivan, head of investor responsibility at Insight Investment. The public policy framework around the issue is not clear enough, making companies reluctant to make substantial low-carbon investments for fear of being left with stranded assets. “The incentives for companies to think about these kinds of issues are not very strong, so investors need to direct some of their energy towards public policy.”

Ms Litvack agrees. “You could say we have had a huge success with climate change because everyone is talking about it, yet we are stuck in a terrible rut. Even with everything we know, we are not changing our behaviour,” she says. “Business has to engage government and say ‘we have the will and the technology to deal with climate change, but we cannot do it unless you change the regulatory framework’.”

Climate change and other environmental issues have grabbed the headlines in the past few years and investors do not seem to be looking at other environmental, social and corporate governance (ESG) issues in the same way.

“Responsible investment is not just about climate change or corporate governance,” says Dr Sullivan. “HIV and the pricing of medicines are equally clearly market failures, for example, but investor engagement with public policy has not been as intensive or as structured as it has been on climate change.”

Corruption is another key issue that must be addressed, says Ms Litvack. “Corruption undermines

everything else – for example, it is really important that we deal with deforestation, which is responsible for 20 per cent of emissions, but corruption thoroughly undermines efforts to deal with the problem.

“It is a massive cause of poverty and a brake to effective development in countries that hold the commodities that hold the key to future growth. Dealing with this is something that is clearly in the interests of all investors.”

Finding the issues that “it is in the interests of all investors to address, but where it is not worthwhile for individual investors to pursue them”, is one of the aims of the engagement clearinghouse, set up under the auspices of the Principles for Responsible Investment (PRI), says executive director James Gifford.

Engaging with companies in emerging markets will become increasingly important as the global economy expands. A report by the Social Investment Research Analyst Network at the start of the year revealed that 87 per cent of emerging markets companies offered some kind of sustainability disclosure, with South Africa leading the way and Chinese companies lagging behind. Siran’s emerging market disclosure initiative is pushing for increased disclosure in emerging market countries.

“There is a long way to go,” says Mike Lombardo, senior social research analyst at US investor Calvert, “but look at the momentum. There is much more consciousness about ESG issues among emerging market companies now.”

Engagement must be viewed from a long-term perspective, adds Emma Howard Boyd, head of SRI and governance at Jupiter Asset Management. “You are not necessarily going to see instant results because a lot of the impacts involved are long-term.”

The focus of engagement must be the impact of an issue on business performance, says PRI’s Mr Gifford. “The business case is the key to successful engagement – it is all about persuading businesses that dealing with ESG issues is in their best interests.”

Engagement is not easy, though. It needs consistency and patience on the part of the engaging organisation and it needs to be taken seriously, says Mr Gifford. “It is incredibly resource intensive – you need specialists who can build up relationships over a number of years.”

Copyright The Financial Times Limited 2008

"FT" and "Financial Times" are trademarks of the Financial Times. [Privacy policy](#) | [Terms](#)
© Copyright The Financial Times Ltd 2008.