

Exploring the Impacts of Shareholder Activism on Sustainability

A Shareholder Activism for Sustainability Report



In collaboration with:



Introducing Shareholder Activism for Sustainability

The Issue

Shareholder activism, where shareholders attempt to influence a company's decisions by exercising their rights as owners, is on the rise. Much of this publicised activism has focused narrowly on improving financial performance, with potential implications for broader sustainability considerations.

Meanwhile, some investors and other activists, usually local and small in comparison, have been engaging companies on sustainability issues, with concrete results. However, these efforts are usually too diffuse and small-scale to achieve sustainability at the pace and scale required.

The Shareholder Activism for Sustainability Project

The Luc Hoffmann Institute and SustainAbility *Shareholder Activism for Sustainability* project aims to convene diverse thinking and practice on the issue of shareholder activism and generate new insights into the intersection of this critical issue with sustainability.

This Report

In April 2018, the Luc Hoffmann Institute published *Shareholder activism: Standing-up for sustainability?* The report examines the current landscape and highlights opportunities, risks and challenges of shareholder activism for sustainability. This report builds further on that research: it explores the potential impacts of shareholder activism on corporate sustainability and seeks to identify opportunities for longer-term approaches that generate wider benefits.

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In coordination with and support from the Luc Hoffmann Institute

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Foreword

Over the past three decades, SustainAbility has taken an active part in driving the evolution of private sector performance on sustainability. Whilst we have seen advances, it is clear that progress is neither at the pace or scale that is required to support a thriving economy operating within ecosystem limits. A step-change is needed.

We believe that shareholders and investors will play a critical role in enabling the transition to a sustainable economy. Shareholder activism has been shown to be an effective tactic to drive forward the sustainability agenda on key issues such as climate change and corporate governance. However, not only do we need more of this, we must broaden the scope of impact to issues currently under-addressed (including biodiversity, health and inequality). Doing so will require shareholders to see the relevance and value of sustainability to their investments, and encouraging stakeholders with an interest in the long-term to

actively use the influence of their shareholding to safeguard against sustainability risks and maximise related opportunities.

In the context of an upcoming climate risk proposal, ShareAction's CEO, Catherine Howarth, recently described one oil major's investors as falling into three groups: "those willing to act to address the risks...; those unwilling to act who have done a lot of talking about the risks...; and those who neither talk nor act on the matter." We are pleased to be partners of the *Shareholder Activism for Sustainability* project and hope that this report serves an opportunity to engage all three of these groups – bringing together diverse actors and generating new insights in support of shareholder activism for sustainability.

Rob Cameron

Chief Executive, SustainAbility



Our recent research [Targeting Value](#) and [Closing the Sustainability-Investor Relations Gap](#) highlights the need for greater clarity, engagement and focus on the impacts of sustainability on corporate performance and the critical role that shareholders have to play. In [Orchestrating Change](#) we address the fact that, whilst the need for collaborations that break down traditional silos is widely recognised, examples of truly effective partnerships are the exception rather than the norm. These reports, alongside detailed desk research and interviews, inform the insights presented in this report.



Executive Summary

Exploring the Impacts of Shareholder Activism on Sustainability provides insights on the shareholder activism landscape, describes the potential impact of financially and sustainability-motivated shareholder activism on corporate sustainability and presents opportunities to deepen thinking and support further collaboration and engagement on this critical issue.

We draw the following key conclusions:

“Short-termist” shareholder activism is primarily a symptom of system-level drivers and a narrow interpretation of corporate performance:

Financially-motivated shareholder activism is often perceived as driven by the motive of maximising short-term gains. Whilst actively engaging with companies to implement changes can boost financial shareholder value, we do not find that these approaches are conducted necessarily or explicitly at the expense of long-term performance. Indeed, some research even supports the idea that financially-motivated shareholder activism can improve a company’s robustness (on some measures) for the long term, however the evidence is mixed.

Where it exists, short-term activism is likely an indirect consequence of two contributory factors, rather than an explicit focus on a quick profit. These factors are:

1. The systemic conditions in which these activities are conducted (incentives structures, quarterly reporting, CEO tenure, shareholder structure etc.) and;
2. A narrow focus on traditional corporate performance metrics or financial evaluation models that fail to take into account broader (typically non-financial) performance factors.

This not only weakens the long-term prospects of the company (through failure to address significant risks and explore related opportunities) but exacerbates impacts on broader environmental and social capitals on which the company depends.

Further research is required to assess the impacts of financially-motivated activists on sustainability:

Our research suggests that, although there are many projects looking at the contributory factors of systemic short-termism and developing fit for purpose metrics (including Focusing Capital on the Long Term (FCLT) and the Embankment Project for Inclusive Capitalism), there are few if any which consider the impact of financially-motivated shareholder activists on sustainability. We believe valuable insight would be gained from a longitudinal analysis of the impact of shareholder activism on corporate sustainability performance.

We identify the following opportunities:

Activism to galvanise progress on sustainability:

We see evidence that shareholder activism for sustainability can be a successful tool in driving improvements in corporate sustainability. However, despite the clear examples referenced in this report and set by organisations including ShareAction and Farm Animal Investment Risk and Return (FAIRR), it is not evident that a sufficient number of actors in the wider NGO and sustainability sphere are adopting this mechanism to support their aims. In particular, we highlight foundations and family offices as significant asset owners who may have appetite for more activist approaches.

We believe that there is an opportunity to galvanise progress on sustainability through:

- ▶ Enabling sustainability-oriented organisations to adopt shareholder activist tactics, build coalitions and engage companies and investors on sustainability issues.
- ▶ Encouraging sustainability-oriented organisations to educate and inform financially-motivated shareholder activists on the material sustainability risks and opportunities relevant to target investments and the benefits of integrating environmental, social and governance (ESG) factors into decision-making.

Embed sustainability into financially-motivated shareholder activism:

The corollary of the above, we invite investors to see sustainability-motivated shareholder activists as valuable partners, collaborators and sources of insight. Engaging with these organisations can provide a useful source of subject-matter expertise on the material risks presented by the erosion of environmental and social capital in the short, medium and long term.

Encourage passive, long-term shareholders to be more active:

Passive shareholders comprise a growing portion of the investor landscape. As both the responsibilities of passive funds grow, and activism matures as a strategy, the role of passive investors is evolving. The largest passive investors understand that their clients want to see evidence of more active engagement. We see an opportunity to support institutional investors to adopt activist tactics that incorporate long-term sustainability considerations. Social and environmental NGOs and sustainability-motivated shareholder activists can play a role in supporting this shift towards activism.



1 Understanding shareholder activism

What is shareholder activism?

The term “shareholder activism” refers to a range of activities undertaken by one or more shareholders in a publicly-traded corporation, who purposefully use their equity stake to influence the target company’s behaviour.¹

A shareholder activist typically seeks to make a significant and direct impact on the management decisions of the companies they target. However, there is a wide spectrum of shareholder activists, who employ a broad range of tactics to achieve the desired objective(s) at the target company.

Who are the key actors in an activist campaign?



The activist spectrum ^{2,3,4}

Level of activism	<p>Primary Focus Activists Investors that specialise exclusively in activism.</p>	<p><i>Example:</i> This includes established pure-play funds (such as Trian Fund Management, Pershing Square Capital Management), whose principal investment strategy is to generate risk-adjusted excess returns. It also encompasses new activist funds continually being launched.</p> <p>This also includes engagement activists such as ShareAction and FAIRR who seek to influence the sustainability performance of companies and investors alike.</p>
	<p>Partial Focus Activists Investors that specialise in activism amongst other strategies.</p>	<p><i>Example:</i> This includes multi-strategy hedge funds that have diversified their approach to include activism.</p>
	<p>Occasional Focus Activists Investors that do not include activism as part of their regular investment strategies but make infrequent, opportunistic activist plays.</p>	<p><i>Example:</i> Typically includes private equity funds (such as Neuberger Berman, T. Rowe Price).</p>
	<p>Emerging Activists Passive investors that are becoming more active.</p>	<p><i>Example:</i> Institutional (mutual funds, investment advisors and pensions funds) or individual investors (that do not have the luxury of exiting a stock) that most commonly push for governance changes.</p>

The tactics ^{5, 6, 7}

There is a spectrum of activist tactics or activities

◀ Less Hostile / Private Approach		More Hostile / Public Approach ▶		
Prepare	Private Engagement	Escalate Ownership	Launch Public Campaign	Force Change
<p>Research: speak with competitors, industry experts, former/current employees, suppliers and customers</p> <p>Contact shareholders to assess likelihood of support</p> <p>Acquire stock without public disclosure: accumulate ownership through a mix of equity and derivatives, avoiding regulatory disclosure for as long as possible prior to launching campaign</p>	<p>No publicly disclosed activism</p> <p>Approach management privately for discussions regarding proposal / demands</p> <p>Request meeting with the board to present thesis</p> <p>Request board seats privately</p>	<p>Increase ownership through a mix of equity and derivatives in order to apply pressure on management</p> <p>Leverage local regulatory filings (public disclosure requirements) to initiate and encourage trigger churn in shareholder base</p> <p>Attract other like-minded activists to increase leverage on management</p>	<p>Release publicly disclosed letter / presentation to management</p> <p>Publicly criticise management and board performance</p> <p>Letter to shareholders</p> <p>Lobby proxy advisors for support for potential proposal</p> <p>Lobby research analysts for public support through sell-side research</p>	<p>Launch proxy fight</p> <p>Issue shareholder proposal</p> <p>Discredit current board as entrenched and ignoring shareholder interests</p> <p>Nominate opposing slate of directors</p> <p>Work with a strategic partner to catalyse M&A</p> <p>Hostile acquisition offer</p> <p>Litigation</p>

Shareholder activism motivations and objectives

Just as there is a range of activist types and activist tactics, so too is there a range of activist motivations and objectives. For the purposes of this report, we distinguish between “financially-motivated activists” and “sustainability-motivated activists”. However, we recognise that there are nuances to the motivations of shareholder activists and, in some cases, convergences between these two positions.

The campaigns of “financially-motivated activists” tend to focus more narrowly on issues related to the financial interests of shareholders only – emphasising profitability, growth, governance and value per share. M&A-related campaign demands (influencing the structure and outcome of M&A) are a strong focus and represented approximately 75% of the total value of activist demands globally for the 2016 and 2017 proxy seasons.⁸

Meanwhile, the campaigns of “sustainability-motivated activists” tend to focus on issues related to the interests of a broader range of stakeholders, including employees, customers and creditors⁹ – emphasising outcomes that positively influence the ESG performance of companies.



Financially-motivated activist objectives may include: ¹⁰

- Capital allocation/return
- Break-up/divestiture
- Sale of company
- Pursue acquisitions
- Oppose merger
- Operational/cost structure
- Governance/management changes



Sustainability-motivated activist objectives may include: ¹¹

- Board diversity
- Employee retention
- Environmental impact
- Supply chain ethics
- Data security and privacy

What timeframes are involved?

Activist holding periods are typically short-term: almost half of activist campaigns are shorter than six months, whilst the average holding period of the largest long-only institutional investors is about three years.¹² However, if compared with typical equities hedge funds, activist funds frequently hold positions for longer.¹³

2 The shareholder activism and short termism debate

Does shareholder activism drive shareholder value in the long term?

Evidence and opinions differ as to whether the short-term abnormal returns following activist interventions come at the expense of subsequent declines in target performance over the long term.¹⁴ There are two overarching schools of thought:

1 Hedge fund activism is a market-driven correction that has turned shareholder governance rights into an effective means of value enhancement.¹⁵

A 2015 study (Bebchuk, Brav, Jiang) tested the validity of the claim that interventions by activist hedge funds have a negative effect on long-term shareholder value and corporate performance. It looked at 2,000 activist interventions between 1994 and 2007 and examined the five-year window following activist interventions. It found no evidence that activist interventions are followed by short-term gains in performance that come at the expense of long-term performance.¹⁶

"It's rarely the case that an activist hedge fund can create the value-enhancing changes it envisions based solely on their own position in the company. To succeed, the fund needs the support of other large investors, such as pension funds and the large passive asset managers. Since both of these types of investors have a long-term view, they are not going to support an activist campaign that is value-destroying over the long-term. The activist hedge fund will have to make a convincing case to them regarding the reasons for and benefits of the changes they are seeking."

Robert Eccles, Saïd Business School,
University of Oxford

2 Hedge fund activism is primarily motivated by short-term interests and seeks interventions that boost a target's short-term share price at the potential expense of long-term performance.¹⁷

Conversely, a subsequent 2015 study (Cremers, Giambona, Sepe, Wang) showed that hedge fund activism more likely destroys long-term value, rather than creates it. It found that the positive long-term association documented in prior studies is likely affected by selection bias, as activist hedge funds tend to target poorly performing firms.¹⁸

"...the effects of the short-termist phenomenon are troubling both to those seeking to save for long-term goals such as retirement and for our broader economy. In the face of these pressures, more and more corporate leaders have responded with actions that can deliver immediate returns to shareholders, such as buybacks or dividend increases, while underinvesting in innovation, skilled workforces or essential capital expenditures necessary to sustain long-term growth."

Larry Fink, Chairman and Chief Executive Officer,
Blackrock, 2015¹⁹

Our Conclusion

We find that existing studies typically focus on the economic performance of the company, and do not explicitly explore the link to wider environmental or social performance measures. There is limited coverage of the consequences of shareholder activism on sustainability and this report seeks to act as the starting point to explore this further.



3 Sustainability and shareholder activism

Shareholder activism has significant potential to influence global sustainability, negatively or positively. In the following pages, we explore these two contrasting outcomes from the perspective of both financially-motivated activists and sustainability-motivated activists.

We ask three fundamental questions:

a.

Does **financially-motivated** shareholder activism impact corporate behaviour **at the expense of sustainability**?

b.

Could **financially-motivated** shareholder activism influence corporate behaviour **for sustainability and enhanced shareholder value**?

c.

Is **sustainability-motivated** shareholder activism effective in influencing corporate behaviour **for sustainability and enhanced shareholder value**?

a. Does financially-motivated shareholder activism impact corporate behaviour at the expense of sustainability?

The Luc Hoffmann Institute report *Shareholder Activism: Standing-up for sustainability?* posited: “The term ‘shareholder activist’ or ‘activist investor’ has come to mean an investor who seeks, above all, economic and financial gains to maximise investments in the short term. This form of shareholder activism almost inherently weighs negatively on corporate sustainability policies which are focused on the longer-term.” In this section we look to examine and understand this dynamic in further detail.

There is evidence to suggest that activist hedge funds, primarily motivated by financial interests, seek outcomes that boost a target’s short-term share price, potentially at the expense of long-term performance.²⁰

However, there is limited quantitative or qualitative research into the consequences of financially-motivated activism on sustainability. Based on desk research, surveys and interviews with expert stakeholders, we have outlined a series of mechanisms through which financially-motivated activism may exacerbate the focus on the short term and, in doing so, negatively impact on sustainability. Our intention is to provide a basis for discussion and debate to identify potential pathways forward.

1 Short-termism is inherent in the financial system in which investors operate. Financially-motivated shareholder activists are strongly incentivised to prioritise short-term performance at the expense of long-term health or growth.

a. Incentive structures: shareholder activists’ agreements can provide a strong motivation for short-term actions. As an example: a hedge fund may promise to their clients to deliver high returns in a shorter timespan (usually against a 20% profit fee, for any increase in value achieved above a fixed percentage).²¹

b. Metrics: the way performance, risks and success are measured tends to focus narrowly on traditional corporate performance metrics, rather than broader non-financial factors.

c. Duration of ownership: shareholder activists have the flexibility to hold stocks for short periods of time, shifting from target to target without regard for the long-term value of each company. A target’s long-term value proposition and sustainability can therefore become collateral damage in the process.

“Short-termism is built into the investment system. Short-termism is driven both by the length of time shares are held and by the way that investment success is measured. If investors prioritise short term gain then this sends signals to companies that short-term profit is the overriding metric of success. This, in turn, drives short-termism right into the heart of corporate decision-making.”

Clare Hierons, ShareAction

2 Financially-motivated activists often take a narrow, rather than a holistic, understanding of corporate performance, which can in turn place pressure on corporate sustainability strategies.

Financially-motivated campaigns may force a target to react quickly to take actions to satisfy or allay demands, with little consideration for the potential side effects for the wider organisation and its social and environmental impacts. Examples include excessively increasing leverage, increasing cash pay-outs to shareholders, reducing investments in R&D or other long-term projects, deprioritising human capital investment and cutting operating costs.²²

a. Long-term projects are not easily explained to short-term minded investors and are often among the first to be reduced or affected when a company becomes the target of an activist campaign. Management prefer investment projects with shorter time horizons based on the belief that investors fail to properly value long-term projects. McKinsey calculates that investors penalise long-term corporate investments by using discount rates that are 5-10% higher than risk and actual returns justify.²³

Research suggests management readiness to delay projects when faced with short-term pressures. 55% of executives and directors at companies without a strong long-term culture say their company would delay a new project to hit quarterly targets even if it sacrificed some value.²⁴

Shareholder activism: a threat to General Electric's Ecomagination?

GE's Ecomagination is a successful growth strategy that has combined sustainable solutions and innovation with economic results. Over 12 years, GE has invested \$20bn in Ecomagination R&D: the strategy has generated \$270bn in revenue and reduced GE's greenhouse gas emissions and freshwater use by 18% and 20% respectively.²⁵

GE became the target of a high-profile activist campaign by Trian Fund Management. GE's CEO Jeff Immelt – well known for his long-term focus – resigned under the activist's pressure in 2017. Trian also gained a seat on the board.

Some commentators think that GE could be broken apart into separate businesses²⁶ and time will tell if this activist intervention will have an impact on Ecomagination.



3 Shareholder activist campaigns can be highly disruptive to companies in terms of cost and time, further distracting from the long-term strategy.

a. Shareholder activism has a real cost to public companies in terms of direct expenses. 2014 data from McKinsey & Company suggests that the cost of each contested activist campaign is between \$10 million and \$20 million.²⁷

Target companies are increasingly heading to proxy fights rather than settling with activist demands and the most expensive activist campaign occurred in 2017. Nelson Peltz of activist hedge fund Trian Fund Management estimated that P&G spent over \$100 million in its efforts to keep the activist investor off the company's board, surpassing previous proxy fight spending records.²⁸ Trian claimed P&G's defense costs included "paying for four investment banks, at least two law firms, two proxy solicitors and a PR firm."²⁹

b. Activist campaigns absorb considerable amounts of management time. McKinsey & Company finds that "weeks of management time" per activist campaign may be spent developing plans and meeting with investors.³⁰

Dealing with activist investors can be a distraction for CEOs and derails their focus on implementing a long-term strategy. Pharmaceutical company Allergan was the target of a high profile activist campaign run by Bill Ackman of hedge fund Pershing Square Capital and pharmaceutical company Valeant. Allergan's CEO David Pyott told CNBC that fending off Ackman and Valeant was a full-time job.³¹ The board may also lose control of a company's strategic narrative if they are preoccupied with dysfunctional board meetings or the prospect of losing their own standing.

The impact of short-termism on corporates

A 2016 survey of over 1000 C-suite executives and board members globally confirmed growing and excessive short-term pressures – affecting the most fundamental decisions that boards and management make. 87% of executives and directors feel most pressured to demonstrate strong financial performance within two years or less.³²

Our Conclusion

Market forces mean financially-motivated activists are strongly incentivised to prioritise actions that are intended to yield short-term results. Negative impacts on corporate sustainability may be a corollary outcome of such activities. The evidence base for this is limited, suggesting the need or gap for a detailed study looking explicitly at the sustainability performance of companies that have been the subject of shareholder activism.

Furthermore, given the impact on time and resources required to respond to shareholder activist campaigns, emphasis should be on constructive engagement on issues to support long term performance.

b. Could financially-motivated shareholder activism influence corporate behaviour for sustainability and enhanced shareholder value?

Conversely, the impact of financially-motivated shareholder activism need not necessarily be detrimental to a company and there can be positive outcomes inherent in engaging with companies.

1 In certain cases, financially-motivated shareholder activism can be beneficial, since activist investors can be a catalyst for change.

a. Shareholder activists can hold companies with poor or stagnated management to account. They can provide candid analysis of a company's state of health - highlighting management weaknesses, organisational inefficiencies, growth options or deficits in asset valuation and capital allocation - to unlock stranded shareholder value.³³

The Investor Responsibility Research Center (IRRC) Institute and ISS undertook a study of hundreds of new directors who joined S&P 1500 company boards as a result of activist campaigns over the period 2011 to 2014. It found that public shareholder activism generally resulted in younger, shorter-tenured and more independent, but less diverse, boards.³⁴

b. Shareholder activists fill a governance void in an increasingly passive market. Passive investing is likely to breach half of US equities fund investments in the near future and over 25% in Europe.³⁵ This raises concerns of investors not holding companies to account - including on their sustainability performance.

There is general agreement that hedge fund activism has brought about sweeping corporate governance changes.³⁶ A June 2015 survey asked 801 US retail investors, "do activists drive shareholder value?" 74% agreed that shareholder activism adds value for companies by pushing for decisions from corporate executives and board members who otherwise would be too complacent.³⁷ In Japan, Prime Minister Shinzo Abe welcomed shareholder activism as a means to encourage the adoption of his administration's Corporate Governance and Stewardship Codes, and the number of 'constructive activists' tackling corporate governance in Japan has grown.³⁸

2 Shareholder activists applying ESG principles can see benefits in terms of both addressing significant risks and furthering the sustainability agenda.

Improvements in ESG factors, such as board diversity, employee retention, environmental policies, supply chain ethics and data security and privacy, can at minimum reduce the risk of litigation and fines.³⁹

Triun Fund Management, Blue Harbour, Red Mountain Capital and ValueAct are activists that have applied ESG principles in various forms. Some of these funds are under pressure from their own investors seeking to own firms that demonstrate a commitment to sustainability.



Blue Harbour Group's CEO believes ESG issues should be on the same level as financial issues. The activist fund integrates ESG issues into its process, examining how much water Xilinx Inc. suppliers use in the production process, for example.

Incorporating sustainability issues can be an opportunity - and discounting them can be costly. In 2012, Blue Harbour sold its stake in packaging manufacturer Gerresheimer AG for a 69% gain (\$32 million profit). However, as the company's efforts to reduce its carbon footprint were realised, reducing costs and increasing profits, the stock continued to rise. Blue Harbour estimates it 'missed out' on an additional \$25 million.⁴⁰

"[ESG] is hugely important for us, and we put it on the same scale as other things we look at - a company's cash flow, its market share, its management...Anything we can do to reduce risk is smart."

Cliff Robbins, Founder, Blue Harbour (2017)⁴¹

3 Institutional investors such as pension funds, foundations and sovereign wealth funds can often act as guardians of long-term value creation.

Many cases show their voting behaviour to be more orientated towards the long term. This influence has helped protect companies from controversial practices, such as excessive executive compensation or investments.⁴²

Passive Investors: the “new” activists?

Passive investments are growing in terms of Assets Under Management (AUM) and influence. Passive mutual funds are accumulating larger stakes in more big companies, often collectively exceeding the holdings of actively managed funds.⁴³ As the responsibilities of passive funds grow, and shareholder activism matures as a strategy, the role of passive investors is evolving.⁴⁴

The largest passive investors understand that their clients want to see evidence of more active engagement with management. BlackRock, Vanguard and State Street recently expanded their corporate governance teams and made their interactions with management more transparent.⁴⁵

Traditionally long-only institutional investors are increasingly embracing activist tactics and engaging in activist campaigns.^{46, 47} In 2017, institutional investors (mutual funds, investment advisers and pension funds) announced 44 campaigns, representing 13% of US campaign volume.

Whilst institutional investors typically have a preference for private engagement and therefore support management in the majority of proxy contests, they are increasingly willing to act when talks do not progress. In 2016 and 2017, they used their votes to influence portfolio companies more often than previously.

The largest asset managers and pension funds vocally outlined their corporate governance priorities in letters to CEOs and public policy statements, openly threatening to use their votes to force change where companies were not being proactive. In particular, investors made increased calls for board diversity and expansion of shareholder powers, such as proxy access, annual director elections and other shareholder-friendly governance changes.⁴⁸

Given their share of the market, winning the voting blocks of passive investors in proxy situations is often pivotal to the voting outcome. Some activist investors recognise this and have begun to structure issues such as governance into their campaigns, in order to appeal to the core issues of large passive voting blocks.

“...our responsibility to engage and vote is more important than ever.”

Larry Fink, Chairman and Chief Executive Officer, BlackRock, Inc.⁴⁹

“To understand the full picture, we often also engage with other investors, including activists and shareholder proponents.”

William McNabb, Chairman and Chief Executive Officer, The Vanguard Group, Inc.⁵⁰

Our Conclusion

There can be positive outcomes from active engagement with companies. Financially-motivated activists are highly skilled and successful in achieving their objectives. By broadening the perspective of financially-motivated activists, to include consideration of ESG performance factors, there is a significant opportunity for broader positive impacts, including on corporate sustainability.

c. Is sustainability-motivated shareholder activism effective in influencing corporate behaviour for sustainability and enhanced shareholder value?

A growing number of investors are adopting shareholder activism as a tool to achieve positive corporate sustainability outcomes. They are engaging companies specifically on sustainability issues, with increasing success. In this section, we seek to examine and understand the impact of sustainability-motivated activism in further detail.

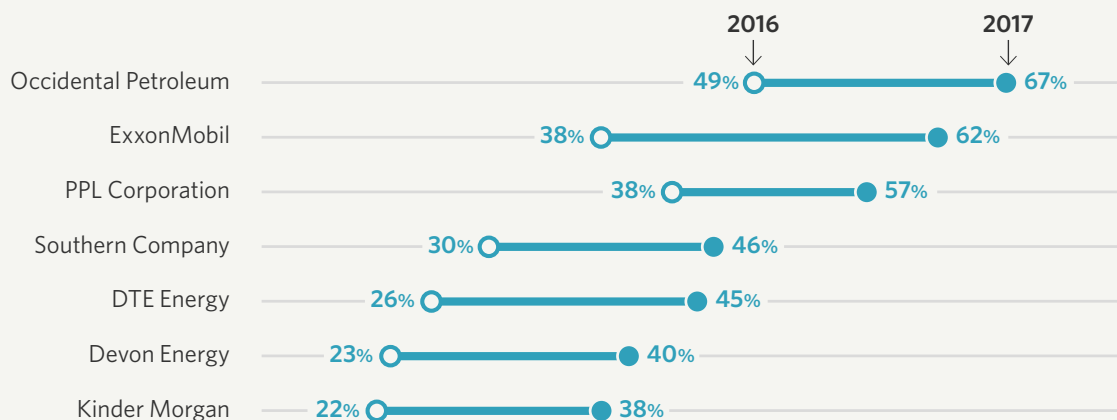
1 Sustainability-motivated activism, that uses activist tactics to force corporate action on sustainability issues, is an effective means to further the sustainability agenda.

Sustainability-motivated activists engage with targets through mechanisms including letter writing, private conversations and filing proposals.

Analysing an extensive proprietary database of ESG engagements with US public companies over 1999-2009, a 2013 study (Dimson, Karakas and Li) found that they were followed by a one-year abnormal return. The positive market reaction to successful ESG engagements was most pronounced for the themes of corporate governance and climate change. After successful engagements, companies experienced improvements in operating performance, profitability, efficiency and governance.⁵²

a. ESG proposals are important catalysts of action within companies and positively influence corporate sustainability performance. Shareholder proposals on ESG topics are rising and support for ESG proposals is also increasing. The chart below illustrates the significant shift in shareholder voting on climate risk proposals in only one year, between 2016 and 2017.

Carbon Risk Resolution Vote Results from 2016 to 2017



Source: Recreation of chart by Lazaro Gamio / Axios. Data: Ceres (rounded to nearest whole percentage point).⁵²

A 2016 study (Grewal, Serafeim, Yoon) provided evidence of systematic increases in companies' ESG performance after shareholder activism.⁵³ Importantly, even if threshold proposal support is not reached, raising social and environmental issues can still push companies – and their peers – to change their business practices.

b. Less hostile tactics, such as letters and private conversations, are also effective catalysts of action.

Letters can prompt conversations with company management to address issues of risk or concern. For example, investment manager Pax World votes against board slates that do not have sufficient gender diversity.⁵⁴ It follows up after voting, sending letters to companies explaining the reason for its opposition and suggesting steps they can take to achieve greater board diversity. This could prompt conversations where a company seeks further advice on hiring female candidates.

2 Sustainability-motivated activist initiatives provide valuable services to enhance investor-company engagements and ultimately advance leading sustainability practices.

This includes movements such as ShareAction, Ceres, Principles for Responsible Investment (PRI) and Farm Animal Investment Risk and Return (FAIRR).

a. They convene actors to create scale around sustainability issues. Demonstrating the power of collaboration, these initiatives bring people together to communicate a combined message that is consistent and reinforced by multiple stakeholders. This can be particularly beneficial for those shareholders holding smaller positions and that might otherwise have limited influence on company management.

b. They collate information and improve understanding on emerging issues. Several activists that we spoke to expressed the value in having initiatives with dedicated resource to collate data and capture best practice. Initiatives, such as the Access to Medicine Index (ATMI), also provide a helpful view of a company's performance relative to others. The pooling of expertise is especially welcome in a market where there are conflicting pressures on investor fees and expenses.

"They [Ceres] do the background research that helps with the dialogues. For example, for Climate 100+ engagements on mitigating emissions in the value chain. We found out that one auto manufacturer is part of the Automobile Association that is lobbying for the US Government to roll back auto emissions standards. At the same time, it is saying that it is lowering the emissions of its product range. The provision of this information helps us to have meaningful and productive conversations with the company on its sustainability strategy and performance."

Interviewee, Global Asset Manager

Initiatives can be effective in raising the profile of an emerging sustainability issue. The Farm Animal Investment Risk and Return (FAIRR) is an investor initiative that aims to put factory farming on the ESG agenda, informing investors about this issue as an investment risk. It believes intensive livestock production poses material risks to the global financial system and hinders sustainable development. It produces research and coordinates investor engagement on the topic. A key attribute of the FAIRR approach is its belief that "it's about materiality, not morality". This means that it focuses on highlighting the material risks for investors and

clearly articulates the investor relevance. Whilst the topic of factory farming was perhaps not previously seen as a high-priority risk, FAIRR's supporter Assets Under Management have now grown from \$800bn in 2016 to a total of \$5.6 trillion today.^{55, 56}

c. They provide a unique forum in which to co-create solutions. These initiatives bridge the gap between investors and corporates, providing a forum where they are free to evolve tools and develop solutions. For example, they provide the space for innovation in areas such as the two-degree scenario analyses recommended by the Task-force on Climate-related Financial Disclosures (TCFD).

ShareAction and successful shareholder activism ^{57, 58, 59}

In 2016, the Great Australian Bight (GAB) – a pristine and biodiverse seabed off the coast of South and Western Australia – was being threatened by drilling for oil by BP. The Wilderness Society in Australia was campaigning to protect the area, whilst the Australian government was being put under pressure to grant a licence for the project.

ShareAction partnered with The Wilderness Society and Greenpeace to take the debate to BP's AGM. Greenpeace campaigned outside the AGM and – having convened a coalition of investors to back the issue – ShareAction attended with Aviva. ShareAction and its partners had produced a comprehensive investor briefing, highlighting that

BP had failed to disclose its Environmental Plan and outlining the operational, economic and reputational risks to the business, as well as the environmental safety risk.

Ultimately, the campaign was successful and BP decided against drilling in the GAB. In this instance, the response was both pure campaign activist and investor-led, backed by a comprehensive investor briefing crafted in the language of risk. ShareAction and its partners not only highlighted the environmental risk, but also the stranded asset risk, and raised investor awareness on these types of projects.

Our Conclusion

The use of shareholder activist tactics to push companies to improve performance on social and environmental sustainability issues is effective. However, it requires significant resource and expertise and at current levels, is too diffuse and narrowly focused to have the level of impact required across the broad range of sustainability issues facing corporates and society at large.

There is an opportunity around the power of collaborative initiatives to pool resource etc. and drive improved performance on sustainability issues.



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