ENGAGING for long-term value creation

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It's the best way to force companies to change for the better.

An essential ingredient in the pantry of the long-term environmental, social and governance, or ESG, investor is the ability and willingness to pragmatically engage with a company. Engaging with a company on material risks and opportunities can provide improvements that enhance value to stakeholders. Sometimes those outcomes can be quantified in monetary terms, but more frequently the outcomes are non-monetary but nonetheless important. Desired engagement outcomes, for instance, might be a reduction in the risk of political interference, enhanced brand perception among customers, or improved sustainability of the societies in which the company conducts its business. In our view, achieving such outcomes requires a pragmatic perspective from investors in recognition that companies operate in complex environments.

'Engagement' simply describes the process of conversing with a company with a view to influencing it to achieve specific outcomes. 'Conversing' could be interacting with relevant board members, senior management, other officials of the company, or advisers to the company. The form of interactions span meetings through to formal letters. 'Specific outcomes' refer to desired strategies or actions from the company; for example, climate-risk strategies or specific employee diversity goals.

Ultimately, an investor's power to engage stems from voting rights that attach to their share ownership. These voting rights are exercised in the 'proxy voting' process, which can result in significant change, including the appointment of new directors and auditors, and approval of specific proposals. Naturally, the size of an investor's ownership in a company has a proportional impact on voting rights and, therefore, influence. Collaborating with other like-minded investors can help increase the pressure on a company for a specific outcome.

It's worth noting some of the most non-ESG companies escape this type of engagement because ESG investors often have specific exclusion requirements from such businesses. Many (including us) choose not to invest in tobacco manufacturers. These sorts of exclusions are sensible because a tobacco manufacturer can't help being other than a purveyor of tobacco products. No level of engagement would prompt them to stop selling packaged nicotine.

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For many other types of business, ESG investors are happy with the products and services but seek to engage for changes that enhance opportunities and reduce risks. Most, say, are content with the business of supplying electricity to homes and businesses; however, sometimes concerns arise that some of these businesses are not properly planning for decarbonisation and climate-related risks.

In these instances, we believe it rational for investors to invest in these businesses and then seek to engage for specific outcomes that improve management of climate-related risks. These investors have the voting power to agitate for improvements and then reap the longer-term rewards of those improvements. Merely divesting those businesses results in no voice with which to engage a company to improve their practices. In these instances, no investment means no impact.

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This perspective, however, does not obviate the rational investment decision to divest a company that chooses not to engage on material risks, or pretends to engage but doesn't make genuine changes, which may then expose the longer-term investor to significant risks.

The explosion of interest in 'sustainability' and 'ESG' considerations in investing has led to a growing number of shareholder proposals being submitted for voting at annual general meetings.[1] Yet many of these shareholder proposals are immaterial to the company, relate to issues already being managed, or are even detrimental to the interests of long-term shareholders. Indeed, this year's proxy voting season (April to June, mostly for US and European companies) has seen the number of shareholder proposals increase by 40% from 2021 for the companies that we vote upon (those stocks we manage on behalf of our clients).

We assess each of these proposals on behalf of our investors. We do not outsource this important responsibility. For each proposal, we assess whether the issue at hand is material to the company, or perhaps to the company's industry, and whether the company is already managing the issue appropriately. If the proposal has merit, we will generally vote for it, while opening a conversation with the company about the issue to express our perspectives and what a desirable outcome might look like. In our assessment of materiality, we do consider how much time and effort is involved in meeting the demands of the proposal and the likely degree of management, or board, distraction involved. Managements should be busy creating value for long-term investors and not be distracted by immaterial matters.

In conclusion, our engagement goal is to recognise our stewardship responsibilities of being custodians of our investors' capital over the long term. This recognition steers us to engagement that improves the management of material risks and opportunities of our investee companies, and not merely box-tick issues that are topical but not material to a company. Properly doing this requires thoughtful and pragmatic consideration of complexities companies and societies face.

1 "A shareholder proposal is a recommendation or requirement that a company or its board of directors take a particular action, which is submitted by a shareholder for consideration at a meeting of the company's shareholders." – Thomson Reuters

IMPORTANT INFORMATION