Executive Summary

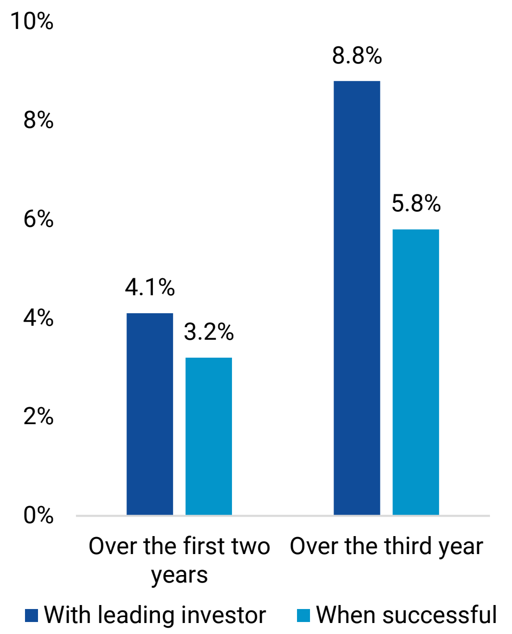
Exit vs. voice – this is the general choice that responsible shareholders face when invested in a company that behaves in a way that does not align with their values. The first option is to dissociate themselves and divest. The second is to engage in dialogue to initiate positive change. The latter strategy refers to active ownership and is the focus of this analysis.

But what is the real impact of active ownership, on the investor and the target company? By divesting from companies with poor environmental, social or governance (ESG) performance, investors have, until the last two years, been rewarded with a momentum effect, but it cannot last indefinitely. On the corporate side, the waves of divestment may encourage a change in practice, but many conditions are necessary for this to take place. What about active ownership, especially when it focuses on ESG issues?

Investors using active ownership incur high administrative and indirect costs but are generally rewarded with higher returns. Active ownership requires listening skills and determination as well as significant resources to rigorously assess the company as well as set and monitor targets. Apart from ESG improvements, investors exposing themselves to the costs of active ownership can justify them in two ways: through increased company value and reduced ex-post risks, and informational and reputational benefits. The latter are not necessarily shared with other shareholders.

Target companies generally improve their ESG practices, especially when lagging their peers. They also experience improved operational and financial performance, through sales growth and increased productivity. Stakeholder relationships are also impacted: shareholders want to retain their stake and employees are more loyal to the company after an improvement in their ESG practices, but auditors appear to be more diligent.

Change in annual cumulative abnormal returns for ESG collaborative engagements



Note: The leading investor guides the dialogue and is supported by the other investors in the collaborative engagement. Successful engagements consider engagements with and without leading investors. Source: Dimson et al. (2021)

Collaboration between investors appears to be a key factor in the impact potential of active ownership. It reduces the costs of duplicating responsibilities and research efforts. While also appearing to be more effective: companies targeted by collaborative engagement perform better over time. A diversified group of shareholders has indeed more influence and sometimes a better understanding of the company's environment and can thus be successful in cases where individual engagement fails or is not financially feasible for the investor.

Key points

1. Investors participating in active ownership face high administrative and indirect costs, particularly when they engage. However, they are generally rewarded with higher returns, especially when engagement is successful and conducted in collaboration with other investors.
2. Companies engaged on environmental, social, and governance issues generally improve their practices, especially when they are lagging their peers. They also see improvements in operational and financial performance and changes in stakeholder relations.
3. Investor collaboration is key. Not only does it spread costs, but it also appears as more effective, further enhancing corporate value and performance.

E4S active ownership series

In December 2021, E4S studied **the impact of divestment** as a response strategy. The E4S series on active ownership investigates an alternative to divestment: engagement and voting. The first analysis of the E4S series on active ownership, **Active ownership: by whom and how?** outlines the status quo of this strategy. **Active ownership: for what impact?**, is the second of the series and analyses the impact of active ownership and more specifically the benefits and costs for the investor who engages as well as the reactions behavioural oral changes of the target company. To be successful in their engagements, however, investors will need to consider several factors. **Active ownership: the keys to success** develops how the profile of the target company and the investor, as well as the characteristics of the engagement, can influence the outcome of a shareholder initiative.

Active ownership: for what impact?

E4S White Paper

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April 2022

Many thanks to Carla Schmid and Nicolas Wille for the research support, to Oscar Vosshage for assisting with the translation, to Dominik Breitinger (E4S), Boris Thurm (E4S) and Jordane Widmer (E4S) for the precious feedback, and to Vincent Kaufmann (Ethos), Gemma Corrigan (Hermes Investment), Iva Koci (Imperial College), Michael Wilkins (Imperial College & TCFD), and Anne-Cathrine Frogg (Jela Capital), Marc Briol (Pictet), Marie-Laure Schaufelberger (Pictet), LaureCastella (Retraites Populaires) and Jean-Christophe Van Tilborgh (Retraites Populaires) for the insightful discussions.

Enterprise for Society (E4S) is a joint venture of the University of Lausanne through its Faculty of Business and Economics (UNIL-HEC), the Institute for Management Development (IMD) and the Ecole Polytechnique fédérale de Lausanne (EPFL), under the stewardship of its College of Management of Technology, with the mission of spearheading the transition towards a more resilient, sustainable, and inclusive economy. E4S is committed to training the next generation of leaders, inspiring economic and social transformation, and promoting change by strengthening start-ups and boosting innovation.

This project was conducted under the aegis of a partnership with Retraites Populaires and Pictet Asset Services.