Enterprise for Society

UNIL | Université de Lausanne
HEC Lausanne

IMD
REAL LEARNING. REAL IMPACT

EPFL

Active ownership: the keys to success

E4S White Paper
2022 - 5

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 how to facilitate the success of active ownership? When are companies more likely to comply with investors' ESG demands? And what to do when they do not? Target companies have a specific profile and this profile, together with that of the investor and the characteristics of the engagement itself, will impact on the outcome of shareholder initiatives.

Mature companies under financial constraints are often targeted, whether they have questionable ESG practices or demonstrate expertise in this area. Targeting large companies has several advantages, such as greater potential for impact and the increased visibility it would provide to the investor. Also, a company under financial pressure and underperforming its peers would be more likely to accept shareholder demands. However, shareholder activists are interested in both companies with a high margin of progress in their ESG practices and companies with proven ESG expertise.

There are three categories of factors influencing the outcome of shareholder initiatives: company profile, investor profile, and engagement characteristics. It is most likely that mature and ESG-conscious companies will comply with shareholder demands. Local institutional investors with a history of successful engagement with the company seem to achieve their goals more frequently. Additionally, two-tiered collaborative engagements, addressing corporate governance and taking a more aggressive approach seem to be more successful.

When active ownership does not work, what should you do? More emph should therefore be placed on collabora investments led by local investors, preferably large asset managers, and targeting mature, ESG-conscious companies. Although their likelihood of success is lower, smaller companies and laggards should not be forgotten. When an initial engagement has failed, intensifying the engagement or collaborating with other actors, such as bond investors and creditors, can help.

Key takeaways

1 Mature and financially constrained companies are more often the target of active ownership.

2 Three categories of factors influence the outcome of shareholder initiatives: company profile, investor profile, and engagement characteristics.

   a. Mature, ESG-conscious companies are most likely to comply with shareholder demands.

   b. Local institutional investors with a history of successful engagement with the company appear to achieve their goals more often.

   c. Collaborative engagements that are multi-level, address corporate governance or have a more aggressive approach appear to be more successful.

3 Although less responsive to engagement, smaller companies and laggards should not be left out. Increased engagement and collaboration with other actors such as bond investors and creditors can help when an initial engagement fails.

E4S series on active ownership

In December 2021, E4S studied the **impact of divestment** as a responsible 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 ?**, develops the status quo of this strategy. The second one, **Active ownership : for what impact ?**, studies the benefits and costs for the investor who engages as well as the reactions and behavioural changes of the target company. To be successful in their engagements, however, investors will need to consider several factors. Active ownership: the key to success develops how the profile of the target company and of the investor, as well as the characteristics of the engagement, can influence the outcome of a shareholder initiative.

Active ownership: the keys to success

E4S White Paper

Jean-Pierre Danthine & Florence Hugard

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) and Boris Thurm (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.