# THREE WAYS TO IMPROVE INVESTOR ENGAGEMENT

Marketing material for professional investors and advisers only

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# THREE WAYS TO IMPROVE INVESTOR ENGAGEMENT

### About this research

Investment stewardship is at the heart of Schroders' investment approach. As guardians of our clients' assets, we have a responsibility to manage investment in the best way possible – including by understanding strategic issues and helping investees manage material risk.

Schroders has been practicing investment stewardship for decades and strives to effectively engage companies to make the best use of resources on both sides. We firmly believe engagement is not a one-way street. By listening to the feedback from companies in our investment portfolios, we can understand motivators, barriers, and practical actions to improve our stewardship activities.

In 2023, we surveyed over 350 investee companies from 45 countries to gather feedback on investor engagement. This paper highlights key findings and proposes three ways for investors to improve investment stewardship in our industry:

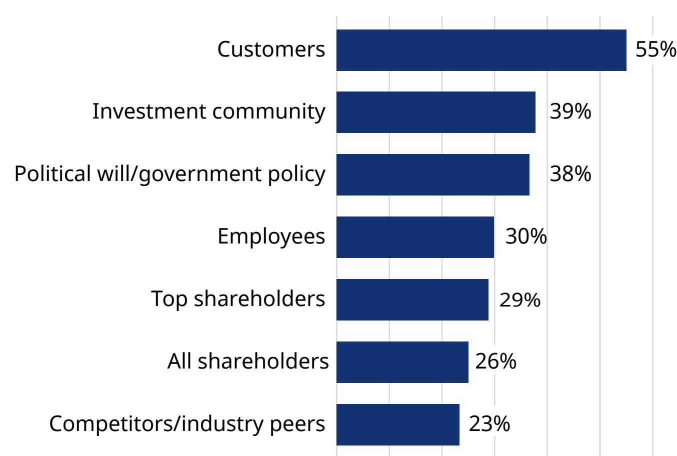
- Use your influence well, directly providing constructive feedback to investee companies and building consensus on expectations with other investors
- Dig deeper to understand business practices and whether third-party ESG ratings are reflective of performance and strategy
- Bring in the experts from both sides, leveraging the in-depth understanding of international standards and good practice from sustainability experts, and advice from investment desks on capital allocation

# #1: USE YOUR INFLUENCE

Customers are the most influential when it comes to companies taking action on material ESG issues (55%). They are a fundamental stakeholder to satisfy in the running of any business – issues like product value and quality are critical. But it's important to balance the needs of customers with other stakeholders. Investors can help get it right.

The investment community as a whole (39%) plays an important role in supporting businesses to deliver long-term value. Political will and government policy are also key to driving change (38%).

**Chart 1: Top ESG influencers**




Not shown in chart: suppliers (6%), internal conviction (3%), activist groups (3%), society (2%), other (2%).

However, companies with above average financial performance[1] are less influenced by political will and government policy (34% vs. 40% for companies with below average performance). Instead, companies with above average performance are significantly more likely to be influenced by the entire investment community (45% vs. 35%). This would suggest strong performers move past basic regulatory requirements and are better able to manage material issues and expectations of the investment community.

> **"Investors can substantially engage in a company's material ESG issues such as environmental protection and social contribution. Energy companies' responsiveness to climate change and the control of greenhouse gas emissions is a key regulatory issue in various countries and is also a focal point for domestic and foreign investors."**
>
> Deputy Director of Public Relations, energy company, China

The investment community as a whole (39%) is more influential than all shareholders (26%) and top shareholders (29%). However in the UK, top shareholders are very important (42%) and significantly more influential than the investment community (28%) in contrast to other regions.

Investor engagement is on the rise. Large companies are particularly well-equipped to engage with investors: just one in ten (11%) cite resourcing as a barrier to engagement, compared to nearly double the rate (18%) for small companies. We interviewed two large companies in the mining and pharmaceutical sectors to understand their approach to investor engagement.

They both had sophisticated systems for tracking investor requests, conducted desk research on ESG priorities, and used this information as competitive intelligence on expectations and emerging market trends. Moreover, investor requests for disclosure drive the development of internal monitoring systems, with an increasing appetite for ESG data hubs that rival the quality of the finance team. Both companies prioritised engagement with current and prospective investors based on the investor's propensity to become a top shareholder. Broadly speaking, small shareholders have fewer in-depth engagements and opportunities to influence management and strategy.

Investors should prioritise quality over quantity – both in investment and engagement – seeking to build trust, create transparency, and drive accountability. This is best done through direct one-to-one feedback and collectively raising major concerns in collaboration with other investors. As one respondent put it, a constructive dialogue is much better than determining market concerns from the front page of the Financial Times.

In taking this approach, investors can be more constructive and effectual. Where Schroders had high levels of recent one-to-one engagement history[2], respondents were significantly more likely to think we are more effectual and constructive than other investors. Over half (53%) of respondents with high rates of one-to-one engagement perceived Schroders as more effectual than others (vs. 40% for limited one-to-one engagement). We were also viewed as significantly more constructive than others with this engagement approach (81% vs. 64%).

> **"Engagement on ESG issues should be a dialogue (as opposed to a monologue where the company merely confirms what they're doing). This will go a long way to managing expectations, giving confidence and support with both parties focusing on the long-term."**
>
> Investor Relations Director, consumer goods company, South Africa

[1]In this study, we refer to companies with above average performance as those with higher peer-adjusted returns on a cumulative basis since January 2022. The peer groups are created using company size, region, and sector.

[2]Defined as having over 40% of engagements as one-to-one meetings and calls since January 2022.

## #1: USE YOUR INFLUENCE

One area respondents felt should be improved is investor consensus on international ESG standards and reporting frameworks. They felt investor expectations, and the reasoning behind them, are not always clear. It can be difficult to determine what disclosure to prioritise with multitudes of ESG questionnaires from different investors. For investees, this can feel like more disclosure is more time reporting, and less time managing and doing.

> **"Would like to see world's largest asset managers take a look at all these standards and ratings and create consensus on expectations for corporates."**
>
> Vice President of Investor Relations, pharmaceutical company, UK

The ESG landscape is especially perplexing in markets with more nascent engagement (Latin America, Middle East, Emerging Markets). Nearly a quarter (23%) of respondents from these markets cited lacking understanding of international standards as a key barrier to effective engagement – over twice the rate of other markets. The same proportion also pointed to lacking questions and materials shared before meetings, suggesting extra preparation and background information is needed when engaging here.

## #2: DIG DEEPER

We asked respondents to reflect on the opportunities and challenges for effective investor engagement, and nearly a third (29%) pointed to ESG disclosure and third-party data. How information is collected and used in financial decision-making is causing some concern amongst surveyed companies.

ESG data collection and processing is becoming increasingly automated with ESG ratings providers deploying Artificial Intelligence to collect data. There can sometimes be shortcomings, including systems not picking up company updates because the information is not machine-readable or behind a paywall. Data for decision-making can be stale while provider methodologies tend to differ, producing varying assessments of a company's performance on material ESG issues. These performance assessments could then be used in financial decision making. For example, some asset managers prohibit investments when excessive revenues are obtained from tobacco, or if a company is classed as a violator of international business standards.

> **"News flow on its own is not a good indicator of material risk. Rating agencies and NGOs seeking to generate public attention can amplify or perpetuate the relevance of legacy issues without acknowledging mitigating actions or solutions.**
>
> **If investors don't reward companies that invest in sustainability and path-break cost-effective solutions, then business model evolutions are going to be painfully slow, and out of sync with what is needed to address externalities and drive a more sustainable mode of business."**
>
> Investor Relations Manager, consumer goods company, Switzerland

# #3: BRING IN THE EXPERTS

Lacking coordination within investor organisations was cited as the biggest barrier to effective investor engagement (27%), and it's significantly more pertinent for companies in the top performance quintile (38%). Moreover, UK respondents are significantly more likely than those in other regions to select this as a top barrier (39% vs. 23% elsewhere).

**Chart 2: Barriers to investor engagement**

Not shown in chart: lacking investor interest (3%), ESG disclosure and third-party data (3%), dual class structure/concentration of power among owners (2%), other (1%).

**"A dedicated ESG meeting is really valuable as it gives us the opportunity to deep dive into our comprehensive disclosures. Investors sometimes find our documents hard to navigate given the detail and size of our reports. It is sometimes a challenge to cover everything an investor wishes to focus on, without bringing 2–3 subject matter experts into our meetings. A pre-briefing on topics they are looking to discuss is usually necessary."**

Manager of Fixed Income Corporate Access, financial services company, UK

**"Remarkably good coordination within Schroders between the different teams, with overlapping participants on the different topics. This is rare however, and rather the exception. With many investors, it is unclear whether portfolio managers and ESG teams even speak with each other."**

Investor Relations Director, technology company, Belgium

One-to-one engagement helps to close the gap on lacking coordination within investor organisations. Companies more exposed to one-to-one engagement with Schroders were less likely to see internal coordination as a barrier. Just 16% of respondents with high levels of one-to-one engagement chose this as a barrier, compared to more than double (34%) for respondents with no recent engagement history. We did not find that high volumes of other engagement types (e.g., emails) had the same effect.

Bringing in the experts may help overcome another prominent barrier to engagement – lacking materiality – chosen by 20% of respondents. Respondents from large companies, who face a more complex set of ESG risks, are significantly more likely than small companies to mention lacking materiality as a top barrier (27% versus 17%). Moreover, respondents in developed European countries (excluding the UK) were more likely to choose this barrier than other regions (27% vs. 17% elsewhere).

By bringing investors and ESG teams to the table, we can better understand international standards and regulations, best practice, and what short to long-term capital allocation is required to meet strategic goals. This will help determine what ESG issues are most material, prioritise risks and opportunities, and set achievable objectives for the short, medium, and long-term.

**"ESG issues, particularly environmental issues, are likely to impact profitability in the short-term and capital allocation decisions that are long-term in nature. We often find that the engagement with portfolio managers is focused on the financials while engagement with ESG teams is on environmental, social and governance matters even though financials and ESG are linked with each having an increasing impact on the other."**

Investor Relations Director, consumer goods company, South Africa

**"Aligning to a key set of issues and desired outcomes which will satisfy enough investors is a challenge. The investor agenda is not always aligned to addressing regulations/ ratings, which results in insufficient company resources/reporting."**

Head of Investor Relations, consumer goods company, Canada

# CASE STUDY: BALANCING SUSTAINABILITY RISKS AND OPPORTUNITIES

Our insights-driven engagement with this major pharmaceutical and crop science company began in 2005. At the time, the company regarded its crop science division as a business opportunity due to global population growth and increased crop yield requirements. Their Research and Development team was focused on improving yield strains to enhance a plant's ability to withstand climatic extremes. The Schroders ESG team wanted to understand how the company was trying to improve crop production in different markets and what engagement was taking place with key stakeholders like farmers.

We felt there was merit in developing products that can withstand our changing climate and society, but the risks should be adequately understood and managed. While emerging scientific consensus at the time had broadly concluded that genetically modified organisms (GMOs) were safe to eat, further research was underway on the impact of genetically modified crops on humans and other plant species. For example, there were concerns that GMOs could overrun existing species, damaging the biodiversity of the planet. The company was also facing public interest in product safety, with concerns that GMOs could have adverse effects on human health.

Through engagement, we wanted to understand how the company was assessing and managing perceptions of product safety and the potential environmental impact of GMOs.

In 2014, the ESG team asked about the evolving regulatory landscape in Europe with a potential ban on some of the company's product. We requested better disclosure on the financial implications of a potential ban and more detail about alternative products. The following year, in collaboration with other asset managers, we met with a senior sustainability executive to glean greater clarity on the company's environmental impact.

In 2016, the company announced an intention to acquire a leading producer of genetically modified seeds and herbicides. They believed this would be a valuable addition their existing crop science business. We met with the CEO, noting potential differences in business culture between the two companies and the prevailing public interest in GMOs in Europe. We also discussed evolving research on biotechnology and the company's own efforts to understand and mitigate the potential risks. The CEO emphasized efforts to improve transparency and engage key stakeholders.

In the following years, we continued engaging on corporate culture, product safety, and stakeholder relations. However, by 2021, the major acquisition resulted in the company being flagged as a potential violator of the UN Global Compact (UNGC) by a leading provider of sustainability ratings over the potential environmental impact of GMO products.

The UK and European Credit desk began engaging this company in 2021. This was an engagement and stewardship opportunity as the issuer could not be invested in while on UNGC violation list. We requested increased transparency on product safety and environmental impact, improved reporting comparing practices to peers, and meaningful engagement with stakeholders including independent ESG assessors.

Speaking with the company's sustainability experts the following year, we were encouraged by their detailed research on the impact of different genetically modified products. Transparency improved: they began granting access to full safety study reports submitted to and evaluated by regulatory authorities, as well as publishing educational resources on the safety of their products.

The company had been working with independent third parties to verify information on product safety and this supported the removal of the UNGC violator flag. Moreover, they had established stronger governance mechanisms to oversee sustainability risk management. This included an independent external Sustainability Council, as well as an ESG Committee set up by the Supervisory Board that includes stockholder representatives and employee representatives.

With these measures, the company was better able to understand the potential risk, verify information, and drive action and accountability through formal governance mechanisms. In 2022, the controversy-related flag had been removed by the independent third party. Furthermore, the company's ESG rating improved to A-grade and the Sustainable Credit Portfolio Manager was able to purchase the company's bonds.

The company's improved third-party ratings also meant we could progress our engagement to consider a wider set of risks and opportunities, particularly its climate and social impact ambitions. We asked about Net Zero targets and requested disclosure of the target-setting methodology. We also asked how the company planned to meet its commitment to support 100 million smallholder farmers in low- and middle-income countries with products, agronomic education, financing and risk mitigation solutions, and market access.

This engagement demonstrated how third-party sustainability ratings can have a material impact on a business. With improved transparency, third party engagement, and robust governance mechanisms, we feel the company has been responsive to investor feedback. This has increased our confidence in the company's approach to risk management. We will continue monitoring progress and look forward to the achievement of the company's climate and social impact ambitions.

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