

Assessing Engagement

A survey of UK practice on Socially Responsible Investment

Sarah Dresner, February 2002

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Executive Summary

Engagement is the means by which fund managers can be active stakeholders and “potentially bring massive economic leverage to bear on other economic players to encourage them to integrate environmental and social with economic aims.” (FoE 2000, pp5). Essentially engagement moves the debate in SRI away from trade-offs between ethics and profits towards dialogue about ‘win-win’ scenarios (Lancaster 2001). By examining methodologies, transparency and outcomes and identifying areas of consensus and best practice, this survey explores the current status of engagement activities, and how their effectiveness can be improved.

Section one describes the methodology used, explaining the reasons for the combined qualitative and quantitative approach.

Section two presents the analysis of the quantitative data. This shows where consensus exists between fund managers in the key areas of the significance of engagement, transparency and credibility, key driving factors, methodology and resourcing, collaborative projects and outcomes.

Section three presents a discussion of the results of the interviews, which focused on methodology, outcomes and transparency. From the discussion, key points of best practice, concerns and opportunity are highlighted.

The final section draws together the main points from the preceding two sections.

Main Findings

- Effective engagement should be formal rather than ad hoc, and should be documented and reported to clients.
- As SRI develops, the pressure for collaboration between fund managers is likely to grow. Collaboration reduces excessive demands on companies (‘questionnaire fatigue’). By collaborating, SRI fund managers can benefit from division of labour and knowledge-pooling, improved quality of information from investee companies and increased shareholder clout as well as reducing perceptions of free-riding.

- Measuring the outcomes of engagement is both difficult, and in some fund managers' opinion, can be counter-productive. Recording and monitoring activities and reviewing these against the issues on which fund managers claim to work is currently of more value in determining the effectiveness of their engagement activities.
- There is a real need for credible benchmarks on SRI performance. These would enhance the credibility of engagement with NGOs and other critics, help develop and disseminate best practice and enable clients to evaluate fund manager performance on SRI engagement. However such benchmarks must recognise the diversity of engagement processes and avoid any tendency to stifle innovation.

This paper is an edited version of *'Engaging Companies – How Can Fund Managers Most Effectively Influence Corporate Environmental and Social Performance?'* by Sarah Dresner. Just Pensions is publishing it as a contribution to the debate over the quality of engagement. The author would like to thank all those interviewed for agreeing to its publication. Sarah Dresner can be contacted on sarahdresner@rathbones.com.

SECTION I - METHODOLOGY

In order to obtain as complete and accurate picture of engagement activities as possible a combination of qualitative and quantitative approaches was utilized. Two types of questionnaires were distributed by post and e-mail to 24 major fund managers, all members of the UK Social Investment Forum. The study was restricted to practitioners of engagement activity, at both basic and advanced levels. The questionnaires were sent out in July 2001 and interviews conducted in July and August 2001.

The first questionnaire consisted of a number of statements and questions to which a choice of set responses were provided. The second questionnaire was a series of longer qualitative questions to which fund managers were invited to respond as part of a face-to-face interview or telephone call. The rationale for this combined approach is explained below:

Purpose of Quantitative Questionnaire: To ascertain the degree of commitment, activity and consensus amongst fund managers in six broad areas relating to engagement. The areas covered were: perceptions of the significance of engagement, transparency and credibility, factors driving engagement, methodology and resourcing, collaborative actions and outcomes.

Purpose of Qualitative Approach: The interviews generally lasted up to an hour and enabled fund managers to explain and develop ideas relating to engagement. It also provided opportunity to seek clarification on issues and activities reported in the media.

The twenty-four fund managers were approached by letter and e-mail asking if they would participate in an interview and complete the short questionnaire. Of the sixteen who replied, fourteen agreed to participate.

COMPANY	MANAGER
Aberdeen Asset Managers	Julie McDowell
Aegon Asset Management	Ryan Smith
Baillie Gifford	Kenny Bell
CCLA	Neville White
CIS	Laverne Picart
Friends Ivory & Sime	Steve Waygood
Gerrard	Andrea Moran
Henderson	Rob Lake
Hermes	Michelle Edkins
Jupiter Asset Management	Mike Tyrrell
Morley	Fiona Cuthbert
Norwich Union	Noel Smyth
Schroders	Rick Stathers
Storebrand	Sarita Bartlett

The results from questionnaire 1 are presented and discussed in [Section 2](#), and the information gained from the interviews collated and analysed in [Section 3](#), highlighting key points arising from each topic of discussion.

SECTION II - DATA ANALYSIS

2.1 – Assessing The General Significance Of Engagement

	Agree Strongly	Agree	Disagree	Strongly Disagree
Engagement is an essential component of SRI – stock selection is insufficient alone to achieve SRI goals.	85%		15%	
Engagement is a complementary, value-adding activity to SRI screening and stock selection.	64%		29%	
Engagement is a fundamental responsibility of fund managers, in playing their part in attaining sustainable development.	79%		21%	

85% of fund managers indicated that they either strongly agreed or agreed with the statement that engagement activities were an essential component of an SRI strategy and 64% that engagement is a complementary and value adding activity. These responses confirm that engagement is a growing phenomenon and is not simply being adopted as a convenient marketing tool.

Encouragingly 79% of fund managers positively responded to the statement that engagement was a fundamental responsibility of fund managers in playing their part in attaining sustainable development. The recognition of this broader context is important if engagement activities are to be an effective vehicle of influence and activity in reducing adverse corporate environmental and social impacts.

2.2 –Improving Transparency And Credibility Of The Engagement Process

	Agree Strongly	Agree	Disagree	Strongly Disagree
Engagement procedures should be documented to improve existing approaches and to reduce real/perceived ‘green-washing’.	93%		7%	
Guidelines on engagement, and what activities constitute a min acceptable level of activity should be made available to trustees and public to improve accountability.	64%		36%	
Claims of participation in engagement activities should be subject to a voluntary/legal requirement of fund managers to report on their activities, at least annually.	86%		14%	

A consensus emerged amongst the respondents on issues regarding transparency and credibility. Clearly, as the concept of engagement has diffused and become adopted there is now a natural desire to regulate this process – to give legitimacy to ‘engagement’ itself and to those organisations genuinely carrying out these activities. In turn this will make it harder for other organisations to be ‘free-riders’ and make claims that cannot be substantiated.

93% of fund managers either strongly agreed or agreed that engagement activities should be documented – this would make explicit the exact activities, which constituted an organisations engagement approach. 64% supported the development of a basic standard/minimum level of activity for engagement to be made available to clients, AND 86% supported some form of voluntary/legal requirement to report on these activities at least annually. A broader discussion on the benefits and disbenefits of reporting is provided in section 3.

	Most	A Few	None at all
How many clients/trustees are interested in the outcomes of your engagement process/ require some degree of reporting to substantiate this activity?	21%	64%	15%

The majority of the fund managers surveyed reported that demand from clients for any form of reporting of activities was low.

However if client demand does grow, (and this may be spurred on by the recent recommendations for improved transparency by fund managers contained in the Myners (2001) report), fund managers may secure competitive advantage by implementing an effective reporting mechanism. Reporting and the subsequent need for a structured approach to activities are likely to have a positive impact on the effectiveness of the engagement process.

2.3 – Factors Driving The Development Of Engagement

	Mostly	Partially	Not at all
The development of engagement activity in your organisation is mainly a response to client/trustee/member demand:	7%	64%	29%
The development of engagement activity in your organisation is mainly a response to demand for feedback by co's as a direct result of SRI stock selection process:		29%	71%

The first two questions in this section aimed to determine whether the development of reporting was a response to client demand, or to companies who are involved in the process. The results indicate that reporting does not appear to be subject to significant levels of demand from either companies or clients.

	Agree Strongly	Agree	Disagree	Strongly Disagree
Engagement activities are now an expected 'norm' or element of SRI products:	79%		21%	

However, 79% of the fund managers agreed engagement activities are now an expected 'norm' or element of a SRI strategies. This would suggest that demand for reporting on these activities will emerge in the near future.

Some fund managers express an opinion that they are simply the 'agents' of individual shareholders and that this in some way limits or mitigates against the need for them to use their influence to improve corporate behaviour. However, these results seem clearly to suggest that shareholders are

increasingly expecting that fund managers act as agents in terms of achieving social and environmental benefits as well as financial gains – this creates the legitimate mandate for fund managers actively to encourage sustainability in the companies they invest.

	Significant Influence	Some influence	None at all
Are fund managers under pressure from NGOs, trade associations and government bodies to exert their influence through engagement?	79%		21%

Fund managers are also subject to influence from NGOs, trade associations and government bodies to encourage better environmental and social performance. 79% of fund managers felt that they were influenced in some way by these third parties. This is another driver of engagement activities and one that will demand more transparency and accountability. Not only do third parties ask financial institutions to support certain issues and campaigns, but financial institutions are increasingly being scrutinised in respect of both their own operations and their products, for example Friends of the Earth (2000) report entitled ‘Capital Punishment’.

2.4 – Methodology & Resourcing

	Yes	No	No answer
Macro approach – Do you believe engagement is most effectively achieved through focusing on a specific macro-issue – i.e. one that impacts across one or several sectors?	30%	35%	35%
Micro approach – Do you believe engagement is most effectively achieved through a focus on company specific issues – i.e. a more general approach on a company-by-company basis?	65%		35%
Do you believe engagement is most effectively achieved through a combination of the above?	65%		35%
Does engagement represent an expanding area in terms of resource allocation in your organisation?	79%	14%	7%
Are engagement activities separated from SRI analysis/research activities?		93%	7%

Concerning macro approaches, the results are inconclusive, with opinion divided equally. However close to two thirds of fund managers believed that engagement was most effective when targeting specific companies or specific issues. This preference of methodology is a distinguishing feature of engagement by the financial sector and, as discussed in section 3.1.2, forms the essential baseline for engagement activities. Rather than campaigning on an issue, engagement focuses on improving shareholder value by identifying the business rational for improving environmental and social performance in specific cases.

Encouragingly the same number of fund managers agreed that engagement activities are more effective if there is also a commitment to macro-issues – for example using environmental reporting as a macro-level framework for engaging specific companies.

93% of fund managers indicated that engagement activities were integrated within their SRI research/analysis functions, and 79% indicated that engagement represented an expanding area in terms of resource allocation. The importance of integration is discussed in 3.1.7.

Please indicate in percentage terms how your engagement activity is distributed amongst the following categories:					
	Proxy Voting	Engagement on one issue targeting one specific sector	Engagement on one issue targeting more than one sector	Collaborative actions of any nature (i.e. involving more than one fund manager)	Engagement with co's on an individual basis on issues arising from SRI co. research
Average	18.5%	10%	10%	6%	33%

Taking a pure average, specific company engagement still comprises the majority of all engagement activities. Of note is the currently low score for collaborative actions (6%). As is discussed in 3.1.8, this type of activity needs to increase.

2.5 – Collaborative Action

	Yes - definitely	Possibly	Not at all	No answer
Would you consider participating in/directing resources towards collaborative engagement projects?	65%	28%		7%
Can competitive issues – cost and benefit allocation – be overcome to achieve more focused/concentrated engagement approaches by a number of fund managers?	51%	28%	7%	14%

	Equal cost allocation	Equal benefit allocation	Both	No answer
Please indicate the main barrier to collaborative approaches:	1	8	1	4

Two thirds of the respondents confirmed they would definitely consider participating in and directing resources toward collaborative engagement projects, and 79% felt competitive issues (cost and benefit allocations) could definitely or possibly be overcome.

Interestingly, the majority of those surveyed identified equal benefit allocation (i.e. credit) as the most difficult barrier to overcome in terms of collaborative engagement projects – interesting because this appears to conflict with the claims by most fund managers in their interviews that taking credit was not important – what was important was the end result.

Formal Approach	Forum proposes issues for group action	Forum bringing together those pursuing same issues	Do not believe this is possible	No answer
Collaborative action can be best achieved through co-ordination by a neutral forum – please indicate how best this might be achieved:	14%	43%	29%	14%

Informal Approach	Participants are identified by company/trade associations	Fund managers pursue allegiances with other fund managers	Do not believe this is possible	No answer
Collaborative action can be best achieved by closed door and select collaborations – please indicate how best this might be achieved:		65%	14%	21%

Formal approaches are likely to be more resource efficient (see 3.1.8) and over half the fund managers supported some form of formal process involving a coordinating forum. Informal approaches to collaborative action received more support with almost two thirds of fund managers indicating a preference for this type of arrangement. This is symptomatic of the problem of achieving co-operation amongst competitors, and how this could stand in the way of operationalising more efficient formal approaches.

	Yes	Possibly if opportunity arose	No	No answer
Do you pursue particular avenues of engagement in collaboration with NGOs, trade associations etc?	72%		14%	14%

72% of fund managers gave a positive response as to whether they would pursue collaborative actions with other third parties, including NGOs.

The largely positive response to questions on collaborative engagement projects is significant. As analysis for SRI portfolios, and many initial engagement projects, is founded on the distribution of questionnaires to companies, questionnaire ‘fatigue’ amongst companies is an increasing problem, and adversely affects the quality of data returned by companies, and response rates. Rather than receiving questionnaires from, or being approached individually by, a multitude of fund managers, companies’ resources could be much more efficiently utilised by collaborative approaches. In terms of the effectiveness of engagement, this is a crucial area of growth particularly if engagement activities are to be extended to smaller companies. Willingness by fund managers to collaborate with not just each other, but through third parties such as trade associations, is likely to be vital to successfully engaging smaller companies. This is discussed in further detail in 3.1.8.

2.6 – Outcomes

	Most	A Few	None at all	No answer
Do many companies demonstrate significant change following engagement?	7%	86%		7%

In terms of outcomes funds managers generally agreed that only a few companies demonstrated any significant change following engagement by fund managers. However recognizing outcomes is very difficult for a number of reasons:

1. Change is more often the result of continuous pressure – engagement is significant in that it contributes to a cumulative application of influence by a broader group of stakeholders;
2. Engagement in many cases serves as a means to put environmental and social issues onto the strategic agenda – an essential prerequisite condition for further significant change at operational and strategic levels;
3. Many changes, if agreed to in principle take much longer to operationalise in practice – for example environmental reporting to any meaningful level.

	Very	Not very	Changes would have happened anyway	No answer
Are substantial changes to company environmental and social practices achieved by engagement?	29%	29%	13%	29%

	Mostly	In a few cases	Not at all	No answer
In relation to the above are these changes easy to identify and document?	7%	57%	22%	14%
Do companies willingly accept/knowledge that influence from fund managers played a substantial part in bringing about environmentally an socially proactive change in their organisations?	22%	50%	21%	7%

While almost a third of fund managers indicated that substantial changes to company environmental and social practices can be achieved by engagement, the difficulties in analyzing the outcomes of engagement are evidenced by the following responses:

- 57% reported that tangible change could only be identified in a few cases only
- 50% reported that only in few cases did companies acknowledge that fund managers' influence had played a substantial role instigating environmental and social improvements.

	Agree Strongly	Agree	Disagree	Strongly Disagree	No answer
Would your engagement activities be enhanced/focused by a diffusion of best practice examples and knowledge?	64%		14%		22%

Two thirds of fund managers agreed that engagement activities would be generally improved by diffusing best practice examples and experiences amongst practitioners. In order that engagement activities can become more focused and effective, documenting the effectiveness of different approaches and learning from past success and failures, through more open reporting is necessary.

2.7 Summary of Survey Data Analysis

The main points arising from this analysis are summarized below. Section 4 draws these summary points together with the key points arising from the discussion in Section 3.

- The majority of SRI fund managers are committed to both the practice and principles of engagement.
- SRI Fund managers recognize the need for a formal reporting structure to increase the legitimacy, accountability and transparency of their activities.
- Internal (e.g. client) pressure for the initial development of engagement activity was not strong, but that now established, engagement has become an expected norm (79%) - suggesting that this internal 'client' pressure will now become significant.
- Outcomes are very difficult to substantiate. However a significant number of Fund Managers were able to identify a small number of cases where engagement has been directly related to environmental and social improvements in companies.

- Effective baseline engagement is focused at company specific issues. This is complemented, not replaced, by macro-level engagement.
- Engagement activities are generally integrated into company analysis and represent an area of resource expansion in financial organisations.
- Although widely supported in theory, collaborative engagement comprises only a small proportion of overall engagement activities.
- Informal approaches to collaborative engagement have more support than coordination through a forum.
- Outcomes are very difficult to substantiate but a significant number of fund managers can identify cases where engagement has been directly related to environmental or social improvements in companies.
- Engagement activities would be improved by developing best practice guidelines through case studies and reporting.

SECTION III - DISCUSSION

The preceding section identified broad areas of consensus. This analysis provides a more detailed description of existing engagement practices, and specific ideas and recommendations as to how engagement can increase its effectiveness. The key points arising from each discussion are highlighted. These are drawn together in the concluding section (section 4) with the results of the data analysis in Section 2.

What was very clear is that there is a broad range of approaches used by fund managers. Definitions of engagement range from letter writing and meetings with individual companies, proxy voting activity (together with dialogue with the companies as to reasons for the voting decision), engagement with groups companies on particular issues e.g. environmental reporting and affordable drugs, to engagement at a policy level e.g. with the EU and WBCSD.

Potentially engagement could be a very significant tool in driving towards a sustainable economy and the results below start to build a picture of not only how this is already being achieved but also how engagement can become more effective.

3.1 – Methodology

3.1.1 Do you forward plan an agenda for engagement, for example on an annual basis?

There is a growing recognition amongst fund managers that activities must be planned. This is advantageous for two reasons – it facilitates a more efficient allocation of resources, by prioritizing issues and providing a baseline against which subsequent activities can be reviewed. The agendas set tend to either be on an annual or quarterly basis.

Mansley and Dlugolecki (2001 pp39) have commented on the benefits of proactive planning also: “In order to make the fund’s position transparent and consistent to investee companies, it would be sensible for the institutional investor to develop a policy statement of what the fund considers to be good corporate practice...This would be a useful prelude to any engagement activity as it will mean companies know what to expect and would ensure engagement is seen to be fair.”

Friends, Ivory and Sime, whose reports point to a number of successful engagement projects, estimate that 80% of their total engagement agenda is forward-planned, supporting the correlation between planning and effectiveness.

However what is also important is that fund managers remain responsive to issues as they arise and are able to incorporate these into their general strategy.

Key Point: *Planning is the basis of effective and accountable engagement activities.*

3.1.2 Do you identify several ‘macro-issues’, i.e. issues that impact generally within a sector, or specific ‘micro’ issues, i.e. issues which are associated with specific companies?

Fund managers who are developing their engagement approach typically indicate a bias towards micro, company-specific issues. These include issues specific to a particular company’s strategic or operational characteristics and also compliance with sector-specific environmental and social standards.

In terms of macro-issues – i.e. developing a stance on environmental reporting, or codes of practice for labour and requiring all companies to work towards these (e.g. Morley Fund Management’s announcement that it will vote against the accounts of any FTSE100 companies not disclosing information on the environment) – only fund managers with a more mature or robust research and engagement methodology approached engagement in this manner.

Focusing on specific company issues is undoubtedly effective in terms of influencing environmental and social policies and tends to be associated with an economic rational that is specifically concerned with the correlation between shareholder values and sustainability. Therefore dialogue with companies on specific environmental and social compliance and risk issues is seen as a necessary element of general and responsible company analysis. This can be termed **baseline engagement**. Friends, Ivory & Sime (FIS) would identify these to be generally either Reactive Issues (those raised by NGOs and the media e.g. Balfour Beatty/Ilisu Dam) and Relationship Issues (specific issues with companies of which FIS have at least a 1% shareholding).

Fund managers taking a macro approach, seeking to influence the adoption of best practice across specific sectors of the business community (e.g. Friends, Ivory & Sime and labour standards in the apparel industry) tended to communicate a stronger economic and moral rational towards their engagement - the economic rational relating to the necessity of a sustainable economy in the long term, and the moral imperative relating to fund managers’ responsibilities to contribute to sustainability. The evidence from this survey indicates that macro-level engagement will increase, as it tends to be a feature of ‘mature’ engagement strategies. This is very important to expanding the scope of engagement.

Key Point: *SRI fund managers generally start off working on baseline engagement on immediate company-specific issues. The more mature SRI funds then progress towards involvement in sectoral issues.*

3.1.3 Do you have a formal method of engagement or a flexible approach based around the issues and parties involved?

The value of developing a formal approach lies in ensuring that when engaging companies the most relevant issues are raised and appropriate question asked. By ‘formal approaches’, we mean periodic review and prioritisation of issues; strategic planning of engagement projects, identifying Key Performance Indicators by which companies’ environmental and social performance can be assessed, research approach (e.g. standard letters, followed by questionnaires, cut-off points for response times etc). Aegon states that developing a formal method helps to ensure ‘value’ areas are identified, so that it is evident where companies are or could make significant changes.

Only one fund manager indicated that they did not have some form of formalised engagement approach (or were developing such an approach). In discussing the value of formalised approaches the following key points emerged:

1. The problem of questionnaire fatigue – if fund managers bombard companies with repetitive questionnaires responses are likely to suffer in terms of quality and response rate.
2. As SRI moves towards portfolios including smaller companies fund managers need to consider that these companies do not have the resources to respond to increasing requests for information. Fund managers need to consider how this problem can be addressed, perhaps through the standardization of information requests.
3. Flexibility is important – this can be achieved by developing a range of approaches (standard letters/meetings/ seminars) and the applying these as appropriate.
4. A formalised approach aids the integration of engagement principles and activities across the whole of an investment house.

***Key Point:** Formalised approaches to engagement bring benefits in terms of a comprehensive and systematic approach to SRI. However, as SRI grows, the problems for companies of questionnaire fatigue are likely to grow, and new approaches will need to be developed.*

3.1.4 Are you responsive to issues brought to you by third parties e.g. NGOs or do these tend to raise defensive positions from the companies these involve.

All the fund managers in the survey said they were responsive to issues brought by third parties such as NGOs. The relationships ranged from being responsive to issues, consulting on issues, to closer research links including staff exchanges (Morley). While good working relationships with NGOs clearly enhance the effectiveness of engagement activities (Oxfam and GSK, Greenpeace and BP) all fund managers qualify their responses with the need for discretion and balance, and that sometimes their response would not necessarily be the one the NGO was hoping for. This is because fund managers must look for the business case through which issues are pursued.

***Key Point:** SRI Fund Managers engage with NGOs both as sources of information, and as a means of identifying areas of public concern. However, they prefer to maintain an arm’s length relationship with the NGOs, in recognition of the different interests and pressures involved.*

3.1.5 Do you make specific requests for change e.g. a public commitment to a written policy, reporting on progress in implementation?

Most fund managers said they would make specific requests of companies – for example in the areas of reporting, disclosure and making a public commitment to a particular standard or policy.

However, two fund managers voiced more caution over this – stating that fund managers can only make suggestions or recommendations in order to prevent alienation by company boards. Furthermore the nature of the request must also depend on the degree of environmental and social development within a company.

The overall response is encouraging. Engagement will become more effective as fund managers use their influence in stronger and more explicit ways. Morley’s recent public announcement of their stance on FTSE 100 companies and environmental reporting is the leading example.

Key Point: *Engagement activities are likely to be more effective if accompanied by public statement of commitment. There is a strong argument therefore that engagement in the UK needs to become more public, as it is in the US.*

3.1.6 Do you aim to participate in major debates and initiatives undertaken by trade associations, NGOs and government – do you feel you can begin to engage at the policy level?

Responses indicate that financial institutions are becoming significant participants in sustainability debates at national and indeed, international levels. Engagement at this level was illustrated by participation in consultations and working groups – for example DETR General Guidelines for Environmental Reporting, Just Pensions, WBCSD (development of eco-efficiency indicators), UNEP Financial Initiative (how financial institutions contribute to Rio+10), OECD (consultation on indicators), and FTSE4Good consultation on ethical criteria.

Consultation with trade associations and NGOs on relevant sectoral issues etc as part of analysis process, and as part of the process of developing issue positions appears increasingly common. FIS terms these relationships as ‘knowledge partnerships’. A significant example of this is the consultation process that has led up to the recent launch of the Association of British Insurers (ABI) guidelines on company disclosure of social and environmental risks.

While engagement at this level is undoubtedly important, engagement activities should have a robust system of company engagement in place - because their influence is likely to be more immediately effective in securing change at the company level.

Key Point: *While baseline engagement remains the key feature, fund managers are increasingly participating in national and international debates, widening the scope of engagement.*

3.1.7 Do you actively use your proxy votes to support your engagement activities or do you feel there are potentially too many conflicts of interest in this area?

The effectiveness of engagement activities must be assessed with reference to proxy voting strategies employed by fund managers.

Most fund managers have developed specific Corporate Governance units to assess how votes should be used. The responsibility of fund managers to vote proxies has recently been reinforced at government level by the Myners Report (2001). The integration of SRI units with corporate governance units is very important if engagement activities are to be influential. Votes against

company management boards are increasingly regarded as final recourse where dialogue fails. This is an effective mechanism, but only if corporate governance and SRI goals are integrated.

From all the responses the most important aspects of this integration are that:

1. Proxy voting strategies, which reflect SRI and engagement principles, should demonstrate that the fund management institution as a whole, rather than just an isolated SRI unit, is committed to the goal of social and environmental sustainability.
2. Voting strategies and reasons for 'no' votes or abstentions must be communicated to the company if they are to achieve their purpose. If these are integrated within a broader engagement programme the significance and influence of all dialogue will be increased.
3. Engagement can be seen as non-confrontational precursor to shareholder activism – thereby protecting and even improving fund manager–company relationships.

Key Point: *Engagement and proxy voting are mutually reinforcing – the effectiveness of each as a tool for improving corporate environmental and social impacts can be dependent on the development of the other.*

3.1.8 Do you participate in collaborative engagement projects:

Collaborative engagement projects are an increasingly important aspect for the following reasons:

1. As SRI grows, the requirement for company information on environmental and social matters is increasing exponentially. Fund managers are sending a growing volume of questionnaires and fatigue is now becoming evident, in the form of poorer data quality, response rates and increasingly public objection.
2. Not only fund managers, but also a rapidly growing body of specialist SRI research agencies e.g. EIRIS, Innovest are collating data via questionnaires. The growth of SRI on the continent and the expansion of SRI to international equities in the US mean UK companies are also subject to approaches from overseas agencies.
3. The spectrum of issues, and positions on issues means that no one questionnaire is the same and increasingly companies are becoming frustrated with varied ratings and requests for similar information in different formats.
4. The similar increase in meetings and dialogue is likely to put companies' resources under further pressure and reduce their willingness to participate.

Collaborative engagement conveys the following advantages:

1. Fund managers approaching companies as a group rather than individually is a much more resource efficient process for all parties.
2. If a company can allocate its resource more efficiently as a consequence of group rather than individual engagement exercise this is likely to improve the quality of the relationship with its major investors and the subsequent response.
3. By collaborating, fund managers can back up their dialogue with enhanced combined shareholdings.
4. Rather than spreading resources thinly over the spectrum of possible issues, fund managers can adopt specialist areas of knowledge and then enter into reciprocal knowledge sharing collaborations.

5. The increasingly significant social institutions and networks through which collaborative engagement is likely to develop would circumvent the problem of free riding.

The most significant barriers to collaborative engagement which fund managers referred to were:

1. Achieving co-operation amongst competitors. However, the small but significant number of collaborative projects e.g. involving GSK (see Appendix III) indicates this can be indeed be achieved. Indeed, several fund managers commented, that competitive barriers tended to be greater in perception than reality.
2. The incompatibility of the different relationships between different investors and the companies involved.
3. Jupiter commented that SRI practitioners should avoid developing 'industry positions'. Investor-investee relationships are more important than the SRI industry having a relationship with a company.

However there is a strong indication that the fundamental need to bring about change, and the reality of the improved access to information and efficiency collaborative action facilitates, will outweigh any perceived disadvantages in terms of competitive and confidentiality issues.

A more formal approach could help to produce more focused activities for example through forums such as UKSIF operating as an issues clearing house to bring fund managers together and coordinate logistics.

Key Point: *By collaborating, SRI fund managers can benefit from division of labour and knowledge-pooling, improved quality of information from investee companies and increased shareholder clout as well as reducing perceptions of free-riding. Competitive pressures and concerns over investor-investee relationships act as counterweights to the pressure for greater collaboration.*

3.2 Outcomes

3.2.1 Can you quantify the outcomes of your engagement activities in any way?

Outcomes of engagement activities by and large cannot be quantified. The overriding reasons for this are:

- It is neither possible (nor desirable to some fund managers) to attribute the influence of one stakeholder as the driving factor behind corporate change - for example the implementation of environmental risk management policies by a company.
- Engagement can be a long-term process and change is often piecemeal and incremental in response to cumulative influence.
- Responses/outcomes can be diverse ranging from implementation of reporting mechanisms to approaches for consultation. Depending on the baseline environmental and social standards of a company, achieving ISO14001 can represent a more significant achievement by one company compared to another.
- Responses and outcomes are also dependent on resources available in the companies themselves.
- Company boards prefer to retain their sovereignty over management decisions, or at least be perceived to do so.

Consequently it is the transparency and integrity of the engagement **process**, which becomes paramount, especially in terms of reporting. Therefore any quantitative reporting on behalf of fund managers would more usefully concern the number of companies approached (letters, meetings etc), and the issues and debates raised and participated in. Reporting issue positions and the rationale behind these also becomes crucial – if a stance is adopted, yet no action reported then claims of engagement would clearly be unjustified. Another important area of quantification is proxy voting – detailing how votes have been used.

Leading engagement practitioners are constructing substantial databases, which record their activities, providing audit trails. CIS have developed a set of Key Performance Indicators against which activities are monitored by an independent body. Jupiter, have developed four 'process categories'; commitment, dialogue, results and communication. For each a qualitative description and a quantitative indicator are provided. Examples of the latter are respectively, number of SRI professionals employed, number of companies met with, frequency of reporting, and the number of occasions in the previous year when your engagement has played a part in environmental or social improvement in companies.

To this extent there are clearly developing a number of robust process recording, monitoring and reporting systems.

Impacts are also generally only seen at the micro level. The effect of engagement at sector and national levels is unlikely to be measurable in the short term, and issues of causality are likely to remain difficult.

***Key Point:** Given the difficulties of measuring outcomes, recording and monitoring activities and reviewing these against the issues on which fund managers claim to work is currently of more value in determining the effectiveness of engagement activities than attempting to quantify the outcomes associated with these activities.*

3.2.2 Do companies openly accept that they have improved environmental and social practices and policies as a direct response to influence from fund managers?

The consensus view on this question was that companies rarely openly accept that they have instigated change as a direct result of shareholder influence – although they may do privately. Furthermore, results were considered more important than taking credit for the means by which they were achieved. There are several reasons which were commonly stated:

1. Companies like to retain board sovereignty over management decisions – at least publicly;
2. It is better for companies to implement change because they make good business sense rather than as a result of 'coercion'.
3. Boards must be seen to consider the views of all stakeholders – not just investors – and to instigate changes accordingly.

***Key Point:** fund managers/shareholders represent only one group of a wider body of stakeholders who influence corporate activities. This is an important aspect, which should be communicated to the readers of engagement reports, and recognized by those seeking to assess the effectiveness of engagement activities.*

3.2.3 What is your most significant achievement over the last year?

Significant achievements must be assessed in context – sometimes just gaining board level acceptance of the importance of sustainability issues is a significant achievement. The response to this question was varied and sometimes limited by concern for confidentiality issues. However, of note was the frequent reference to the successful campaign on affordable medicines involving GSK. For example, according to *Professional Pensions*, 28 June 2001:

GlaxoSmithKline has responded to pressure from socially responsible investment managers and reduced the costs of essential medicines and drugs for developing countries. GSK will start offering all under developed countries... “preferential prices” for HIV/AIDS and anti-malarial drugs. GSK’s new policy follows a ‘round table’ meeting that took place in March of the teams from Morley Fund Management, Jupiter Asset Management, Friends Ivory and Sime and Henderson Global Investors. The managers worked together to compare their strategies on petitioning GSK after fears over negative media coverage on the pharmaceutical company’s pricing policies.

Key Point: *the significant number of references to the GSK engagement project and its outcome highlights the effectiveness of collaborative engagement projects. The development of these activities must be a key area of research.*

3.2.4 Are companies becoming more responsive to investor influence or more wary – essentially do you believe engagement is likely to continue to be a growing activity?

The consensus from fund managers was that overall companies are progressively more responsive to the interests of their shareholders. This is driven by increased corporate understanding of what the engagement process is and what it is trying to achieve.

This improved understanding is illustrated by the increased instances when companies approach fund managers for advice, prior to reporting or tabling resolutions, either to improve their output or to identify and redress potential areas of conflict.

The continuance of this trend is susceptible, however, to companies becoming frustrated by the multitude of requests for information and meetings by individual fund managers. Therefore, if engagement is to continue to grow as an effective tool of sustainability, collaborative engagement activities must increase.

Another important issue that arose from this discussion is the quality of the relationships between fund managers and companies. Fund managers with an established track record of SRI and engagement activities can point to greater longevity and quality in their corporate relationships. FIS suggest that engagement will become increasingly professionalised in the management of these relationships.

Maintaining the objectivity and transparency of these relationships can be problematic, especially where ‘traditional’ relationships between fund managers and companies are concerned. Storebrand commented that fund managers may well exercise more restraint in the requests they make, particularly of some of largest global corporations, if they fear more forceful requests could provoke an adverse reaction which could jeopardize the traditional relationship. The balance of power in investor-investee relationships is therefore an important factor in determining the efficacy of engagement.

The relative bargaining positions of investors and investees may be balanced by not only increased public reporting of engagement by fund managers, but also as NGOs become more skilled at drafting shareholder resolutions. The increasing media interest in how major shareholders then vote on these NGO sponsored resolutions will encourage companies to be more responsive to shareholders to avoid public condemnation.

Key Point: *Engagement is as much about managing relationships as exerting influence. Engagement must be assessed with a regard to the balance of power held by the parties, and in this regard collaborative engagement would be beneficial by ensuring shareholders hold this balance of power.*

3.3 Transparency

3.3.1 Does your engagement process have an audit trail – can outcomes be substantiated or does this undermine the achievements attained by informal, closed-door engagement?

Only one fund manager stated that there was no audit trail for their activities. Two however had a formal process that including verification by an external body. All other fund managers had some form of internal auditing process through which their activities could be monitored, usually via the maintenance of issues and company databases.

The issue of substantiating outcomes versus process was discussed in section 2.6 and, with reference to this, further discussion here will focus on activities rather than outcomes. In terms of disclosing activities pertaining to informal and closed-door engagement, fund managers who have a well-developed reporting system stated that documenting these activities openly was only problematic during the process - careful reporting subsequent to their conclusion would not jeopardize or undermine them. Jupiter (2001 pp7) provide an example of how reporting can be sensitive, stating prior to results that;

“We know that companies are subject to influence from a range of sources and so we are wary about making direct links between any suggestions that we make to companies and improvements that companies subsequently make. However we do believe that our engagement and support has had a discernible impact in a number of the companies mentioned.”

Key Point: *achieving transparency and accountability for all types of engagement activity is both preferable and possible, with carefully managed reporting.*

3.3.2 Do you report your engagement activities and are they measured against any agendas set at the beginning of the engagement period? And

3.3.3 If you do report on engagement, how frequently do you do this and how detailed is the information?

A few fund managers distinguish themselves in terms of the quality and detail of their reporting, to both private clients and the public. The nature of these reports demonstrates that despite the difficulty in terms of quantifying engagement activities and relating these to particular outcomes, reporting is ‘doable’.

An obvious and natural correlation between good public reporting and a high standard of engagement activities is apparent. The importance of public reporting is that it subjects engagement

activities to wider scrutiny and naturally encourages results to be backed by robust and transparent evidence.

Reporting is increasing, and the best practice standards are being set by a small number of fund managers. Governmental support for reporting has been expressed in the Myners Report (2001), which recommended that fund managers need to increase the transparency of their activities to clients.

Key Point: *Reporting is an essential element to ensuring engagement activities are effective in their implementation.*

3.3.4 What are the barriers to more transparent reporting?

In broad terms fund managers agreed that confidentiality issues remained the principal barrier to increased reporting. In most instances, resource limitations were either seen as temporary or largely irrelevant, and that careful reporting could guard intellectual property.

Confidentiality concerns are expressed as reluctance on behalf of fund managers to be too open about their relationships with specific companies and report sensitive issues. This is partly because certain issues are open to mis-interpretation or manipulation in the public arena by the media, and could potentially damage investor-company relations.

Key Point: *While client confidentiality remains an obstacle, the majority of fund managers do not regard resourcing and competitive issues as significant barriers. This indicates that reporting can continue to develop, with fund managers using the quality of their reporting as a source of competitive advantage.*

3.3.5 Do you believe increased voluntary reporting by fund managers of their engagement activity would help to provide a basis for some ‘ground rules’ or minimum acceptable standards that trustees/clients/members could use to assess engagement performance?

Interviewees generally agreed that some ‘ground-rules’ for engagement would be advantageous, both to clients and fund managers. The discussion focused on the advantages and disadvantages of developing a formal set of guidelines. In addition a number of recommendations as to the possible form of such a set of guidelines would take were discussed.

Disadvantages of Guidelines

- Targets and standard may reduce the quality of existing reporting if efforts become concentrated on meeting quantitative targets.
- Solely focusing on engagement activities may not be the most appropriate issue. Rather, it may be better to investigate more general client reporting guidelines that span the whole fund management process of which engagement is only one activity.

Advantage of Guidelines

- Reports based on a common set of guidelines provide a better basis for comparison.
- There is an increasing tide of opinion voiced by traditional analysts and ‘deep green’ ecologists that engagement is being used purely as a marketing tool, and existing claims of

engagement and reporting are ‘green-wash’. Developing guidelines mean that fund managers can publicly accredit their activities and reporting to these critics.

- Improving the public accountability of engagement activities could encourage better responses by corporate managers.
- Setting minimum standards is useful for clients to gauge the success of their fund manager’s SRI strategy. Just Pensions (2001) provides a first attempt by outlining a number of questions that trustees should ask of their fund managers to ascertain the extent and quality of engagement provided by fund managers.
- Improving the transparency and credibility of existing activities should enhance their effectiveness by ensuring verbal statements are matched equally by actions.
- Reporting will increase the understanding of clients and may encourage them to participate in engagement activities more directly as shareholders themselves. By directly engaging with supply chains, win-win solutions are more likely to be identified.

Recommendations Arising from the Discussion:

From the discussion on this topic, a number of key recommendations can be drawn.

- Guidelines should avoid imposing rigid standards. The quality of some reporting may be lost if it becomes a bureaucratic exercise.
- Flexible guidelines are needed to allow for the various approaches taken by fund managers. The variation in approaches allow fund managers to distinguish themselves from one another – for example whether their engagement activities are designed to encourage sustainable business solutions, support ethical campaigns, for example against animal testing, or policy level engagement.
- Representatives of the financial industry as a whole must develop a set of industry accepted indicators. Jupiter stated they would genuinely like to be able to report against a set of industry accepted set of indicators, but that one fund manager cannot make these rules alone.
- Indicators to measure engagement activities and their effectiveness should be developed from best practice examples derived from experience and case studies, and achieve a balance between quantitative and qualitative indicators.
- Best practice needs to include the reporting of instances when companies are NOT responsive to engagement. Baillie Gifford commented that this is as important as reporting successes.
- Reporting on a no-names basis in certain instances must be recognized as a valid when particularly sensitive issues are being addressed.

Key Point: *There is a real need for credible benchmarks on SRI performance. These would enhance the credibility of engagement with NGOs and other critics, help develop and disseminate best practice and enable clients to evaluate fund manager performance on SRI engagement. However such benchmarks must recognise the diversity of engagement processes and avoid any tendency to stifle innovation.*

SECTION IV - CONCLUSIONS

Engagement is a dynamic activity, which has developed rapidly as a means of influence to change corporate environmental and social practices. The broader movement within which engagement is placed, SRI, is evidently well established and growing, and its links with sustainable development clear and tangible.

The varied and ad hoc development of engagement means that there is now considerable interest in formalizing this channel of influence – not only to improve the transparency, accountability and credibility of activities, but also to improve the effectiveness of engagement and increase the significance of the positive environmental and social outcomes achieved.

This study has collected opinions and views, many of which have been voiced within the SRI community already, but which have until now not been captured and presented as a whole. Therefore the results do not present any surprising or vastly novel ideas, but do confirm positive support for the issues summarized below in Table 2 and help to develop a clearer overall picture of the opportunities and barriers to improving the effectiveness of engagement. Ideally this would be a starting point from which more formal guidelines could begin to be drawn, especially in respect of accountability and transparency issues.

In order to develop an overall picture, the level of detailed analysis has necessarily been limited. Discussion of collaborative engagement projects is a particular area where further in depth analysis would be beneficial as this appears to be a particularly effective area of engagement.

The methodology would also benefit from incorporating a greater number of fund managers and other organisations involved in engagement activities – for example NGOs (e.g. Forum for The Future’s Centre for Sustainable Investment), trade associations (e.g. Association of British Insurers), rating agencies (e.g. Global Risk Management & EIRiS), large pension funds (e.g. University Superannuation Scheme) and other advisory bodies (e.g. Local Authority Pension Fund Forum and National Association of Pension Funds). Detailed case studies of specific engagement projects e.g. GSK would also be useful.

Finally, Table 2 below brings together the analysis presented in Section 2 with the discussion in Section 3; drawing together consensus data with recommendations to indicate the areas where progress is most likely.

TABLE 2: How Key Points Arising From Discussions Relate To The Areas Of Consensus And Need Identified In The Quantitative Data Analysis

TABLE 2: Results	
SUMMARY POINTS FROM DATA ANALYSIS	KEY DISCUSSION POINTS
The majority of fund managers are committed to both the practice and principles of engagement. (3.1)	4.1.5 Key Point: Engagement activities are likely to be more effective if accompanied by a public statement of commitment. There is a strong argument therefore that engagement in the UK needs to become more open, as it is

	<p>in the US.</p> <p>4.1.6 Key Point: While baseline engagement remains the key feature, fund managers are increasingly participating in national and international debates, widening the scope of engagement.</p> <p>4.1.7 Key Point: Engagement and proxy voting are mutually reinforcing – the effectiveness of each as a tool for improving corporate environmental and social impacts can be dependent on the development of the other.</p>
<p>Fund managers recognize the need for a formal reporting structure to increase the legitimacy, accountability and transparency of their activities.</p> <p>(3.2)</p>	<p>4.1.1. Key Point: Planning is the basis of effective and accountable engagement activities.</p> <p>4.1.3 Key Point: Formalised approaches to engagement bring benefits in terms of a comprehensive and systematic approach to SRI. However, as SRI grows, the problems for companies of questionnaire fatigue are likely to grow, and new approaches will need to be developed.</p>
<p>Engagement activities are increasingly demand driven. Clients and NGOs want their interests (financial, environmental and social) as shareholders represented.</p> <p>(3.3)</p>	<p>4.1.4 Key Point: SRI Fund Managers engage with NGOs both as sources of information, and as a means of identifying areas of public concern. However, they prefer to maintain an arm’s length relationship with the NGOs, in recognition of the different interests and pressures involved.</p>
<p>Effective baseline engagement is focused at company specific issues. This is complemented, not substitutable, by macro-level engagement.</p> <p>(3.4)</p>	<p>4.1.2 Key Point: SRI fund managers generally start off working on baseline engagement on immediate company-specific issues. The more mature SRI funds then progress towards involvement in sectoral issues.</p>
<p>Engagement activities are generally integrated into company analysis and represent an area of resource expansion in financial organisations.</p> <p>(3.4)</p>	<p>4.3.4 Key Point: While client confidentiality remains an obstacle, the majority of fund managers do not regard resourcing and competitive issues as significant barriers. This indicates that reporting can continue to develop, with fund managers using the quality of their reporting as a source of competitive advantage.</p>
<p>Although widely supported in theory, collaborative engagement comprises only a small proportion of overall engagement activities.</p> <p>(3.5)</p>	<p>4.1.8 Key Point: By collaborating, SRI fund managers can benefit from division of labour and knowledge-pooling, improved quality of information from investee companies and increased shareholder clout as well as reducing perceptions of free-riding. Competitive pressures and concerns over investor-investee relationships act as counterweights to the pressure for greater collaboration.</p> <p>4.2.3 Key Point: The significant number of references to the GSK engagement project and its outcome highlights the</p>

	<p>effectiveness of collaborative engagement projects. The development of these activities must be a key area of research.</p>
<p>Informal approaches to collaborative engagement have more support than coordination through a forum. (3.5)</p>	<p>4.2.4 Key Point: Engagement is as much about managing relationships as exerting influence. Engagement must be assessed with a regard to the balance of power held by the parties and in this regard collaborative engagement would be beneficial by ensuring shareholders hold this balance of power.</p>
<p>Outcomes are very difficult to substantiate but a significant number of fund managers can identify cases where engagement has been directly related to environmental or social improvements in companies. (3.6)</p>	<p>4.2.1 Key Point: Given the difficulties of measuring outcomes, recording and monitoring activities and reviewing these against the issues on which fund managers claim to work is currently of more value in determining the effectiveness of engagement activities than attempting to quantify the outcomes associated with these activities. 4.2.2 Key Point: Fund managers/shareholders represent only one group of a wider body of stakeholders who influence corporate activities. This is an important aspect, which should be communicated to the readers of engagement reports, and recognized by those seeking to assess the effectiveness of engagement activities</p>
<p>Engagement activities would be improved by developing best practice guidelines through case studies and reporting. (3.6)</p>	<p>4.3.1 Key Point: Achieving transparency and accountability for all types of engagement activity is possible, with carefully managed reporting. 4.3.2/4.3.3 Key Point: Reporting is an essential element to ensuring engagement activities are effective in their implementation. 4.4.5 Key Point: There is a real need for credible benchmarks on SRI performance. These would enhance the credibility of engagement with NGOs and other critics, help develop and disseminate best practice and enable clients to evaluate fund manager performance on SRI engagement. However such benchmarks must recognise the diversity of engagement processes and avoid any tendency to stifle innovation.</p>

[ENDS]