Investor engagement with companies is reported as being on the rise,¹ with clear evidence demonstrating the ability of investors to successfully promote change at investee companies. There are a number of academic and industry studies which, looking at different aspects of active ownership, consider its impact on corporate social and financial performance. These studies paint a compelling picture showing that investors could at the same time improve the potential social impact of their shareholdings through stewardship as well as improving companies’ financial performance.

The following document reviews the academic and industry evidence for the impacts of shareholder engagement. It groups the papers discussed in four key themes which examine:
1. the increase in active ownership and the growing role of institutional investors as activists;
2. the link between corporate social responsibility, shareholder activism and corporate financial performance;
3. the market reactions following shareholder campaigns;
4. the effects of active ownership on companies’ social and environmental performance.

### The Rise of Active Ownership and The Role of Institutional Investors

[http://www.shareholderforum.com/access/Library/20150130_ActivistInsight-SRZ.pdf](http://www.shareholderforum.com/access/Library/20150130_ActivistInsight-SRZ.pdf)

The latest “Annual Review of Trends in Shareholder Activism” published by Activist Insight (2015) argues that corporate governance is now more shareholder-centric as a result of the activist movement, with far less passivity from shareholders and proxy voting advisors, even in areas traditionally within the exclusive remit of the board of directors. The report indicates that a total of 344 companies worldwide were subjected to activist demands in 2014, up 18% from the 291 recorded in 2013. In 2014, 75% of demands were at least partially satisfied, up from 67% in 2013.

#### OECD (2014) Institutional Investors and Ownership Engagement

This recent OECD (2014) report provides evidence of the rise of public equity held by institutional investors across the world. In the last 50 years in the UK, the portion of public equity held by individual investors, as opposed to institutions, has decreased from 54% to only 11%. Similar trends are observable elsewhere in the world as well. In the mid-1960s, individuals held 84% of all publicly listed stocks in the United States, whereas today they hold around 40%. In Japan the proportion of direct shareholdings is even smaller – in 2011 only 18% of all public equity was held by individuals.


The paper cited above argues that: “Corporations increasingly face a new type of shareholder: the shareholder activist. The rise of shareholder activism suggests that engagement with companies can be an effective approach to socially responsible investing.” Institutional investors can successfully promote change at investee companies because they are the most powerful shareholder group and can put pressure on the board of directors.

This report by the Deutsche Bank group is based on research produced by the European Centre for Corporate Engagement. It assesses the importance of withdrawn shareholder resolutions as a governance mechanism and analyses a sample of proposals at S&P1500 companies from 1997 – 2009. The results indicate that a significant number of proposals are withdrawn (approximately 20% each year). Institutional investors filed 2,392 proposals over the period, of which 810 or 33.9% were withdrawn before the AGM, indicating the reaching of an agreement with management. The paper argues that institutional investors appear able to promote changes in corporate behaviour pertaining to ESG issues.

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According to Burkhart, Gromb and Panunzi (1997), as well as Scheifer and Vishny (1986), large shareholders are important and powerful corporate monitors because they have more influence and incentives to incite change in corporate behaviour due to their large stake in targeted firms. However, investment portfolios tend to be greatly diversified as shareholders seek to mitigate risk by spreading their shares across a variety of different companies. As the recent Kay Review of UK Equity Markets and Long-Term Decision Making (2012 – published by BIS)™ revealed, the price of this diversification is a loss of information and control. Investors are less familiar with the activities and performance of any one individual company in their portfolio.


All four references cited above, which are representative of the recent corporate governance literature, discuss the growing importance of corporate engagement by institutional investors (see McCahery, Sautner, and Starks, 2011; Skancke et al., 2014; Bauer, Clark, and Viehs, 2013). According to Goldstein (2014) the extent of engagement between corporations and investors is now at an all-time high.


Sparkes and Cowton (2004) argue that, compared to other more passive SRI strategies, shareholder activism is a more powerful tool for influencing companies. The impact of investors is likely to remain marginal at best if they continue adopting a passive policy focused on avoiding investment in companies disapproved of. Large institutional investors have the ability to express meaningful dissent, and influence company policy, rather than just divest from companies.

Margolis and Walsh (2003) review 127 empirical papers examining the relationship between companies’ socially responsible conduct and their financial position and conclude that the majority of results point to a positive relationship between social and financial performance.


Dimson, Karakas and Li (2015) examine the highly intensive environmental, social and governance corporate engagement activities at 613 US firms between 1999 and 2009 (the sample consists of a total of 2,152 engagement sequences). The findings reveal that ESG engagements generate a cumulative size-adjusted abnormal return of 2.3% over the year following initial engagement. Successful engagements, where the institutional investor achieved change, generate much higher cumulative abnormal returns of +7.1%. The research provides evidence that ESG engagement activities can be value enhancing for shareholders as the targeted firms’ operating performance, profitability, efficiency and governance indices improve as a result of successful engagements.


Recent research by Alliance Trust Investments (2015) compared a set of companies over time – one set with a strong ESG programme, and another similar set with no emphasis on ESG or sustainability. The findings show that the group of companies with a strong sustainability focus outperform their peers both in terms of stock market value and financial returns. Such evidence suggests that investor engagement with investee companies with the goal of improving their sustainability performance results in clear benefits for shareholders.

Similarly, Becht et al. (2010) studied the private engagement activities of the Hermes UK Focus Fund and concluded that they create shareholder value, which also translates into superior performance of the entire fund. The fund substantially outperforms benchmarks and the authors estimate that returns are largely associated with engagements rather than stock picking.

Positive Market Reactions to Shareholder Activism


This study investigates the market reaction to shareholder-filed governance proposals that pass or fail by a small margin of votes at AGMs. The findings reveal that passing a proposal leads to significant positive abnormal returns. Adopting one proposal increases shareholder value by 2.8%.


The authors examine shareholder activism campaigns by hedge funds and other private investors. The main similarities between the groups are a significantly positive market reaction for the target firm around the initial Schedule 13D filing date, a further significant increase in share price for the subsequent year, and the activist's high success rate in gaining its original objective.

The Effectiveness of Active Ownership In Changing Company Behaviour


Reid and Toffel (2009) hypothesise that shareholder actions and regulatory threats are likely to prime firms to adopt practices consistent with the aims of a broader social movement. They find empirical evidence of direct and spillover effects. In the domain of the company’s internal operations, shareholder resolutions filed against a firm and others in its industry increase a firm’s propensity to engage in practices consistent with the aims of the related social movement. Similarly, in the realm of public politics, threats of state regulations targeted at a firm’s industry as well as regulations targeted at other industries increase the likelihood that the firm will engage in such practices. These findings show that both activist groups and government actors can spur changes in organizational practices, and that challenges mounted against a single firm or a single industry can inspire both firm and field-level changes.


With a geographical focus on the US, the authors examine the effect of environmental shareholder resolutions on chemical and petroleum firms’ environmental performance. They track thirty eight public corporations for thirteen years, using data from the Toxic Release Inventory, and conclude that the resolutions have a significant and positive effect on the targeted firms’ environmental performance.


In a study which discusses socio-ethical shareholder proposals from a legal perspective, Telman (2011) explores in detail the legal case of Lovenheim v. Iroquois Brands (1985). The article’s main argument is that filing shareholder proposals facilitates open, clear and specific communication between firms’ management and shareholders, and has the potential to influence corporate decision making. Moreover, the implementation of activists’ ideas advanced by the proposal can be of benefit to the corporation.
The authors examine ‘Just Vote No’ campaigns whereby activists encourage their fellow shareholders to withhold votes towards a director’s election in order to express dissatisfaction with performance or the firm’s corporate governance structure. The results suggest that such campaigns are effective and lead to companies taking actions as operating performance improvements and abnormally high CEO turnover are observable following such interventions. A recent example of this happening in practice is Aviva’s 2012 AGM held during what became known as the ‘Shareholder Spring’ where almost 60% of all votes (against and withheld) did not support the company’s executive pay proposal and, as a result, Aviva’s CEO Andrew Moss stepped down.3


In another study that explores vote-no campaigns, Ertimur, Ferri and Muslu (2010) analyse 134 vote-no interventions and 1,198 shareholder proposals related to executive pay between 1997 and 2007. Mostly sponsored by union pension funds, the majority of proposals relate to the pay-setting process (e.g., proposals to subject severance pay to shareholder approval). The results reveal that firms with excess CEO pay targeted by vote-no campaigns experience a significant reduction in CEO pay ($7.3 million).


This study is based on a survey of 302 senior financial executives and the aim is to test the extent to which ethics codes are actually used by executives when making strategic choices as opposed to being merely symbolic. The authors find that financial executives are more likely to integrate their company’s ethics code into their strategic decision processes if they perceive pressure from market stakeholders to do so (suppliers, customers, shareholders). Shareholder activism is related to the adoption and internalisation of ethics codes by financial executives.

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3 | See: http://www.bbc.co.uk/news/business-17938865