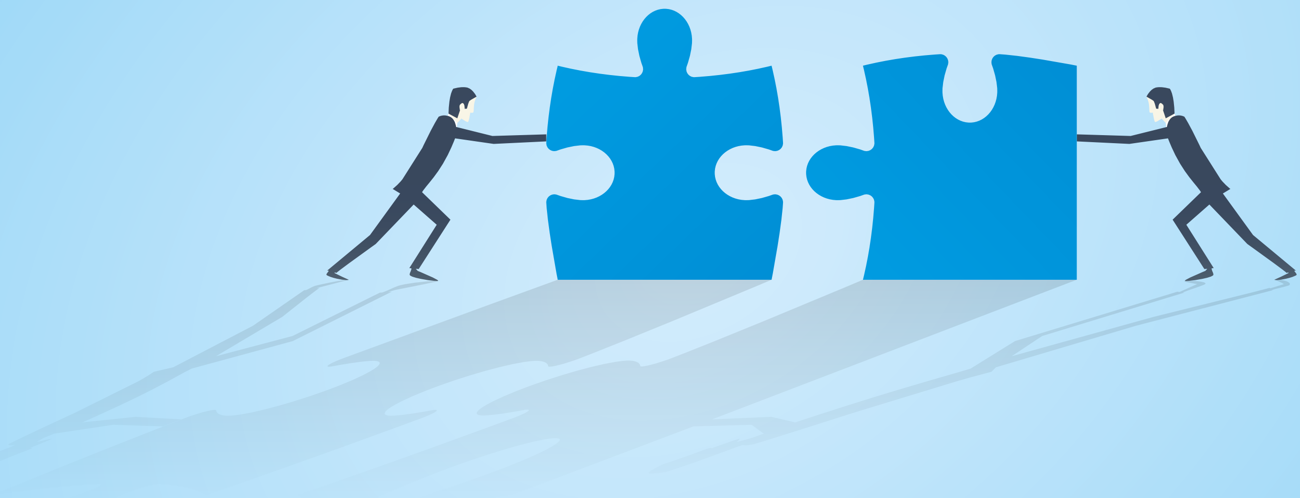
HOW ESG ENGAGEMENT CREATES VALUE FOR INVESTORS AND COMPANIES



An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ABOUT THE AUTHORS

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EXECUTIVE SUMMARY

- There is clear evidence that engagement by investors with companies on environmental, social and governance (ESG) issues can create shareholder value. But, **despite the growth in engagement activity by investors, exactly *how* ESG engagement creates value is poorly understood**. The Principles for Responsible Investment (PRI) therefore commissioned this research to explore the question.
- We carried out 36 interviews with representatives of large listed companies to obtain a corporate perspective on engagement. We combined this research with two earlier studies of engagement practices involving 66 institutional investors.
- Our interviews highlight three ESG engagement dynamics that create distinct types of value for companies and investors: (a) **communicative dynamics** – engagement enables the exchange of information between corporations and investors, creating 'communicative value'; (b) **learning dynamics** – engagement helps to produce and diffuse new ESG knowledge amongst companies and investors, creating 'learning value'; and (c) **political dynamics** – engagement facilitates diverse internal and external relationships for companies and investors, creating 'political value'.
- Combined with our previous research on investor engagement activities, we present unique insights into the differences between corporate and investor perspectives on these engagement value-creating dynamics, as well as the meaning of engagement 'success'.
- We reveal divergent corporate and investor views on the benefits and challenges of individual versus collective forms of engagement.
- We identify specific corporate and investor enablers and barriers to engagement success.
- Finally, we present recommendations for companies and investors to improve the success of engagement.

KEY RECOMMENDATIONS

FOR COMPANIES:

- Companies can enhance their communication with investors by closing the loop between internal ESG information systems, ESG engagement information and ESG reporting practices. This can be enabled by deploying dedicated information systems to manage investor relations.
- Learning opportunities can be extended by 'acting rather than being acted upon'. Corporations can use engagement proactively and strategically to test ESG policies, identify more efficient ESG targets and KPIs, and build better ESG management systems.
- Political benefits can be maximised through enhanced internal coordination between corporate investor relations departments, sustainability departments, and board-level executives before meeting with external investors.

FOR INVESTORS:

- Investors can enhance the communicative value of engagement by making their engagement objectives, expectations and desired form of success clear to companies upfront. Communicative value can also be increased through improved public transparency and disclosure – and hence social accountability – of how engagement processes are initiated, executed, managed, monitored and evaluated.
- Learning value can be advanced if investors strengthen the feedback loop between new ESG information and knowledge gained through engagement, and their main ESG integration databases and decision-making processes. Learning opportunities can be lost however, if engagement is outsourced without any standardised feedback process.
- Political benefits can be derived internally if ESG and financial analysts work more closely together on engagements. External political value can be gained through better collaboration with clients and their beneficiaries when developing or refining engagement policies, objectives and accountability mechanisms, as well as through balancing individual and collective forms of engagement to create and maintain long-term relationships with investee companies.

INTRODUCTION

A growing number of investors are undertaking corporate engagement and exercising their rights as shareholders to influence corporate behaviour. Between 2014 and 2016, the volume of assets managed with explicit commitments to engage or vote on ESG issues grew 41% (GSIA, 2016). In Europe alone, engagement (and exercising voting rights) is the third most popular responsible investment strategy. It is carried out by managers of more than €4.27 trillion assets under management, a figure that grew by 30% in the two years to 2016 (Eurosif, 2016: 22).

This growth will continue to be sustained through the support of regulatory changes such as the EU Shareholders' Rights Directive, the progression of global corporate governance and stewardship code requirements, and mounting social pressures on companies and investors to adopt of more sustainable business practices (Çelik & Isaksson, 2013).

This shift in institutional investor practices towards 'active' forms of ownership indicates that institutional investors recognise that their fiduciary duty to clients and beneficiaries should involve purposeful consideration, monitoring and intervention regarding ESG factors affecting investee companies.

However, despite the increasing amount of resources devoted by institutional investors to engagement practices, the manner in which ESG engagement creates value remains understudied. Moreover, studies that focus on the role of companies in the engagement process are especially scarce. This report addresses these gaps, and acts as the first product of an on-going research project commissioned by the Principles for Responsible Investment (PRI) to develop a better knowledge of how and why ESG engagement can create value for both companies and investors.

MOVING FROM WHETHER TO HOW: VALUE-CREATION DYNAMICS

Studies have shown that engagement can help protect long-term investment value (Blackrock & Ceres, 2015: 2; see also: OECD, 2017; Smith, 1996). Dimson, Karakaş and Li's (2015) analysis of 2,152 engagement exercises with 613 public firms between 1999 and 2009 offers, thus far, the most convincing empirical results that successful ESG engagement leads to cumulative size-adjusted abnormal returns over the years following the initial engagement. Dimson et al. (2017), confirm these results with regard to collective rather than individual engagement.

This report extends and complements these insights by investigating **'how', rather than 'whether', ESG engagement creates different types of value for companies and investors alike**. In line with O'Sullivan and Gond (2016), we regard engagement as being worth more than its pure financial returns, and we adopt a **broad definition of value** that recognises a variety of benefits of engagement beyond financial performance alone.

These include: enhanced exchange of information ('communication value'); the production and diffusion of new ESG-related knowledge ('learning value'); and the political benefits that can be derived from engagement, for instance, through enhanced executive support for ESG issues ('political value')[1]. These facets of value help us to understand how and why corporations can integrate and manage ESG issues so as to: reduce their exposure to various risks; ensure long-term financial value creation; and contribute to more sustainable societies. This report unpacks the value-creation dynamics by which these benefits are captured by investors and corporations through ESG engagement.

BRINGING THE CORPORATE PERSPECTIVE TO THE FORE

A distinctive feature of this study is its adoption of the **corporate perspective on engagement**. Engagement is a relational process between investors and companies (McNulty & Nordberg, 2016). The intra-organisational dynamics that take place within companies are therefore as central to the investigation of whether and how ESG engagement can create long-term financial value as are those taking place within institutional investor organisations.

For instance, recent practitioner reports suggest that engagement is often merely a box-ticking exercise for compliance experts, rather than a genuine catalyst for ESG policy implementation by corporate board members (VBDO, 2014). Further, they also shed light on the differences arising between corporate investor relations and sustainability specialists – with regard to language, timeframes, knowledge, and resources – which can lead to a 'sustainability-investment' gap within companies (SustainAbility, 2016).

1 This approach to value and worth, are consistent with the *Oxford English Dictionary* definitions of these terms, according to which value is: "a standard of estimation or exchange; an amount or sum reckoned in terms of this; a thing regarded as worth having"; and worth is: "the relative value of a thing in respect of its qualities or of the estimation in which it is held."

Our research examines the interactions between the actors in charge of ESG engagement within corporations (e.g. investor relations or sustainability department executives), and/or institutional investors (e.g. ESG or financial analysts in asset management firms). We focus on increased communication, learning opportunities and executive support for ESG issues during, and as a result of, engagement.

We do not assume that the dynamics we identify in this report are present in all their dimensions in every ESG engagement process. Rather, we regard them as a **range of plausible explanations for how and why engagement practices may contribute to the long-term value of investments and delivery of abnormal returns.** As a result, **these dynamics offer a useful tool to evaluate and analyse how a given process of ESG engagement can produce benefits for companies and investors alike**.

RESEARCH PROCESS AND METHOD

In order to provide corporations with a voice, and to understand their perspectives on ESG engagement, we adopted a qualitative approach, conducting interviews with 52 executives responsible for the management of investor ESG requests at 36 companies, between January and August 2017. These global corporations operate across a broad range of industries and are listed in Asia, Australia, Europe and North America. We deliberately sampled corporations known for having been engaged through PRI-led collective investor engagements in prior years.

This primary data obtained from the interviews was complemented with numerous secondary data about each specific corporate case. Appendix A provides a more detailed presentation of our sample of interviewed companies.

Although the key results presented in the report are mainly derived from the analysis of corporate interviews, our analysis was also informed by broader knowledge of the ESG engagement context. That is, our comparison of corporate and investor perspectives was also enabled by our access to approximately 30 interviews with investors conducted by the PRI about their ESG engagement practices, as well as insights gained through a prior study incorporating 36 interviews with institutional investors based in Europe (see: O'Sullivan & Gond, 2016).[2] Our results are thus based on in-depth, qualitative insights gained from more than 102 interviews with ESG engagement professionals.

2 We would like to thank Sustainalytics for having allowed us to use the empirical material from the O'Sullivan and Gond (2016) report, to extend the empirical foundations of the present report.

HOW ENGAGEMENT CREATES VALUE FOR CORPORATIONS AND INVESTORS

We identified three main sets of ESG engagement dynamics which create value:

- Communicative dynamics – engagement leads to a better flow of information and quality of understanding between companies and investors, thereby creating the 'communicative value' of engagement;
- Learning dynamics – engagement helps corporations and investors produce and diffuse knowledge on ESG issues, thereby extending learning opportunities and creating 'learning value';
- Political dynamics – engagement enables the development of internal and external relationships for both companies and investors, which help to advance the ESG agenda within their organisations, generating political value.

Below, we unpack these ESG engagement dynamics. Table 1 provides an overview of the three dynamics, while Appendix B provides a more detailed summary of the mechanisms underlying them.

Table 1. Mechanisms of Engagement Value Creation

VALUE CREATION DYNAMICS	CORPORATIONS	INVESTORS
COMMUNICATIVE EXCHANGING INFORMATION	Clarifying expectations and enhancing accountability	Signalling and defining ESG expectations
	Managing impressions and rebalancing misrepresentations	Seeking detailed and accurate corporate information
	Specifying the business context	Enhancing investor ESG communication and accountability
LEARNING PRODUCING AND DIFFUSING KNOWLEDGE	Anticipating and detecting new trends related to ESG	Building new ESG knowledge
	Gathering feedback, benchmarking and gap spotting	Contextualising investment decisions
	Developing knowledge of ESG issues	Identifying and diffusing industry best practice
POLITICAL DERIVING POLITICAL BENEFITS	Enrolling internal experts	Advancing internal collaboration and ESG integration
	Elevating sustainability and securing resources	Meeting client expectations
	Enhancing the loyalty of long-term investors	Building long-term relationships

COMMUNICATIVE DYNAMICS: CREATING VALUE BY EXCHANGING INFORMATION

CLARIFYING EXPECTATIONS AND ENHANCING ACCOUNTABILITY

A strong consensus emerged among all corporate interviewees that ESG engagement offers a unique opportunity to understand and clarify investor ESG expectations. This helps them to adjust and enhance their external ESG transparency and communication to investors. For instance, in one French multinational, human resource (HR) executives had developed an internal ESG policy to address discrimination concerning homosexuals in a specific country in which the company was operating. However, it was not until prompted by questions from investors that decided to disclose the information externally. Most corporate interviewees therefore, regard engagement as a way to better appreciate how investors perceive them and their activities, and to learn what their specific ESG expectations are.

> "Engagement helps us better understand how people view us and what they understand about us. We will often then see that reflected in the language of our website."
>
> Investor relations, Chemicals, Canada

This willingness to adjust ESG communication to suit investor interests, is best exemplified by an interviewee who recruits external consultants annually to help evaluate how a number of important investors measure progress towards the United Nations Sustainable Development Goals (SDGs) by investee companies. The analysis is used so that the company's external ESG reporting – and presentation of their sustainability strategy in particular – can be aligned with these investors' expectations.

In general, we found that ESG engagement greatly contributes to improved corporate ESG disclosure towards investors and, simultaneously, enhances the information made available to a variety of other stakeholders, such as governments, regulators and non-governmental organisations (NGOs).

MANAGING IMPRESSIONS AND REBALANCING MISREPRESENTATIONS

Beyond the clarification of investor expectations, engagement allows companies to manage investor impressions of them. For instance, engagement can be used to convey a more accurate picture of company positions in ESG-related controversies, than that which may be portrayed in the media. Here, engagement provides an opportunity to enter into a dialogue in a less biased, semi-private context, where corporations can explain their side of the story.

The majority of corporate interviewees also stated that they aim to respond to all questions raised by any investor about controversies, regardless of their size or holding in the corporation. Some interviewees explained that this approach emerged from the recognition that a small, but vocal activist or ESG-specialist investor can shape the whole dynamics of a controversy. This type of investor's "ability to reflect positively on the company or negatively on the company can outweigh their holding," according to a sustainability specialist at a US food sector company.

Therefore, when carefully managed, ESG engagement can ultimately lead to enhanced corporate communication about ESG issues in the media, with the aim of rebalancing prior misrepresentations of the corporation and/or misplaced investor impressions of them. One European chemicals firm gave the example of a significant institutional investor bringing up an issue of "growing concern within the community in London and elsewhere", and suggesting that the company seek to discuss the issue with other investors and the media. "They wanted to give us a chance to explain what we do. I thought that this was a very good thing," the individual said.

Engagement can also provide more up-to-date information to refine investors' internal ESG scores or external data-provider ESG ratings. Numerous corporate interviewees expressed their frustration with seeing their efforts to improve ESG communication undermined by investors' reliance on an outdated ESG performance rating. For example, ratings that were dependent on outdated news reported in the media were deemed unfair. In such cases, ESG engagement allows corporations to provide updated data and a more nuanced explanation of their ratings to investors.

SPECIFYING THE BUSINESS CONTEXT

Most corporate interviewees also use ESG engagement dialogues to explain how their management of ESG issues is related to broader, strategic considerations. These dialogues are used to clarify the relationship of ESG issues with the overall business model, and/or the systemic functioning of the company.

This dimension of enhanced communication was most significant in the case of conglomerates. Interviewees from such companies consider conglomerates to be systematically penalised, because most ESG assessments by third parties or investors are based on industry-specific evaluation frameworks. As a sustainability practitioner in a UK food processing group complained, their company is "scored badly sometimes" by ESG rating agencies, "because the questioner hasn't understood the makeup of our business and the questionnaire doesn't fit that makeup."

Beyond these cases, interviewees regard engagement as a way to make sure that their business processes and management systems are well understood by investors. They explained that during the engagement dialogue, they can clarify the connections between different ESG issues and provide a more systemic perspective on their ESG policies and performance. This allows them to explain trade-offs between the E, S and G dimensions of their performance, or the link between their ESG actions and overall strategy.

In some instances, our interviewees said that ESG key performance indicators (KPIs) were becoming integrated into the standard presentation of their corporation's strategy to mainstream investors, in a general move towards further integration of ESG and strategy information. For example, a European oil and gas company noted that its targets for greenhouse gas reduction and total recordable injury frequency rates "are KPIs strategic to the company and are presented to the market during the strategy presentation".

In general, engagement helps corporations develop long-term relationships with investors, so that investors can gain a more relevant and accurate picture of the business context, as well as the main drivers of the industry, and thus fully appreciate the management of a given ESG issue in the specific firm context.

COMMUNICATION ACROSS CORPORATIONS AND INVESTORS

> "Ten years ago, we engaged [company] and it didn't have a sustainability report. We wrote a letter to the CEO, and he eventually agreed that it made sense for the company to define itself. What we realised is that the company had great practices internally, but just wasn't disclosing them. So we told them: "Don't let other people define you, but rather disclose what you have." And our guidance here was that for us, as investors, the more disclosure and transparency, the better."
>
> Asset Manager, US

As shown in Table 1, the communicative dynamics mentioned by investors differ from those reported by companies in several ways. First, investors consider engagement as a way to alert potential investee companies of the relative importance of ESG issues, and to convey their expectations in terms of ESG performance and disclosure.

Second, and in parallel to the corporate quest for a more accurate representation of their ESG performance, investors also rely on engagement to seek out insights about current corporate ESG activities. In this regard, ESG rating agency information is usually used by investors as an early step in their engagement processes. Engagement can also be specifically motivated by the lack of up-to-date ESG ratings, or ambiguities created by contradictory evaluations of corporate ESG performance by different ESG rating agencies.

Third, we found a distinct benefit of enhanced communication for investors, in that it helps them to report, and be accountable, to their clients – asset owners in the case of asset managers, and beneficiaries in the case of asset owners – on how they are addressing their overall (ESG) fiduciary/stewardship duties. Simultaneously, engagement can enhance investors' internal management of information regarding their investee companies, and in so doing help improve the quality of their ESG reporting and accountability not only to clients, but also to regulatory authorities and the general public.

LEARNING DYNAMICS: CREATING VALUE BY PRODUCING AND DIFFUSING KNOWLEDGE

ANTICIPATING AND DETECTING

The reinforcement of the communication channels between investors and their investee companies through ESG engagement also creates new opportunities for learning about ESG issues on the corporate side. Several of our corporate interviewees found that dialogues with investors – and in particular specialist ESG investors – can help anticipate new ESG trends in the financial marketplace.

> "I think of ESG investors, particularly in extractive industries, as an early warning system. They're the canary in the coal mine. You know they're ahead of everyone else in terms of their thinking about what a problem is and what a risk is. Eventually, governments, civil society and mainstream investors will share the same concerns."
>
> SD, Oil & Gas, Canada

In this regard, engagement can help corporations to identify emerging trends or weak signals from the broader socio-political environment within which they operate. Although not all informants recognised this role for investors, most interviewees agreed that engagement helps to make sense of changes in investor ESG preferences.

GETTING FEEDBACK, BENCHMARKING AND GAP-SPOTTING

Recognising that ESG engagement is a two-way street also means that companies can use this communication channel with investors strategically to get feedback to advance their sustainability strategy. Several of our corporate interviewees use ESG engagement to actively seek advice from investors on, for example, how to develop their ESG strategies, management systems, or programmes. A small number of corporate interviewees acknowledged cases in which an investor spotted an important gap in their ESG strategies or management systems, which could be addressed in a timely fashion thanks to engagement.

In addition, these engagements can be useful for companies to understand "how they see us compared to our peers," as one interviewee from a German chemicals company put it. These investors were also frequently cited as a source of information about best practices within and beyond a company's industry sector: "We want their advice because they see more than we do," said a sustainability executive at a UK mining company.

However, not all of our interviewees share the view that they can learn from investors about how to improve their ESG management system or strategies, as investors are sometimes perceived as insufficiently knowledgeable of ESG issues to conduct a relevant engagement. Yet, at the same time, no interviewee challenged the view that "there is always something to be learned" from such dialogues.

> "[ESG investors] can give us tips to improve either our strategy or the way we are communicating our strategy. In that sense, I consider that these interactions with investors are very important to us."
>
> SD, Mining, Brazil

DEVELOPING KNOWLEDGE OF ESG ISSUES

Engagement dialogues with investors can help companies further enhance their knowledge of ESG issues. For example, in the context of an ESG controversy triggered by a new practice (e.g. hydraulic fracking in the oil and gas industry), ESG issues can be difficult to evaluate with certainty (e.g. risks of water pollution or health and safety issues for local communities). In these uncertain circumstances, knowledge about ESG issues can be shared among the actors involved (e.g. NGOs, academic experts, companies and investors).

In such contexts, collective forms of ESG engagement, which usually bring third-party experts into the dialogue, provide opportunities to develop deeper knowledge of ESG issues. But corporations can also develop their own knowledge of ESG issues in the context of individual ESG engagements by interacting with ESG analysts within the investors engaging them, thus benefiting from unique insights from these ESG experts. A sustainability expert at a Canadian oil and gas company, who learnt from ESG investors how to present an advanced ESG practice to a wider investor audience, offers a case in point. She explained that mainstream investors were sceptical about the company's investments in renewables, which weren't generating the same rates of return as its oil sands operators: "We were able to work with ESG investors to ask, how we might close that gap? How do you communicate this with mainstream investors? What would make this business more financially attractive?"

LEARNING OPPORTUNITIES ACROSS COMPANIES AND INVESTORS

> "In many cases, our engagement is not necessarily looking to force change. It may also be about deepening our understanding."
>
> Asset Manager, UK

A comparison of learning opportunities, as presented in Table 1, suggests that different benefits may arise for investors. Even both sides report a greater understanding of the management of ESG issues, investors are likely to benefit more from this process, especially in the context of collective engagements such as the ones organised by the PRI, that provide access to ESG experts and NGOs. Investors can enhance their own knowledge of ESG in specific industries by engaging with multiple companies and interacting with other investors. "When there is a huge emerging issue with an issuer, we really need to work together with other investors to understand more and to form best practices," noted one French asset manager.

A better understanding of corporate ESG contexts can improve investment decisions. On the whole, our analysis of learning opportunities suggests that investors' role in the detection of emerging ESG trends, and their attempts to diffuse ESG best practices within and across industries, can directly nurture corporate learning opportunities.

POLITICAL DYNAMICS: CREATING VALUE BY BUILDING RELATIONSHIPS

ENROLLING INTERNAL EXPERTS

We found that ESG engagement nurtures multiple dimensions of relationship building. These relationships reflect the potential reinforcement of the position and status of ESG experts within their organisations. ESG engagement usually involves conference calls or face-to-face meetings at companies or in the context of roadshows. Corporate actors in charge of engagement can invite internal operational or functional experts (e.g. managers in charge of the supply-chain and/or HR executives for human rights-related issues) to such meetings.

In so doing, ESG engagement can facilitate the enrolment of multiple operational experts across the corporations, raising inter-functional awareness of ESG issues. In particular, we found that ESG engagement facilitates the development of stronger relationships, and enhanced coordination, between ESG departments, investor relations and/or the finance function within companies. Consequently, engagement can help close the "sustainability-investment gap" often found between corporate sustainability and financial experts (SustainAbility, 2016).

ELEVATING SUSTAINABILITY AND SECURING RESOURCES

More fundamentally, when investors with sizeable holdings ask questions about ESG issues, they give more visibility to internal ESG experts and help raise awareness of ESG issues at the board level, thus reinforcing the position of sustainability experts. Although such an effect was more obvious at companies within which the board was not yet fully convinced of the need to address ESG issues, numerous interviewees mentioned how glad they were when an ESG request from a group of investors came through the board, rather than directly through them.

According to the head of corporate responsibility at a French food processor and retailer, engagement is more "value creating" from his perspective when "it focuses on the board and then gets down to us". Nevertheless, benefits can also be obtained even when sustainability and ESG topics are already discussed in the boardroom: "The importance of ESG and the importance of sustainability and stakeholder engagement are already well prioritised within the company, but the investor reinforcement of those issues can only help," says a sustainability practitioner at a US-based oil and gas company.

The affirmation of the importance of corporate sustainability experts that results from engagement can also help showcase the strategic nature of ESG issues for a company, and helps to progress the integration of sustainability within its corporate strategy. Furthermore, it offers a lever to secure or consolidate resources to advance the management of ESG issues internally.

> Interviewer: "Is ESG engagement useful for you internally to obtain resources?" Respondent: "Of course. For instance, the human rights department, with three full-time staff, wouldn't be there if there was no interest from investors. I'm not saying that we wouldn't deal with the topic, but the impact and the means would be different."
>
> IR, Oil & Gas, France

ENHANCING THE LOYALTY OF LONG-TERM INVESTORS

The benefits of relationship building through ESG engagement are not only intra-organisational in nature. Engagement also helps companies secure and nurture relationships with investors, especially long-term investors. Several interviewees, especially those within investor relations departments, mentioned the importance of maintaining the shareholder register of investors with significant holdings and/or a long-term investment horizon. These interviewees see ESG communication as a way to attract and secure the investment of specialist ESG investors, as well as mainstream institutional investors interested in ESG issues due to their long-term investment horizon.

Although none of our interviewees were able to quantitatively evaluate whether ESG-focused investors actually make a difference to their cost of capital, a few companies are deliberately and proactively trying to take advantage of their ESG credentials to attract these investors. This strategy is deemed particularly relevant in markets that are traditionally less sensitive to ESG issues.

RELATIONSHIP BUILDING ACROSS CORPORATIONS AND INVESTORS

The benefits companies and investors derive from relationship building are complementary (see Table 1). In line with the results of O'Sullivan and Gond (2016), the 'enrolment of experts' and the 'elevation of sustainability' on the corporate side mirror the mobilisation of engagement by ESG analysts operating within institutional investors, which enables and facilitates their ESG integration efforts.

> "Portfolio managers are becoming much more aligned with integrating ESG issues into their investment decisions. Over the past two years, there's been a huge shift internally in terms of how they are taking these issues into account."
>
> Asset Owner commenting about his observations of the asset management firms he is working with, UK

ESG engagement encourages closer collaboration between ESG and financial analysts and/or fund managers. In addition, the relationships between investors and companies support the integration of ESG, in a self-reinforcing manner, within both investment firms and companies. We believe the common goal of developing long-term relationships can only reinforce the process of alignment of corporate and investor expectations.

The main noticeable difference between the two parties however, concerns the fact that investors, and in particular asset managers, can also easily consolidate their position vis-a-vis key clients and/or beneficiaries through engagement, notably by delivering on their fiduciary and stewardship duties. However, the value of investor-corporate relationships around ESG for corporate marketing purposes is less obvious and direct.

(RE)DEFINING ENGAGEMENT SUCCESS

An implication of both the consideration of the corporate perspective on engagement, and a broader definition of value, is the reconsideration of how engagement success is defined. Companies, like investors, consider the success or failure of a particular engagement in relation to specific criteria that reflects their own goals and interests. This criteria may be related to their own organisation (corporate-centric criteria), or to the investor that engages them (investor-centric criteria).

Hence, following and extending the logic of the three dynamics of value creation presented earlier, we can identify:

- A communicative dimension of success that corresponds to information exchange;
- A knowledge-based dimension of success that reflects the learning opportunities engagement enables;
- A political dimension of success that points to transformation of behaviour obtained through the relationship-building activities of actors involved in engagement.

Table 2. Contrasting Corporate and Investor Perceptions of Engagement Success*

DIMENSIONS OF SUCCESS	CORPORATIONS		INVESTORS	
	Investor-centric criteria	Corporate-centric criteria	Investor-centric criteria	Corporate-centric criteria
COMMUNICATIVE / NORMATIVE	RESPONDING TO INVESTORS' REQUESTS *Example: Avoiding investors' requests by proactively providing ESG information.*	ALTERING EXTERNAL COMMUNICATION AND DISCLOSURE *Example: Improving external ESG communication.*	IMPROVING STEWARDSHIP AND ACCOUNTABILITY *Example: Letting clients know what their money is invested in.*	GETTING RESPONSES TO QUESTIONS *Example: Timely attention from the board.*
COGNITIVE / KNOWLEDGE-BASED	ALTERING INVESTOR PERCEPTIONS OF THE CORPORATION *Example: Shaping the ESG agenda by 'educating' investors about ESG practices.*	ENHANCING KNOWLEDGE OF ESG STRATEGIES *Example: Discovering new ESG practices, modes of communication or techniques.*	ENHANCING ENGAGEMENT AND ESG-RELATED KNOWLEDGE *Example: Learning about ESG engagement methods from other investors.*	DEVELOPING KNOWLEDGE OF THE CORPORATE CONTEXT *Example: Reassurance that ESG risks related to prior controversies are under control.*
POLITICAL / INSTRUMENTAL	CHANGING INVESTOR BEHAVIOUR *Example: Having investors speak highly and positively about the company's ESG policy to their colleagues and peers.*	CHANGING ESG PRACTICES *Example: Designing a new ESG policy to better fit investor expectations.*	IMPROVING THE FINANCIAL PERFORMANCE OF ASSETS *Example: The contribution of engagement to an enhanced alpha.*	CHANGING CORPORATE DISCLOSURE... *Example: Influencing changes in ESG reporting.* ...AND BEHAVIOUR *Example: Corporate adoption of new ESG practices.*

* In this table we provide only one illustrative example of criteria for each dimension of "Perceptions of Engagement Success". Please see Table B2 in Appendix B for a more detailed presentation.

Table 2 maps these dimensions of success while considering their focus (i.e. corporate centric vs. investor centric) for both corporations and investors. The table sheds light on important differences between corporate and investor perceptions of what makes engagement successful.

Indeed, Table 2 suggests that the communicative dimensions of success only constitute one of the avenues used by actors to gauge engagement success. Some interviewees consider that success is simply "when investors are happy with the answer", and regard a situation where engagement does not take place as successful, because "all the required ESG information is already externally communicated". Ironically, one interviewee commented that success could be defined as "when investors are satisfied with the answer and do not come back with questions". Such answers justify the fear that some corporations approach ESG engagement as a box-ticking exercise (VBDO, 2014).

Yet, these concerns cut both ways. Several corporate interviewees said that some investors were not necessarily interested in their business model and process, but just wanted to check their internal framework to demonstrate that they had completed their due diligence. On the investor side, this potentially superficial dynamic consists of getting answers to specific questions, without trying to learn much more through the engagement process. Such an approach is unlikely to improve stewardship and deliver robust accountability to beneficiaries or clients.

Furthermore, our research suggests that engagement provides learning opportunities beyond enhanced communication, which in turn suggests that a broader definition of engagement success is needed. Strikingly, investors and corporate interviewees alike tend to regard a successful engagement as one in which they have "learned something new", that can help them to advance, for example, their practice of engagement (investor side), the management of ESG issues (corporate side), or their knowledge of an ESG issue associated with a specific controversy or industry (both sides).

More interestingly, our results reveal that the improved knowledge of the corporate context that is often mentioned by investors as an important criteria of successful engagement (see, for example, O'Sullivan & Gond, 2016), relates directly to the possibility of developing a genuine two-way discussion about the ESG issues at stake.

> "I really appreciate when I meet an investor who's done some homework beyond just reading articles or some sound bites, which are usually very negative towards us. Then you have a more meaningful discussion. It's a much better use of our time if they've done a little bit of background work we and we can really get into the issues."
>
> SD& IR, Agribusiness, Asia

On the corporate side, the enhancement of ESG knowledge therefore seems to depend closely on investors' efforts to add to their own ESG understanding. Here, a 'virtuous cycle' of ESG knowledge production may be triggered which serves both parties, provided that the learning opportunities inherent in engagement are recognised by both sides.

In addition, some companies define success as having altered the perception or evaluation of their ESG practices by investors. Several interviewees operating in companies that are well-advanced regarding ESG issues consider engagement as a way to 'educate' investors and the market in general about specific ESG issues, and the best approaches to addressing these issues.

> "Educating ESG investors on a topic, and what's involved from a business perspective, helps them understand that solutions tend to be more collaborative than win/lose. They're more a negotiated outcome versus somebody wins and somebody loses."
>
> SD, Food processing & retail, US

For some of our interviewees, a successful engagement is when investors are sufficiently impressed to communicate externally about the corporations' ESG practices. Following this logic, ESG engagement may not only produce an expected change on the corporate side, in relation to ESG practices, for example, but can also be regarded by companies as a way to influence investor behaviour. Accordingly, investors can become a 'corporate ambassador', speaking positively about the ESG practices of the corporation to their colleagues and peers.

For a small number of corporate interviewees, this view of successful engagement justifies a shift from a reactive to a proactive approach to ESG engagement, for example through the creation of a dedicated position bridging the investor relations and sustainability functions, and the proactive targeting of long-term and/or ESG investors as relevant capital providers.

RECONSIDERING THE PROS AND CONS OF INDIVIDUAL VS COLLECTIVE ENGAGEMENT

When asked about the pros and cons of individual as opposed to collective forms of engagement, few of our corporate interviewees could clearly differentiate between the two forms, as in both cases, a lead investor may be charged with approaching them. However, the subset of corporate interviewees who experienced both forms of ESG engagement, and are able to clearly discriminate between them, provided clear insights about the pros and cons of each type. Table 3 summarises these results, while contrasting them with insights gathered from prior interviews with investors.

We found, companies usually favour individual forms of ESG engagement, because they make the tailoring of the engagement process to the specific needs of a given investor a lot easier. Investors' specific ESG interests and needs can be more easily identifiable for one investor than for a group of investors. An appropriate internal expert (e.g. health and safety or climate change expert) can be involved in the engagement, depending on the sophistication and degree of knowledge of the investor.

Table 3. Contrasting Perceptions of Individual and Collective Forms of Engagement*

	INDIVIDUAL INVESTOR ESG ENGAGEMENTS		COLLECTIVE INVESTOR ESG ENGAGEMENTS	
	Corporate Perceptions	Investor Perceptions	Corporate Perceptions	Investor Perceptions
PROS	▪ Face-to-face and one-to-one dialogues are effective to address multiple ESG issues. ▪ Avoidance of misrepresentation of ESG performance by third-parties. ▪ One-to-one interactions allow the building of trust, and long-term relationships, with investors.	▪ Alignment of engagement goals with internal ESG and engagement policies. ▪ Strategic benefits of proactively addressing emerging ESG topics. ▪ Enables a strategic focus on corporate stocks with ambiguous ESG scores.	▪ Larger, collective assets under management working together can give more leverage to internal corporate drives on ESG issues. ▪ Cost savings in terms of time spent with investors. ▪ Perceived higher ESG expertise of the investor group.	▪ Higher power and influence through the collective assets under management. ▪ More relevant for systemic and marketplace issues, or if investors have 'thematic' engagement policies. ▪ Cost savings on monitoring.
CONS	▪ Need to manage numerous, different investor requests. ▪ Redundancy in questions asked by multiple, individual investors. ▪ Costly and time consuming process, especially if ESG requests by multiple investors increase.	▪ Potentially low shareholding insufficient to capture board-level attention. ▪ Limited resources that can be spent to maintain the continuity of engagement and/ or financial analyst engagement.	▪ Lack of interest from investors for overall corporate ESG management activities, due to specific ESG thematic focus. ▪ Higher coordination costs if investors fail to coordinate their efforts. ▪ Investors with no or too little shareholding may attend meetings.	▪ Broad international focus that may not be coherent with national investment strategies. ▪ Possibility of free-riding. ▪ Time-consuming process if investor views are divergent.

* In this table, we provide only the three most important advantages (Pros) or inconvenient (Cons) disadvantages mentioned by interviewees. Please see Table B3 in Appendix B for a more detailed presentation.

In addition, one-to-one, and ideally face-to-face, dialogues were regarded as more productive by several corporate interviewees, because they allow them to explain how ESG issues are related to each other and to their corporate strategy, and can support the development of long-term relationships with institutional investors. These meetings were viewed as being easier to organise with one single investor.

However, the same interviewees also identified a potential drawback with individual engagement in terms of cost and redundancy of demands, particularly in a scenario where the same request was received from numerous investors. For instance, in the event of a controversy, investor demands can peak all at once and become hard to manage.

In contrast, corporate interviewees noted that collective forms of engagement can save time and reduce costs by avoiding consecutive engagements with individual investors. "Frankly, it's helpful to be able to speak to multiple investors in one day as opposed to the individual conversations that otherwise might happen," noted a sustainability practitioner at a US food processor and retailer.

By and large, collective engagement is also seen as more likely to provide opportunities for relationship building and give more traction to ESG issues within companies, given the total amount of assets under management usually involved in such processes. Some corporate interviewees commented that the collective nature of engagement is also likely to enhance the quality of investors' knowledge of ESG issues, providing more potential for ESG learning opportunities discussed above.

However, a number of interviewees expressed concern that not all investors involved in collective engagements may have the same interest in the company, nor a significant holding and, as a result, they may lack the level of commitment needed to truly understand the investee company and the specific ESG challenges it faces. In addition, coordinating with a group of investors makes it difficult, if not impossible, to organise the real-time, face-to-face interactions that can be deemed highly valuable by interviewees. These corporate perceptions of the differences between individual and collective forms of engagement, thus suggest that both forms of engagement are potentially useful and value-creating, even though they each come with their own limitations.

Table 3 contrasts the pros and cons of individual and collective engagement as outlined by companies, compared with those reported by investors. Investors also see distinct benefits and limitations in both forms of engagement. For instance, individual engagement can be used strategically to clarify the ESG status of a stock that has received divergent ratings in an internal investors' scoring system.

> "One-on-one conversations can get into the very specific detail that the investor is interested in. When it's a group, there's more of a discussion, with the benefit of different views. We're therefore happy to do both. The people who tend to join a collective engagement are those who are less specifically interested, but have more of a general interest; they want to hear what other people are saying, rather than coming with a long list of questions."
>
> SD, Aerospace, UK

Such an engagement for the sake of updating internal ESG scoring, may strategically loose its importance if conducted collectively, but may be difficult to conduct for a single investor with a low shareholding in the targeted company.

Conversely, collective engagement can encourage investee companies to respond to investor ESG requests by bringing more weight to the engagement in terms of collective investor assets under management. Moreover, all investors involved can share the improved knowledge of the corporate context. However, the increased number of participants can increase coordination costs of engagement, as well as potentially allowing some participants to free ride on the efforts of others (Gond & Piani, 2013).

The comparison set out in Table 3, suggests that engagement practices should be adapted to balance the trade-offs of individual and collective forms of engagement. This could be the case, for example, when several investors delegate part of their engagement activity to a third-party advisor (diminishing the cost of collective engagement for investors), who can then leverage this collective effort (mobilising the total size of investors to influence corporations) to engage a long-term relationship with the corporation (more beneficial to corporate actors); in order to advance the engagement process. This also suggests that companies and investors should search for optimal resource allocation between both forms of ESG engagement.

ENABLERS AND BARRIERS TO SUCCESSFUL ENGAGEMENT

We also identified common enabling factors and barriers to successful engagements, from corporate and investor perspectives (see Table 4).

These factors could be straightforwardly classified into company-related factors, investor-related factors, and relational factors (i.e. factors that characterise the interactions between corporations and investors).

Table 4. Contrasting Perceptions of the Enablers and Barriers to Engagement Success

	CORPORATE PERSPECTIVES		INVESTOR PERSPECTIVES	
	Enablers	Barriers	Enablers	Barriers
RELATIONAL FACTORS	▪ Existence of an actual two-way dialogue. ▪ Being honest and transparent in the dialogue, and having an 'open and objective discussion'.	▪ Language barriers and communication issues. ▪ Lack of continuity in interactions.	▪ Good level of commitment on both sides to meet objectives. ▪ Reciprocal understanding of the engagement process and issues on both sides. ▪ Good communication and listening capacities on both sides.	▪ Language barriers and cultural differences can hamper dialogue.
CORPORATE FACTORS	▪ Responsiveness and willingness to act upon investor requests. ▪ Selecting appropriate internal experts. ▪ Knowing your investors, access to prior discussions to tailor conversations. ▪ Systematic tracking of interactions with investors.	▪ Company bureaucracy preventing changes in internal practices and/ or external reporting on (new) practices. ▪ Lack of resources, insufficient knowledge to meet investor demands. ▪ Lack of actual ESG policies, practices and/ or results that can be reported externally.	▪ Corporate reactivity to requests. ▪ Board-level access in targeted companies. ▪ Access to appropriate corporate experts. ▪ Long-standing relationships with key corporate actors. ▪ Corporate proactivity to inform investors when engagement objectives/targets have been met.	▪ Refusal by top executives to be engaged on ESG issues. ▪ Functional/ sustainability manager struggles to advance ESG related issues. ▪ Too small a shareholding to attract sufficient attention. ▪ Corporate inability to meet (on-going) objectives and targets.
INVESTOR FACTORS	▪ Listening capacities of investors. ▪ Communicating in different languages. ▪ Providing questions in advance. ▪ Prior knowledge of corporate ESG practice and performance. ▪ Genuine interest in (improving) the management of ESG issues at the company. ▪ Patience and understanding regarding corporate ability to address ESG challenges.	▪ Lack of investor preparation, overly generic questions/ requests. ▪ Lack of knowledge about the company (e.g. ESG policy, track record). ▪ Lack of sufficient investor tracking process to determine whether engagement requests have been met. ▪ Changing engagement objectives and targets.	▪ Client or beneficiary requests for the consideration of ESG issues. ▪ Top-management support for ESG-related investment activities. ▪ Well-resourced and experienced ESG team. ▪ Clear engagement objectives and targets. ▪ In-house tracking tools to monitor and evaluate engagement progress. ▪ Pooling of resources through collective engagement.	▪ Lack of buy-in from clients and/or top management for ESG-related investment activities. ▪ Small, under-resourced ESG team. ▪ Lack of clear engagement policies, objectives and monitoring systems. ▪ Under-developed relationships with key corporate actors. ▪ Difficulty demonstrating materiality of engagement. ▪ For (interested) asset owners: Insufficient mechanisms to guarantee asset managers conduct successful engagements.

The relational factors identified by companies and investors mirror each other. In both cases, the capacity of participants to conduct a dialogue that is actually a 'two-way street', is regarded as a crucial enabler. Corporate actors emphasise the need to conduct such a dialogue in a transparent and honest manner, whereas investors insist on the need to clarify expectations and the understanding of positions, on both sides, to enhance the quality of the dialogue.

Cultural and linguistic barriers may prevent such high-quality dialogues from taking place, and soft, communicative skills, though not necessarily explicitly mentioned, seem to play an important role in overcoming such barriers. Several corporate respondents in the sustainability function suggest that the competencies they acquired through engaging in dialogue with activists, NGOs, governments or other stakeholders, are also relevant in managing their relationship with institutional investors.

Both corporations and investors regard the timeliness of responding to requests, and the presence of a tracking system to record prior ESG-related interactions, as important factors enabling successful ESG engagement. On the other hand, bureaucratic burdens (such as the difficulty to collect the relevant ESG information for investors) and a lack of resources in terms of time and ESG expertise, were commonly mentioned as barriers to successful engagement.

Some differences emerge, however, regarding perceptions of corporate- or investor-related factors, because of the specific context within which each type of organisation operates. Accordingly, corporate interviewees insist on the importance of getting 'the right person in the room', by which they mean that appropriate and knowledgeable corporate experts should be involved in the engagement process, to provide investors with a direct insight into what is going on internally in relation to a given ESG issue.

One sustainability expert at a European-based mining company, said their firm aims to collect questions before a face-to-face meeting "to make sure that we have the right people in the room to provide information." Rather than charging one individual with collecting information and reporting back to investors, as some companies do, "we try to let our experts speak for themselves because then you can have a much more direct conversation," he/she adds.

From the investor viewpoint, enabling factors are related to the level of corporate access they have (board-level access can expedite ESG requests, for example), the existence of pre-existing, long-term relationships with key corporate actors, and the presence of strong 'buy-in' from top management or clients/beneficiaries for ESG engagement.

On the other hand, investors identify the following barriers to successful engagement: an overly patronising approach to dialogue with companies; a lack of a sufficient shareholding to attract company management's attention; a lack of internal resources dedicated to engagement or the absence of a formalised engagement process (for example the lack of a monitoring system and/or measurable outcomes to assess progress); and the disempowerment of sustainability experts on the corporate side. For corporations, it is mainly the lack of preparedness of investors, either in terms of knowledge of the ESG issues or of the corporate context (e.g. business model, industry drivers or company ESG performance track record), that are likely to undermine an ESG engagement process and its ultimate success.

CONCLUSION

By evidencing how corporations experience ESG engagement, unpacking the dynamics through which multiple forms of value are created for corporations and investors, and contrasting corporate and investor perspectives about the value of engagement, our analysis has resulted in a number of key insights. These insights have implications for current and future engagement practice, and serve as the basis for our recommendations provided in our **Executive Summary**.

As summarised by Figure 1, our results place most emphasis on the deeply relational dimension of engagement, and invite engagement practitioners (companies, investors and the PRI) to consider engagement not only as a relationship that allows for ESG issues to be collectively discussed and addressed, but also as a space within which communication, knowledge, and power, flow in ways that create (potentially) unintended benefits on the investor as well as on the corporate side.

Figure 1. Value creation mechanisms.

VALUE CREATION MECHANISMS

CORPORATE SIDE	VALUE CREATION DYNAMICS	INVESTOR SIDE
▪ Clarifying expectations & enhancing accountability ▪ Managing impressions & rebalancing mis-representions ▪ Specifying the business context	Communicative dynamics	▪ Signalling & defining ESG expectations ▪ Seeking out detailed & accurate information ▪ Enhancing ESG communication & accountability
▪ Anticipating & Detecting ▪ Getting feedback, benchmarking & gap-spotting ▪ Developing knowledge of ESG issues & practices	Learning dynamics	▪ Building new ESG knowledge ▪ Contextualizing investment decisions ▪ Identifying & diffusing best practices
▪ Enrolling internal experts ▪ Elevating sustainability & securing resources ▪ Enhancing the loyalty of long-term investors	Political dynamics	▪ Advancing internal collaboration & ESG integration ▪ Meeting client expectations ▪ Building long-standing relationships

Future empirical studies of engagement could rely on methods such as fuzzy-set Qualitative Comparative Analysis (fs/QCA)[3], to study how value-creating dynamics combine to explain the success of engagement from both corporate and investor perspectives. More research access to investors' proprietary datasets, and the possibility to conduct in vivo ethnographic studies or observations of engagement, could also further advance our knowledge of the micro-dynamics (e.g. impression management, rhetorical strategies) that underlie corporate-investor ESG engagement dialogues.

Ultimately, in uncovering three value-creating dynamics, and providing a vocabulary to understand and explain what is at stake through the practice of engagement, we hope that this report will help practitioners to continuously improve their engagement practices to make them as value-creative as possible.

3 fs/QCA is a method that "enables a fine-grained conceptualization and empirical investigation of causal complexity through the logic of set theory" (Misangyi et al. 2017: 255), ideally suited to investigate complex phenomenon such as the drivers of corporate sustainability that is rarely produced by a single cause, but rather results from interdependent factors. For a simplified illustration of the application of QCA vis-à-vis regression and cluster analysis methods, please consult Fiss (2011).

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APPENDIX A: CONTEXT, METHODS AND DATA

CONTEXT OF THIS STUDY

This report presents the first insights to emerge from a research project commissioned by the PRI in August 2016, to analyse the "factors for success in corporate engagement", with the aim "to help signatories review and implement their engagement strategies more effectively" (see: PRI, 2016). This research was led by Professor Jean-Pascal Gond from Cass Business School, City, University of London, from ETHOS and co-developed with Dr Niamh O'Sullivan from the International Centre for Corporate Social Responsibility (ICCSR), Nottingham University Business School, and Dr Rieneke Slager from the University of Groningen; with the support of Dr Michael Viehs, Engagement Professional, Hermès EOS, and Mika Homanen and Szilvia Mosonyi from Cass Business School.

Our overall project – entitled "How institutional investors' collective engagement on ESG issues creates value for corporations and investors: A configurational analysis" – aims to identify which factors contribute to successful engagement from corporate and investor standpoints. As very little is known about how corporations perceive and react to ESG engagement, how and why engagement creates value for them, and whether and how corporations and investors define ESG engagement 'success', the first stage of our analysis focuses on these topics.

OVERALL APPROACH

To analyse *how* and *why* (rather than *whether*) ESG engagement can create value, we framed our investigation with three questions: (1) *How do engaged corporations handle ESG requests from investors?* (2) *Which types of value do corporations derive from ESG engagement?* (3) *What are the mechanisms through which engagement creates value for corporations, and are these mechanisms similar for investors?* We developed a qualitative research design to address these questions, and adopted a research approach derived from organisational and sociological theory rather than finance. Furthermore, we focused our qualitative data-collection effort on corporations, as we had already interviewed investors on these issues in a prior study (see: O'Sullivan & Gond, 2016).

CONSTRUCTION AND DESCRIPTION OF THE CORPORATE QUALITATIVE SAMPLE

Qualitative researchers follow a logic of 'theoretical sampling' (Yin, 2003), and are more concerned by the theoretical purpose beyond their sampling than by its statistical representativeness. Qualitative exploratory studies, such as this one, aim at capturing and understanding differences in opinion about a new organisational practice. They deliberately target specific interviewees ('purposive sampling') to gain these opinions and insights. Hence, we purposefully selected corporations that had been approached by the PRI, at least once, to become involved in a collective ESG engagement process.

We did not focus only on companies that were the most reactive to investors' solicitations – according to the PRI archives – but rather included companies that reacted in various ways to these collective engagement requests. This was in order to highlight the factors influencing a 'lack of corporate responsiveness', as opposed to corporate 'best practice', in ESG engagement.

In total, we conducted 36 interviews with 52 corporate actors in charge of investor ESG engagement issues, with whom the PRI had put us in contact with. By 'corporate actors', we mean the individuals in charge of responding to investor requests and/or participating in dialogues with investors. Depending on the structure of the firm, these individuals are located in corporate responsibility or sustainability departments, in the investor relations department, or, in some rare cases, a dedicated function spanning both departments.

In the majority of cases in our study, the corporate interviewee was in charge of sustainability (22/36; 61%); and in the second most common instance, corporations organised the interview so that it could be attended by at least one member of the investor relations team, and one member of corporate responsibility or sustainability team (9/36, 25%). In the few remaining cases, our interviewee had a hybrid function (3/36; 8.5%), or was the head of investor relations (2/36; 5.5%). Figure A1 describes the functional background of our interviewees.

Our final sample also reflects the PRI's focus on large multinational corporations, publicly held and headquartered in European and North American countries, for their collaborative engagements (see also: Dimson et al., 2017). As a result, the majority of our interviewees operate in companies headquartered in Europe (21/36; 58.3%), and North America (10/36; 27.7%). A minority works for Asia-based (3/5; 8.4%) or South American (2/36; 5.6%) firms. Figure A2 provides an overview of the various locations of the sampled firms.

In terms of industries, the most represented sectors are food processing (10/36; 27.8%), followed by oil and gas (7/36; 19.4%), and mining (5/36; 14%). Figure A3 provides more details on these aspects.

Figure A1. Functional Background of Interviewees

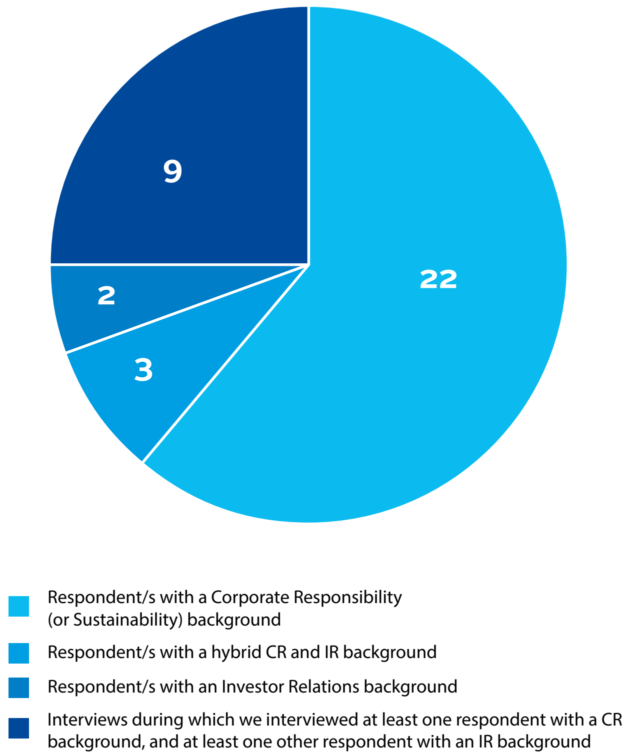


Figure A2. Location of the Headquarters of Interviewed Corporations

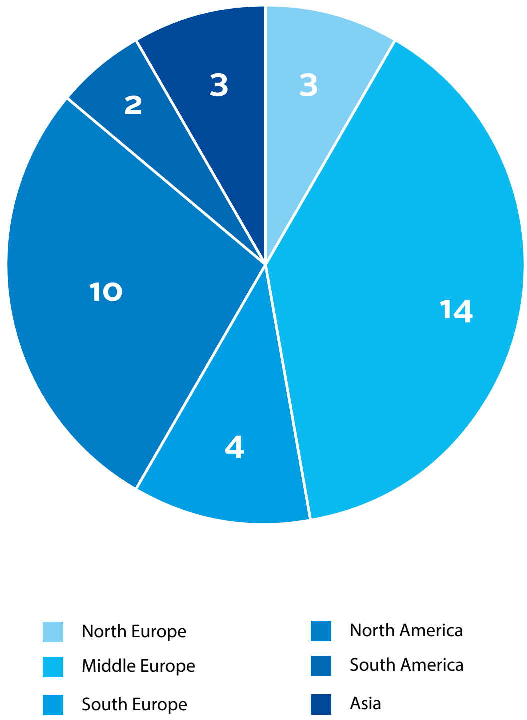
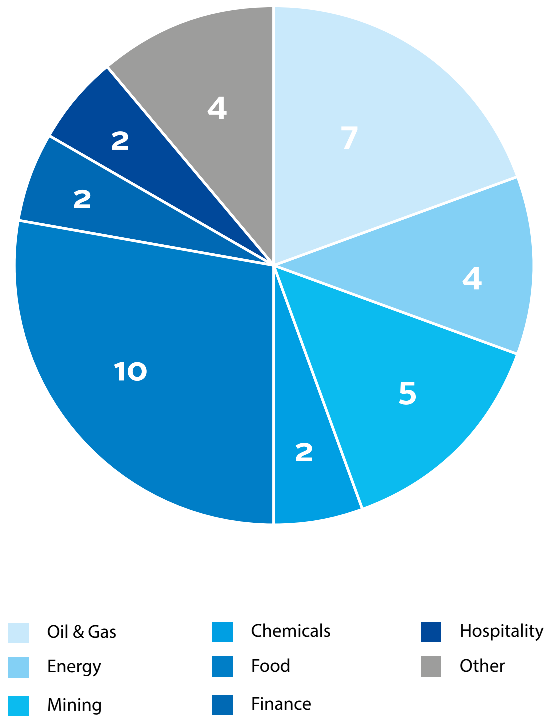


Figure A3. Industry Sector of Interviewed Corporations



CORPORATE INTERVIEW QUESTIONS

In our interview guide, we defined "ESG engagement" very broadly as: "any form of discussion between your organisation and one or more investor(s)" focused on environmental, social and governance (ESG) issues. We explained to our interviewees that we were interested in their own perspective on engagement, rather than investor perspectives, and focused our interviews around four key themes and associated questions:

(1) **Corporate management of ESG requests from investors** *(e.g. Who in your organisation handles ESG requests from investors? Are board members involved in the process?).*

(2) **Corporate actors' prior experience interacting with institutional investors on ESG issues** *(e.g. What form do these dialogues take? Could you describe a typical process of engagement?).*

(3) **Corporate actors' evaluation of engagement** *(e.g. Do you evaluate the success of engagement processes? Do you see engagement as valuable to you or your organisation and, if so, why?).*

(4) **Corporate actors' views on the social roles of engagement, its future and current challenges** *(e.g. Do you see ESG engagement as helping to progress the sustainability agenda internally? How do you foresee the future of ESG engagement?).*

CORPORATE INTERVIEW ANALYSIS

All interviews but one, were recorded and then transcribed (n = 35). The transcripts were then analysed by the lead researcher and another member of the research team. Through multiple readings of the transcripts and interview notes, we could identify interesting differences and commonalities on ESG engagement across the various corporations participating in our study.

Guided by our research questions, we focused in particular on the commonalities, in order to identify **value-creating mechanisms for corporations**. In the context of this research, we define mechanisms in line with Stinchcombe (1991), as: "bits of theory about entities at a different level (e.g., individuals) than the main entities being theorized about (e.g., groups), which serve to make the higher-level theory more supple, more accurate, or more general" (p. 367).

Specifically, we focused on how interactions between corporate and investor actors conducting engagement (individual and inter-organizational levels) produce different forms of value for corporations (organisational level). Going back and forth between our data and a prior typology of forms of ESG engagement value (see: O'Sullivan and Gond, 2016), we found that multiple mechanisms can create different types of value for corporations. For instance, several interviewees mentioned that they often ask the investors engaging them questions – and sometimes even regard investors as "free consultants".

Engagement here adds value to corporate actors, because it is a way to obtain information about best ESG practices in their industry and beyond, to benchmark corporate efforts in the ESG domain, and/or identify any gap in their current ESG strategy. We labelled this mechanism '**gathering feedback, benchmarking and gap-spotting'**, and clustered it with other mechanisms that also contribute to corporate learning through engagement, under the umbrella of 'learning dynamics'.

Following a similar approach, we could identify a whole set of mechanisms that supported three distinct value-creating dynamics presented in the left column of Table 1 (and detailed in Appendix B, Table B1): ***communicative dynamics***, ***learning dynamics***, and ***political dynamics***. Although we provide only a few narrative illustrations in the report, the mechanisms and overarching value-creation dynamics we present in this report are all grounded in wider empirical evidence from our interviews.

INTEGRATION OF FINDINGS WITH QUALITATIVE DATA FROM INVESTORS

Once we had completed our analysis of the corporate data, and in light of these dynamics, we revisited our prior empirical corpus of investor interviews (from O'Sullivan & Gond, 2016) (n = 36), as well as a complementary set of interviews conducted by the PRI (n = 30), to identify whether similar mechanisms were at play amongst investors. We found **slightly distinct mechanisms for investors** in relation to the three **value-creating dynamics of communication, learning and politics**. Table 1 provides an overview of these mechanisms. Appendix B presents these mechanisms with more details (see Table B1).

APPENDIX B: DETAILED TABLES

Table B1. Mechanisms of Engagement Value Creation for Corporations and Investors

<table>
<tr><th rowspan="2">VALUE CREATION DYNAMICS</th><th colspan="2">CORPORATIONS</th><th colspan="2">INVESTORS</th></tr>
<tr><th>Mechanisms</th><th>Benefits of engagement</th><th>Mechanisms</th><th>Benefits of engagement</th></tr>
<tr><td rowspan="3">POLITICAL DYNAMICS

DERIVING POLITICAL BENEFITS</td><td>CLARIFYING EXPECTATIONS AND ENHANCING ACCOUNTABILITY</td><td>▪ Helps to define and clarify investor expectations, and to adjust external communication/ reporting accordingly.
▪ Can inform/ enhance general ESG disclosures for broader stakeholders (e.g. regulators, NGOs).</td><td>SIGNALLING AND DEFINING ESG EXPECTATIONS</td><td>▪ Helps investors signal to investee companies which ESG issues are of most importance to them, and the related ESG performance and disclosures they require.</td></tr>
<tr><td>MANAGING IMPRESSIONS AND REBALANCING MIS-REPRESENTATIONS</td><td>▪ Allows companies to manage investor impressions and to convey an accurate picture of the firm after/during controversies.
▪ Can help to address challenges posed by ESG ratings perceived by companies as outdated or inaccurate.</td><td>SEEKING OUT DETAILED AND ACCURATE CORPORATE INFORMATION</td><td>▪ Allows investors to enter into direct dialogue with companies to gain more in-depth, and/or accurate knowledge about corporate activities and performance; than may be portrayed in corporate (sustainability) reports, or third-party ESG scores.</td></tr>
<tr><td>SPECIFYING THE BUSINESS CONTEXT</td><td>▪ Opportunity to clarify the business model and to explain firm-specific ESG challenges.
▪ Allows companies to discuss their ESG policy in a holistic manner, and explain possible trade-offs between E, S, and G dimensions of performance.</td><td>ENHANCING INVESTOR ESG COMMUNICATION AND ACCOUNTABILITY</td><td>▪ Helps develop improved lines of communication and accountability between asset managers and asset owner clients.
▪ Can facilitate better internal information and management control systems for improved ESG reporting to clients, regulators, standard-setters and the general public.</td></tr>
</table>

Table B1. Mechanisms of Engagement Value Creation for Corporations and Investors (Continued)

VALUE CREATION DYNAMICS	CORPORATIONS		INVESTORS	
	Mechanisms	**Benefits of engagement**	**Mechanisms**	**Benefits of engagement**
LEARNING DYNAMICS PRODUCING AND DIFFUSING KNOWLEDGE	ANTICIPATING AND DETECTING	▪ Helps anticipate emerging ESG trends and future requests from investors. ▪ ESG analysts can help detect weak ESG signals.	BUILDING NEW ESG KNOWLEDGE	▪ Allows investors to gain ESG knowledge and expertise of particular industries and/or companies. ▪ Allows for greater interaction between investors and ESG experts and/or NGOs.
	GATHERING FEEDBACK, BENCHMARKING AND GAP-SPOTTING	▪ Provides feedback about sustainability policies and reporting, best practices, and helps benchmark efforts. ▪ Can help identify problematic gaps in current ESG policies or systems.	CONTEXTUALISING INVESTMENT DECISIONS	▪ Helps to better identify and understand material ESG risks associated with particular industries and/or companies.
	DEVELOPING KNOWLEDGE OF ESG ISSUES	▪ Helps to advance knowledge about ESG issues, and to present ESG policies to mainstream investors.	IDENTIFYING AND DIFFUSING INDUSTRY BEST PRACTICE	▪ Allows investors to identify company and industry ESG best practices, and to encourage their diffusion.

Table B1. Mechanisms of Engagement Value Creation for Corporations and Investors (Continued)

VALUE CREATION DYNAMICS	CORPORATIONS		INVESTORS	
	Mechanisms	Benefits of engagement	Mechanisms	Benefits of engagement
POLITICAL DYNAMICS DERIVING POLITICAL BENEFITS	ENROLLING INTERNAL EXPERTS	▪ Helps to enrol operational and subject ESG experts as well as other functional experts to address investor questions, and subsequently advance sustainability strategies.	ADVANCING INTERNAL COLLABORATION AND ESG INTEGRATION	▪ Closer collaboration and comradery between internal institutional investor ESG and financial analysts, which in turn advances ESG integration efforts.
	ELEVATING SUSTAINABILITY AND SECURING RESOURCES	▪ Greater board-level manager awareness of ESG issues, reinforcing the position of sustainability professionals internally. ▪ Assists internal lobbying for resources for sustainability practices.	MEETING CLIENT EXPECTATIONS	▪ Allows institutional investors to fulfil stewardship and fiduciary duties to clients and beneficiaries; thus raising awareness of materiality of ESG issues internally and through financial markets.
	DERIVING POLITICAL BENEFITS	▪ Development and enhancement of strong, on-going relationships with long-term investors. ▪ Attracts ESG investors, potentially lowering the cost of capital.	BUILDING LONG-STANDING RELATIONSHIPS	▪ Facilitates establishment of long-term, trusting relationships with investee companies, which can increase the likelihood of engagement success.

Table B2. Contrasting Corporate and Investor Perceptions of Engagement Success

<table>
<tr><th rowspan="2">DIMENSIONS OF SUCCESS</th><th colspan="2">CORPORATE PERSPECTIVES</th><th colspan="2">INVESTOR PERSPECTIVES</th></tr>
<tr><th>Investor-centric criteria</th><th>Corporate-centric criteria</th><th>Investor-centric criteria</th><th>Corporate-centric criteria</th></tr>
<tr><td>COMMUNICATIVE / NORMATIVE</td><td>RESPONDING TO INVESTORS' REQUESTS
■ Satisfying investor ESG requests or informational needs.
■ Demonstrating that ESG risks are actually managed and under control.
■ Avoiding requests by proactively providing relevant ESG information.</td><td>ALTERING EXTERNAL COMMUNICATION AND DISCLOSURE
■ Improving external communication of ESG management.
■ Adjusting reporting to prevent future direct calls/demands.</td><td>IMPROVING STEWARDSHIP AND ACCOUNTABILITY
■ Informing clients how their money is invested.
■ Maintenance of stocks with strong financial performance in the portfolio, without breaching stewardship or owners' policies.</td><td>GETTING RESPONSES TO QUESTIONS
■ Being responded to, having the attention of the board in a timely manner.
■ Being provided with a satisfactory answer to requests, which meet pre-defined objectives and/or reduce uncertainty.</td></tr>
<tr><td>COGNITIVE / KNOWLEDGE-BASED</td><td>ALTERING INVESTOR PERCEPTIONS OF THE CORPORATION
■ Shifting investor perceptions of the ESG issue in relation to the corporation.
■ Moving investors from a focus on ESG results, to a deeper understanding of corporate (ESG) systems and business models, to develop a new way of looking at the corporation.
■ Proactive shaping of the ESG agenda in the market by 'educating' investors about ESG best practices.</td><td>ENHANCING KNOWLEDGE OF ESG STRATEGIES
■ Discovering new practices, modes of communication or techniques, that can improve the sustainability strategy.
■ Better understanding of internal ESG risks.
■ Feedback about the ESG policy or reporting.
■ Helping to build an internal consensus about ESG issues.</td><td>ENHANCING ENGAGEMENT AND ESG-RELATED KNOWLEDGE
■ Learning best practices about ESG issues in investee companies' industries.
■ Knowledge of how things are happening 'on the ground'.
■ Learning about ESG engagement methods from other investors.</td><td>DEVELOPING KNOWLEDGE OF THE CORPORATE CONTEXT
■ Having the assurance/ reassurance that ESG risks related to prior controversies are under control.
■ Knowing more generally what is happening in the company, and in relation to emerging or new ESG risks.</td></tr>
</table>

Table B2. Contrasting Corporate and Investor Perceptions of Engagement Success (Continued)

DIMENSIONS OF SUCCESS	CORPORATE PERSPECTIVES		INVESTOR PERSPECTIVES	
	Investor-centric criteria	Corporate-centric criteria	Investor-centric criteria	Corporate-centric criteria
POLITICAL / INSTRUMENTAL	CHANGING INVESTOR BEHAVIOUR ▪ Avoiding divestment and/or maintaining long-term investors. ▪ Changing investor behaviour to reflect their appreciation of the value of corporate action (e.g. increased financing or shareholding). ▪ Having investors speak highly and positively about the company to their colleagues and peers. ▪ Improving third-party ESG scores. ▪ Being invited by investors to different forums because of the quality of the sustainability strategy.	CHANGING ESG PRACTICES ▪ Adopting new practices as a result of the dialogue. ▪ Adopting more proactive management of ESG gaps or risks. ▪ Designing a new ESG policy to better fit investors' expectations. ▪ Acceleration or facilitation of choices related to the ESG strategy.	IMPROVING THE FINANCIAL PERFORMANCE OF ASSETS ▪ Enhanced financial performance – contribution of engagement to an enhanced alpha and investment/ portfolio performance (difficult to measure/ assess). ▪ Reduced risks – contribution of engagement to reduced beta and lower variability in risks of the invested companies (more plausible for some investors).	CHANGING CORPORATE DISCLOSURE... ▪ Influencing changes in the reporting of ESG performance (attribution of success issue and/or need for a collective definition of success). ▪ Contributions to the formalisation of ESG policies and/or to changes in corporate decisions to make ESG policies publicly available. ...AND BEHAVIOUR ▪ Corporate adoption of new ESG practices; consideration of previously neglected ESG issues. ▪ Contribution to actual progress in ESG performance as measured by third-party organisations.

Table B3. Contrasting Perceptions of Individual vs. Collective Forms of Engagement

<table>
<tr><th></th><th colspan="2">INDIVIDUAL INVESTOR ESG ENGAGEMENTS</th><th colspan="2">COLLECTIVE INVESTOR ESG ENGAGEMENTS</th></tr>
<tr><th></th><th>Corporate Perceptions</th><th>Investor Perceptions</th><th>Corporate Perceptions</th><th>Investor Perceptions</th></tr>
<tr><td>Pros</td><td>Easier to identify the ESG interests of investors in the context of individual engagement.
One-to-one interactions provide an opportunity to closely match answers to individual investor questions and needs, and to adjust to the degree of investor ESG knowledge and sophistication in general.
Avoidance of misrepresentation of ESG performance by third-parties (rating agencies).
Face-to-face and one-to-one dialogues are effective to address multiple ESG issues and their link to corporate ESG strategy.
Trust-building with investors.
Development of long-term relationships with 'strategic' investors.</td><td>Alignment of the engagement goals with internal ESG and engagement policy; possibly focusing on specific themes.
Strategic benefits of proactively addressing an ESG topic that is not yet on investee companies' agendas.
Enables a strategic focus on corporate stocks with ambiguous ESG scores.
Tailored individual engagement may be more relevant to investors with very concentrated portfolios.</td><td>Impression management between investors participating in collective meetings, which can help them act and behave more professionally.
Perceived higher expertise of the group, as they are sometimes 'briefed' by experts about specific ESG issues through the process.
Higher number of investors with large amount of assets under management working together can give more leverage to internal corporate actor drives on ESG issues.
Cost savings in terms of time spent with a group of investors at once.</td><td>Higher power and influence through the collective assets under management.
Enhanced visibility and legitimacy of the ESG issue as investors 'speak with one voice'.
Enhancement of pre-existing individual engagements.
Possibility to access high-level and relevant ESG issue experts.
Useful to engage in new markets to benefit from other investors' experience; and education of investors new to engagement.
More relevant for systemic and marketplace issues, or if investors have 'thematic' engagement policies.
Cost savings on monitoring.</td></tr>
<tr><td>Cons</td><td>Need to manage numerous, different investor requests, especially after major events or ESG controversies.
Redundancy in questions asked by multiple, individual investors.
Possibility to receive unmanageable volumes of requests if engagement practices become widely diffused.
Costly and time consuming process, especially if ESG requests by multiple investors increase.</td><td>Potentially low shareholding in 'strategically relevant' corporations that may not be sufficient to capture board-level attention, and thus advance ESG issues within the corporation.
Limited resources that can be spent to maintain the continuity of engagement and/or need to engage with financial analysts to enhance the reach of engagement.</td><td>Lack of clear common interest and expectations, vis-a-vis a given corporation, by the investor group.
Lack of interest from investors for the corporate system of ESG management due to specific thematic focus.
Investors with small shareholding, but an interest in the topic, may attend meetings, and this can be regarded as intrusive.
Coordination of issue/cost if companies have to handle calls with multiple individual investors who struggle to coordinate their efforts.</td><td>Broad international focus that may not be coherent with nationally focused investment strategies.
Difficulty of keeping momentum in the group.
Less possibility for one-to-one interactions.
Coordination costs, and time-consuming process due to the potentially divergent views and interests of investors.
Possibility of free-riding during the process of engagement.</td></tr>
</table>

CREDITS

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

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UNEP FINANCE INITIATIVE

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact