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Mark Lyster

Towards defining "engagement best practice"

In my previous column I showed that corporate engagement is a well-established and an essential ingredient of some of the leading SRI portfolio manager's strategy and toolkit. Engagement is practised in many styles and forms, depending on the particular charter, mandate and style and the fund manager. Corporate dialogue, voting of shares, proxy voting, filing of resolutions and ultimately divestment are all part of the shareholder activism continuum. Engagement strategies also appear to be used to enhance the credibility of SRI processes and are used in conjunction with negative, positive and best of sector screening.

Whilst engagement is an accepted SRI tool, it is not without its problems. Engagement requires considerable corporate performance information and data. To be effective it requires good research which is costly and time consuming. Engagement is also time consuming for the companies involved. Given the lack of standardisation and the various engagement 'styles', companies complain about the increasing scope of issues covered, inconsistent evaluation processed and the proliferation of questionnaires and meetings.

Notwithstanding the wide range of applications and jurisdictions within which engagement occurs, one can establish the characteristics of what might be defined as "engagement best practice". The following are some initial suggestions put forward to stimulate further discussion and to assist a range of SRI stakeholders (fund managers, investors, trustees, companies, NGOs, industry associations etc) in evaluating engagement as a legitimate part of the SRI process.

1. Principles of engagement – the rationale and objectives of engagement should be derived from the fund manager's specific mandate or own SRI charter and policies.

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2. Strategy – the overall method of engagement (how and when) should be developed in the form of a project plan, indicating key performance indicators, engagement style and process, resources, budget etc. Ad hoc, under-researched and poorly planned engagement activities are likely to undermine the efficacy of engagement as a legitimate SRI tool.

3. Performance indicators – specific, measurable environmental and social performance indicators should be developed, defining levels and standards of performance in different sectors. Making expected engagement outcomes specific and measurable means setting targets like (for example) “company x to reduce use of PVC by y kgs in z years”.

4. Research – engagement relies on performance data and research. The quality and credibility of the research methodology and subsequent analysis is likely to be a key factor in the success of the engagement process.

5. Focus – a list of key issues, and themes and sectors should be decided upon – it is not possible to tackle all issues and all sectors. Priority areas should be related to the SRI charter and/or mandate and on consultation with other stakeholders, such as NGOs.

6. Collaboration – the efficacy of engagement is greatly enhanced through responsible collaboration. Choice of partners, alignment of interests and effective models of collaboration need to be explored and decided upon.

7. Transparency and disclosure – The fund managers SRI charter and/or mandate and performance expectations should be available to companies. Manager’s intentions, recourse options and collaborative intentions should also be made clear. Shortcomings of a particular engagement approach should be acknowledged where appropriate and care should be taken to not misrepresent the actual and expected outcomes in marketing material. Monitoring and disclosing progress on a regular basis, the format, and to whom information is disclosed should all form part of the overall project plan. The establishment of an external advisory committee, or appointment of third-party verifiers also needs to be evaluated.

8. Recourse – most engagement programs have recourse to a number of strategies should companies not meet expectations. These range from doing nothing, through to publicised divestment. Engagement without recourse is unlikely to be successful and appropriate options need to be considered. Stand-alone engagement mandates without an associated investment mandate require special attention to clarify the recourse options.

9. Consistency - a key requirement is that engagement criteria and performance evaluation is applied in a consistent and fair manner across all sectors and companies.

10. WALKING THE TALK – SRI fund managers need to need their own advice and be able to meet the requirements of their own engagement performance criteria.

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