

Research Report: Talk is not cheap – The role of interpersonal communication as a success factor of engagements on ESG matters¹

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Summary

- Successful engagements on material environmental, social and governance (ESG) matters have been shown to generate positive returns, and they are increasingly in the spotlight to evaluate the performance potential of companies.
- Engagement process characteristics, especially personal interactions, have a substantial influence on the success chances of engagements. On average, per additional personal meeting, the chance of progress in the engagement, increases by about 5 percentage points.
- Our findings suggest that several ways lead to engagement success, which can be reached in different combinations of various factors, such as company properties, type of communication and contact person. Successful configurations differ depending on the engagement type.
- In emerging markets, engagement success appears most idiosyncratic. Engagements should thus be particularly customised in developing countries.

Motivation

Environmental, social and governance (ESG) factors are an increasingly important aspect in investment decision-making processes and the estimation of the future performance of companies. This is backed by research showing that engagements on ESG matters, on average, have positive abnormal returns of 1.8%. Some successful engagements are even associated with average abnormal returns of 4.9% (Dimson, Karakaş and Li, 2015). In this context, we sought to find out how engagement process characteristics – those factors that can be shaped and influenced by the engaging party – contribute to the success of engagements. This study aims to shed light on that by focusing on the effects of personal interaction between the engaging party and the engaged company, and choice of contact person in the company. We have analysed interactions between Hermes EOS and companies in its engagement programme.

Analytical approach

We conducted a two-step analytical approach investigating 936 completed engagements at 520 companies recorded in the Hermes EOS database. First, we undertook standard regression analyses to find out about average effects – factors that increase engagement success² chances as they become more pronounced. Regression analysis is increasingly applied to practical contexts to serve as a tool for predictive analyses. Second, we use fuzzy set quantitative comparative analysis (fsQCA) to derive configurations of conditions that consistently lead to engagement success. This allows us to leave the ‘the higher x, the higher y’ logic of regressions. Instead, it implies the application of set theoretic thinking. If condition a, b, and c are fulfilled, d is happening.

¹ This is an independent research project conducted by Michael Wolff, Hülgen Coskun and Laura Jacobey from the University of Göttingen. Hermes Equity Ownership Services (Hermes EOS) provided the data on an arm’s length basis and the research project did not involve any funding made by Hermes EOS or any associated party. Hermes EOS was only involved in providing the access to the online database and all analyses has been made by the authors. The data is subject to a non-disclosure agreement so that companies are anonymised. The authors are grateful for the vivid discussion with Hermes EOS’ clients and partners, which was very helpful for further idea generation and results interpretation.

² The engagement process will be defined as successfully, if the targeted company implemented the change that Hermes EOS proposed, i.e. when the last milestone is reached and the engagement objective is achieved. For example, engagement success takes place if the engagement objective was to nominate another independent director and by the end of the engagement process, the company’s board indeed names an independent director. On the contrary, the engagement process will be defined as unsuccessfully, i.e. when the company Hermes EOS is engaged with refused to agree on the organizational changes that Hermes EOS called for.

Thereby, we can profit from two key features: equifinality and causal conjunction (see figure 1). This is particularly promising in this context as engagement success is highly idiosyncratic. As several approaches are used and different conditions do not work in isolation, this gives a more differentiating picture.

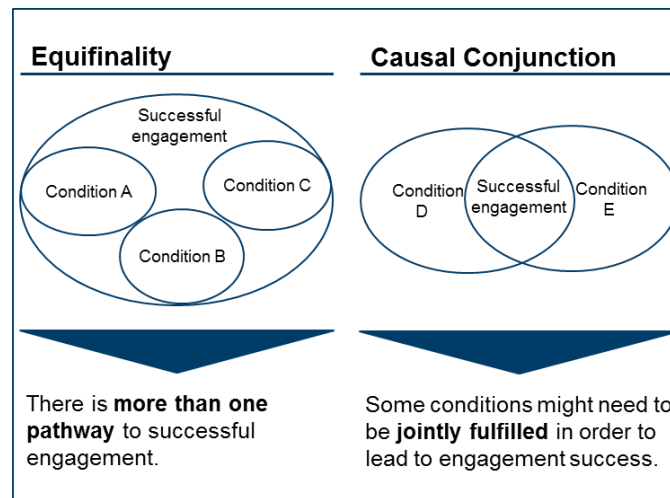


Figure 1: Two key features of fsQCA

In sum, based on the fact that engagement differentiate from company to company, the fsQCA approach helps to understand that it does not exist only one way to characterize engagement success. Instead, the outcome of fsQCA is a number of consistent success patterns in the form of combinations of conditions.

Analyses results

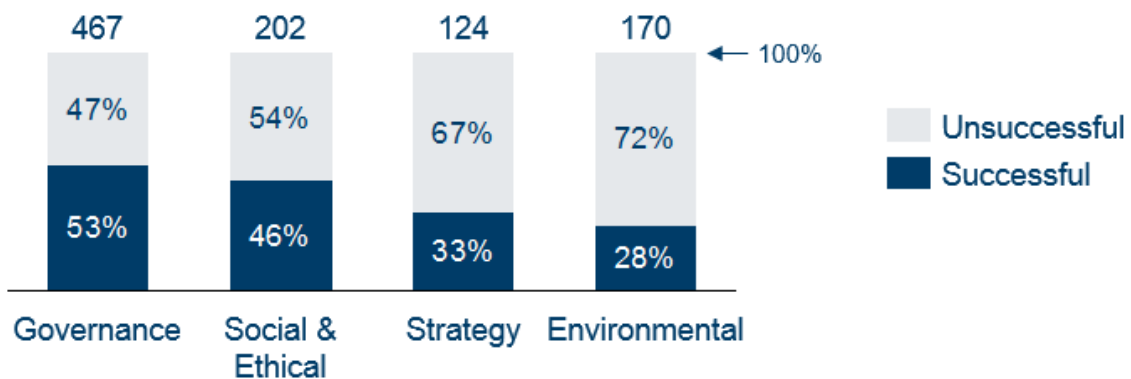


Figure 2: Success rates by engagement theme

The descriptive analyses of the dataset show that success rates vary widely by engagement theme (see figure 2). Our regression analysis of almost 1,000 engagements shows some major success factors that, on average, contribute to engagement success. For instance, company size and prior company performance are positively associated with increased chances of engagement success.

Considering the variation in the success rates by the different engagement themes, it is unsurprising that the fsQCA analysis did not lead to a consistent success pattern. Not only do the outcome differ depending on the engagement theme but the approach and the process of an engagement need to be tailored to the overall context. Differentiating the dataset according to the theme led us to different success patterns for engagements on ESG matters. We focused on the communication type (written, interpersonal and communication by telephone) and the contact person of the engagement (for example, C-level executives, board chairs, CSR representatives and investor relations).

Four key messages can be derived from the analysis of governance engagements

1. High levels of voting rights are no necessary condition for engagement success. A good level of corporate governance performance³ is an effective substitute for a high level of voting rights. It is however also possible to derive a consistent success pattern with both conditions being absent (see figure 3, configuration 9).
2. Contact with the chair is a condition present in most of the successful engagements (configuration 2, 4, 6, 7, 8, 9, 11, and 12). There are also configurations where contact via different approaches with the company substitutes for dialogue with the chair. These configurations take place when a high level of voting rights and/or a high number of meetings are given.
3. A high number of meetings covers many successful cases. In fact, this feature is only rarely substitutable when other powerful levers are present, such as when a large number of voting rights and a prior high corporate governance performance by the company.
4. There is no consistent configuration where a C-level executive is present and contact with the chair or company secretary is not available. This suggests that C-level contact should be accompanied by dialogue with the chair or company secretary.

The following figure shows the fuzzy set quantitative comparative analyses results table of the success pattern for **governance engagements**.

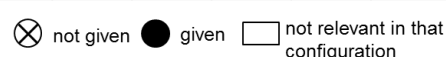
		1	2	3	4	5	6	7	8	9	10	11	12
Company properties	High level of voting rights	⊗	●	⊗			●	●	●		●	●	⊗
	High CG performance	●		●	●	●	●	⊗	●	⊗	●	⊗	●
Type of communication	High level of written communication	●			●	●	⊗	●	●	●	⊗	●	⊗
	High number of meetings	●	●	●	●	●	●	●	⊗	●	⊗	⊗	●
Contact person	Contact with a C-level executive (0/1)		●	●		●	⊗			●	⊗	●	●
	Contact with chair (0/1)		●		●		●	●	●	●	⊗	●	●
	Contact with corporate secretary (0/1)	●	⊗	●	●	●	⊗	⊗	⊗	⊗	●	●	
Overall consistency 87% Overall coverage 31%													

Figure 3: Success patterns of governance engagements

Successful environmental engagements show different patterns but also share some similarities with governance engagements.

Our explorative analyses show that prior company performance and voting rights are not as consistently relevant in the setting of environmental engagements. Furthermore, the influence of written communication does not play a consistent role in those cases. Instead, industry affiliation and company size are consistently relevant in this setting. We summarise the insights from the environmental analysis as follows:

1. In the environmental setting, there are consistent patterns without chair or secretary contact. A greater variety of contact persons (i.e. Investor relations and CSR representative) can be chosen.
2. C-level contact alone is not consistently related to engagement success. Instead, it should be accompanied by contact with the board or investor relations.

³ Corporate governance performance reflects a score provided by Thomson Reuters' ASSET4 database. It refers to the degree to which firms have shareholder friendly governance mechanisms in place (Cheng, Ioannou and Serafeim, 2014).

3. Companies that are in the spotlight due to their size (>50,000 employees) or operating in a carbon-intensive industry (e.g. energy or manufacturing) are easier to achieve engagement success. If none of these spotlight conditions are present, personal communication is critical.

For social engagements, our explanatory analysis highlights the relevance of emerging markets affiliation and the importance of economic and social performance.

Industry affiliation does not play a consistent role in the success of engagements in the social and ethical category. Similarly to environmental engagements, written communication does not play a consistent role in the success patterns. In addition, similar to engagements on governance and environmental issues, contact to C-level executives should always be combined with another point of contact. Below are the most important insights for social engagements:

1. There are only two consistent patterns for emerging market companies, none of which involves contact with the chair, but all of which involve dialogue with investor relations.
2. With low prior social performance⁴, fewer conditions need to be met. That could be because those companies are in the spotlight (comparable to industry membership of environmental companies).
3. In non-emerging markets, a large number of meetings is always a success element.

Summary

Company-specific success factors as in the traditional corporate governance view do not always consistently influence engagement success patterns



Ownership and voting stakes

High levels of voting rights and/or ownership stakes facilitate engagement success, but are not a necessary condition for it.



Company size

Large companies tend to be more associated with engagement success. Not in every setting size influence the success of engagement strategies.



Industry

It can influence the configurations of engagement success when the industry is highly exposed to environmentally-sensitive sectors. However, no industry-specific success formula can be derived so far.

Engagement-specific factors have a major influence on engagement success



Personal interaction

Meeting face-to-face is consistently associated with a higher probability of engagement success and is only substitutable in special cases.



Contact with the chair or secretary

It pays off to maintain a dialogue with the board's chair or, if applicable, the company secretary.



C-level executive contact should always be combined

Contact with C-level executives only (excluding the chair) does not consistently lead to engagement success.



Engagement success needs tailored approaches

There is no off-the-shelf solution, as engagement success depends on many interrelated factors.



Emerging markets

Likewise, there is no indication of region-specific success formulas so far. However, we do see that approaches need to be customised in emerging markets, as engagement success there is highly idiosyncratic.

⁴ The social performance (provided by ASSET4) measures a company's capacity to generate trust and loyalty with its workforce, customers and society (Thomson Reuters, 2017).

Bibliography

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Thomson Reuters, 2017. *Environmental, Social and Governance Performance*. Online: <https://www.thomsonreuters.com/en/about-us/corporate-responsibility-inclusion/esg-performance.html>.

Further readings

Barko, T., Cremers, M., and Renneboog, L. 2017. *Shareholder Engagement on Environmental, Social, and Governance Performance*. European Corporate Governance Institute, Finance Working Paper No. 509/2017.

Author information



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Research partner



What is Hermes EOS?

Hermes EOS helps long-term institutional investors around the world to meet their fiduciary responsibilities and become active owners of public companies. Our team of engagement and voting specialists monitors the investments of our clients in companies and intervenes where necessary with the aim of improving their performance and sustainability. Our activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.