SDG Engagement Equity Fund

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Federated Hermes International

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For professional investors only

Federated Hermes SDG Engagement Equity Fund

Launched in January 2018, the Fund aims to deliver attractive returns while having a measurable impact on the real world.

By engaging with companies on their ability to support the attainment of the Sustainable Development Goals (SDGs), we target both traditional financial performance and positive social and environmental change. The SDGs are a set of 17 interconnected goals that were adopted by all UN member states in 2015. They are a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere, by 2030.

There are a number of core beliefs that underpin our strategy, including that:

- Public companies can contribute to and benefit from efforts to achieve the SDGs. Meeting the SDGs is expected to be a primary driver of future economic growth, providing opportunities for firms to boost revenues and earnings. Companies are uniquely positioned to significantly impact lives due to their integral position within communities, direct relationships with employees and connections with suppliers.
- The long-term commercial performance of companies is connected with the success of the environments in which they operate and in which their employees and customers live. Firms that fulfil their responsibilities towards society are more likely to be rewarded with greater brand loyalty, employee motivation and more innovative products and services.
- Investors can influence companies to improve their operations in support of the SDGs, creating a virtuous circle of change, benefiting employees, communities, supply chains and other stakeholder groups. Engaging with companies on the SDGs provides investors with valuable insights into their current levels of sustainability and longer-term commercial risks and opportunities.

How we measure impact

Our twin objectives of investment returns and positive social and environmental impacts are always front-of-mind when we are appraising, monitoring and speaking with the companies we invest in.

However, the real-world impact of our engagements may not be immediately quantifiable nor comparable across the companies in the portfolio. For instance, it is not appropriate to rate the relative merits of, say, a utility company that is starting to provide renewable energy against an organisation that is employing those living under the national poverty line or who are long-term unemployed.

Despite the challenges, we are committed to reporting both on the progress and outcomes of our engagement efforts. First, we explain our theory of change. Second, we use narratives to communicate how our corporate engagement has generated or is generating real changes within companies, and in so doing is addressing a social challenge or need. Unless impractical, we also report widely accepted and standardised metrics, such as those from impact investment organisation IRIS, targeted to the individual company in question and around specific engagement objectives.

Throughout, we are acutely aware that it is the companies we are investing in that are delivering the outcomes that create the positive impact. Through our engagements we hope to catalyse new initiatives, create new relationships, accelerate progress and heighten ambitions. We nonetheless recognise that it is the companies that ultimately deserve the credit.

> **Meeting the SDGs is expected to be a primary driver of future economic growth**

Engagement commentary

Will Pomroy Lead Engager

All in it together?

In just a few short months, the world has changed dramatically. Nonetheless, the topics we have focused on since the Fund's inception remain pertinent, and arguably more so than ever before.

The reality for many (if not all) companies this year has been an atmosphere of unprecedented disruption and companies, communities and nations are still grappling with their own unique challenges. The decisions that firms make during this period will likely have a long-run impact on their corporate reputation and ability to attract and retain employees and win new business (see the box on page 5 for more information about how our portfolio companies have responded to the pandemic).

While this has been a time of turmoil, the pandemic has reinforced our contention that companies have a responsibility to their employees that goes beyond paying them for their labour. Job creation and access to employment underpin many of the SDG targets, lifting people out of poverty and bringing previously underrepresented groups into employment – and in doing so, reducing inequalities.

In 2019, the global unemployment rate finally fell to pre-financial crisis levels (although large disparities still existed). Also, from 1990-2019, the number of people in absolute poverty – in other words, subsisting on less than $1.90 per day – fell from 36% of the world's population to just 8%.

Number of people in absolute poverty globally:

1990 36%

2019 8%

This incredible progress is now being reversed – and quickly. It is clear that the pandemic will greatly exacerbate pre-existing inequalities within society.

Some argue that the pandemic has been a great leveller – people across the globe have been forced to self-isolate, regardless of their income or status. However, we believe it has been quite the opposite. Global job losses could reach the hundreds of millions, and the pandemic will have a disproportionate burden on lower-skilled workers.

A recent poll of economists[1] found that the vast majority are concerned that the coronavirus will increase inequality. Recessions exacerbate pre-existing inequities and have a larger impact on the health of vulnerable disadvantaged groups, such as people with disabilities and diseases and the unemployed.

An opportunity to change course

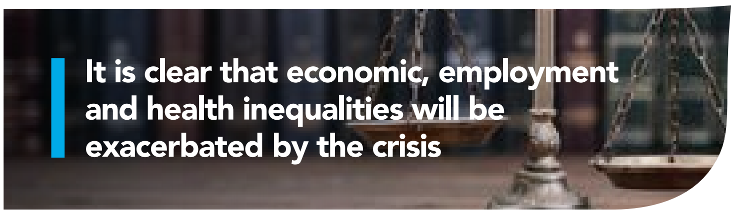
> You never let a serious crisis go to waste. And what I mean by that is it's an opportunity to do things you think you could not do before.
>
> **– Rahm Emanuel, former Mayor of Chicago**

It is clear that economic, employment and health inequalities will be exacerbated by this crisis. While this is unavoidable, we must work to mitigate the downsides as best we can.

In 2019, we spent much of our time discussing the role that companies can play in providing decent work opportunities (find out more by reading our series on the topic). The pandemic has given this subject even greater salience than before and we are pleased that many (although not all) firms have reacted in a sensitive fashion and are willing to talk about how they are dealing with the disruption their employees face.

Over the past few years, we have spoken at length with companies about the challenge of sourcing sufficient skilled labour and the need to reimagine hiring and employment practices. In depressingly short order, the immediacy of that challenge has disappeared. Nonetheless, we contend that pulling back on initiatives to broaden the pool of labour, diversify workplaces and embed inclusion is short-sighted and the wrong course of action.

The protests sparked by the death of George Floyd in the US has rightly (and belatedly) shone a spotlight on the continuing need to overcome racial inequalities as much as those related to gender, class and other characteristics. Companies should endeavour to maximise the pool of people from which they recruit, and where practical to represent the communities in which they operate and serve.



Driving a green recovery

While the economic, health and social pain brought about by the pandemic cannot be underestimated, there are some silver linings. The largest may be greater social awareness and a revised appreciation of what constitutes social value. Another may be the hope that governments now feel emboldened to tackle the long-term – but ever-nearing – threat of climate change. Indeed, global carbon emissions

[1] 'Inequality and the Covid-19 crisis', published by the IGM Forum on 13 April 2020.
[2] 'Covid-19 pandemic could lead to fall in CO2 not seen since the end of WWII', published by Newsweek on 3 April 2020.

could fall by more than 5% this year,[2] the largest decline since the Second World War (although perhaps not such a startling figure, given that most economic activity came to a standstill in March).

The pandemic offers an opportunity for businesses to embrace strategies that decouple growth. In conversations over the past few months, many companies have acknowledged that working practices will almost certainly not return to normal.

The reorientation of supply chains that was already underway before the crisis may also accelerate. As companies reengineer these supply chains, they also need to consider environmental factors – for example, by asking if a region already prone to flooding is likely to become more so as temperatures rise. It is clearly less expensive to prepare than to repair or retrofit. In January 2018, the National Institute for Building Sciences estimated that spending $1 to build resilient infrastructure saved $6 in future costs.[3]

Aviation is not directly included in the Paris Agreement but carbon emissions from the sector are expected to increase by a third by 2050. Aviation remains one of the largest contributors to professional-service sector emissions. For context, a return business flight from London Heathrow to Chicago O'Hare (one I used to take regularly) has an individual carbon footprint of 5.51 tonnes of CO_2. To offset this, it would require 91 tree seedlings to be grown for 10 years.

Yet there is hope this trajectory can be reversed. Trucost analysis[4] shows that if every company currently travelling for business reduced air-travel miles by 40%, the whole aviation sector would be aligned with a scenario that anticipates 2°C of global warming by 2030.

Moreover, if all businesses in the professional-services sector implemented a three-day work-from-home policy, it would align emissions from passenger transport with a 2°C climate scenario for the next five years – although further efficiency gains and more sustainable use of transport are needed elsewhere after 2026 to keep emissions reductions in line.

As we all know, this year has hit the aviation industry hard. With most companies focusing on cash preservation, it is likely that business travel will be severely reduced. As a result, it would not be unrealistic to expect much of this cost-cutting to extend to longer-term changes in business-travel policies. Changes to travel patterns will go further than there being fewer transatlantic flights and glasses of champagne in airport lounges.

Having spent months working from home, businesses and their staff have removed many of the technical and behavioural barriers associated with remote working. This could produce long-lasting impacts on how companies and their employees view flexible working practices and change daily commuting habits (for the sizable minority capable of doing their jobs remotely).

The impact on carbon emissions from passenger transport could be significant. Many companies we have spoken to acknowledge this and are assessing how they can maintain greater flexible working arrangements such as staggered hours and working at home. Remote working also has the potential to bring more people into the available labour pool, while less commuting can make work more accessible for people with disabilities – and this flexibility can be particularly helpful for single parents and caregivers.

2020: the biodiversity challenge

A landmark UN report from last year identified climate change as one of the greatest threats to biodiversity loss.[5] Although climate change has risen up the corporate agenda, the impact from companies – and their dependence on biodiversity and ecosystem services – remains largely underexplored.[6]

While positive momentum had been building, the pandemic has dashed this year's packed schedule of international meetings and negotiations to hash out what the future could hold for the earth's ecosystems and wildlife. More positively, given that the coronavirus likely originated in an animal, there is hope that the crisis could accelerate efforts to address the relationship between drivers of biodiversity loss and human health. As we noted in a recent thought piece, "biodiversity protection should be seen as non-negotiable: it is one of our greatest assets in adapting to climate change."

Some companies and industries are already responding to this challenge. Earlier this year, the Innovation Centre for the US dairy industry held a spring conference – which we were delighted to participate in – and set ambitious new environmental stewardship goals to advance the industry's role in building a sustainable future. These included stating its ambitions to achieve neutral or negative carbon emissions by 2050. More pertinently, the industry also committed to coming forward with similarly ambitious goals around land use and biodiversity in the near future.

Well-managed forests provide livelihoods, clean air and water, while also maintaining biodiversity and mitigating climate change. But as the rates of deforestation worldwide increase at a concerning pace, there is a clear need to promote the sustainable management of forests to ensure that they renew and grow. This a theme we have been exploring with a number of holdings with a reliance on forestry materials. These include Huhtamaki, which uses fibre sourcing for packaging, and Fortune Brands, which relies on timber for its manufacture of kitchen cabinets.

[3] 'National Institute of Building Sciences issues new report on the value of mitigation', published by the National Institute of Building on 11 January 2018.
[4] Stepping up to a sustainable future, post Covid-19', published by S&P Global Market Intelligence on 22 April 2020.

Pandemic shock: how our portfolio companies reacted

Many of our holdings have been badly affected by the pandemic. SSP, which runs retail units at railway stations and airports, has essentially been in hibernation since lockdowns began and had to raise capital by selling shares, furloughing employees (in other words, encouraging them to take a temporary leave of absence) and releasing a small dividend-reinvestment equity offering to retain cash (this is when the investor does not receive dividends as cash, which are instead reinvested in the underlying equity).

Not all firms have behaved with the desired level of sensitivity. Cineworld faced criticism after allegedly emailing front-of-house UK staff to inform them they would be laid off with immediate effect, after closing all of its cinemas on 18 March following industry-wide advice from UK Prime Minister Boris Johnson. Reportedly, the decision was reversed within 48 hours in response to an employee backlash and the introduction of the UK government's furlough scheme (an initiative, due to run until October 2020, where employees receive 80% of their salary up to a total of £2,500 a month).

Nonetheless, many companies have responded to the crisis in a constructive way. A number have cancelled or paused dividends or share buybacks, many management teams have taken pay cuts and others have used their position to provide support to wider stakeholders.

- **Merlin Properties**. The Board of Directors reduced its compensation by 25% and agreed with the CEO, general corporate manager and all members of the senior management team to waive all variable compensation and stock plan awards (both of these are additional forms of renumeration) for 2020. In addition, it granted 100% rent relief to its tenants from the middle of March until the end of July. While this resulted in a near-term cost impact, the move recognised the longer-term benefit to the company's reputation and tenant retention.
- **Huhtamaki** suspended its dividend and repurposed one of its factories in Northern Ireland to produce 4m face shields a week for the UK's National Health Service. It subsequently replicated this activity across other sites to reach 10m units a week.
- **Aptar** has sought Emergency Use Authorisation from the US Food and Drug Administration for a solution that allows N95 filtering facepiece respirators to be easily disinfected, as well as 3D printing for mask holders and face shields. It has also declared a one-time cash bonus for more than 70% of its employees.
- **Wiley** has made research content and data on the coronavirus readily available. This includes providing access to thousands of related studies and articles and its digital courseware solutions.

We hold all the companies mentioned in this box in the SDG Engagement Equity Fund.

[5] 'World is "on notice" as major UN report shows one million species face extinction', published by UN News on 6 May 2019.
[6] 'The Dasgupta Review – independent review on the economics of biodiversity', published by www.gov.uk in April 2020.

The progress of our engagements in H1 2020

It typically takes three-to-five years for a meaningful engagement objective to culminate in a delivered outcome:

- Year 1: build a relationship
- Year 2: gain buy-in and agree on a case for change
- Years 3-4: develop and implement a plan for change. This may entail a new budget, resource and teams, as well as external partnerships
- Years 4-5: deliver, measure and report on outcomes.

It is encouraging to note that approximately 62% of our engagement objectives with existing holdings are now at milestones three or four (the development and implementation of relevant plans).

Key engagement metrics

Number of companies in the portfolio:

47

% of portfolio companies engaged with:

89%

% of companies with progress towards engagement objectives:

38%

Numbers of engagement interactions with portfolio companies:

115

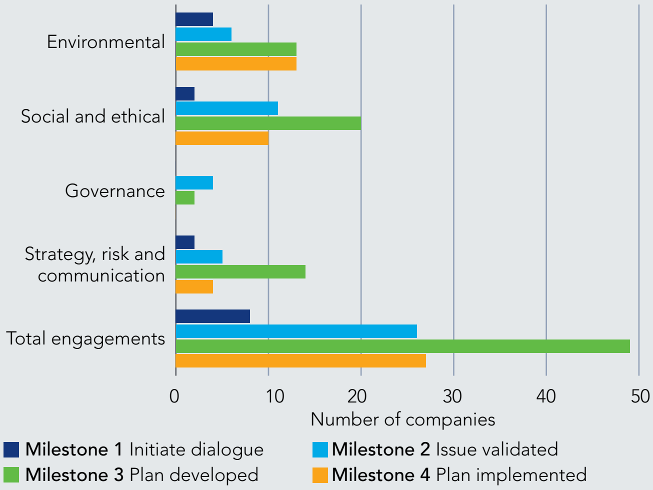
% of company meetings where we voted against management at least once:

51%

Completed engagement objectives:

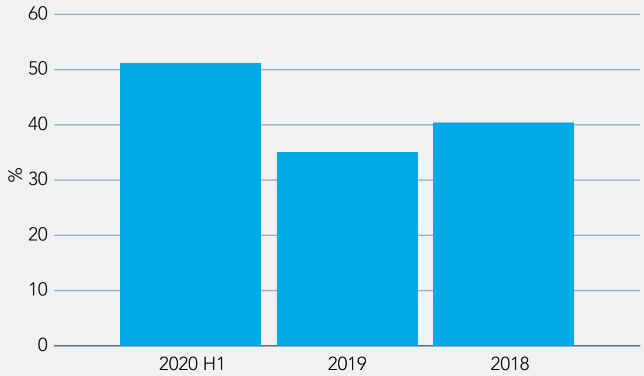
10

Figure 1. Milestone progress of engagements



Source: Federated Hermes, as at June 2020.

Figure 2. Votes against management at company meetings



Source: Federated Hermes, as at June 2020.

SDG engagement intensity

We carried out 87 unique SDG-orientated engagement interactions in the first half of 2020 (these are engagement actions which exclude those relating to governance or other, non-SDG-related matters). The graphic below illustrates the intensity of those engagements for each SDG. The larger the SDG icon, the greater our focus on the corresponding goal during the period.

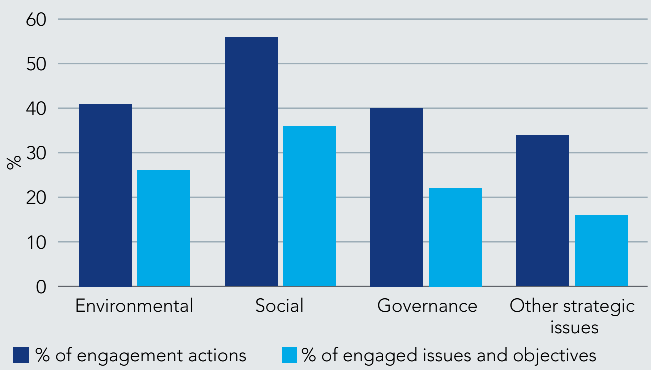
Source: Federated Hermes, as at June 2020.

Unsurprisingly, our strong emphasis on social issues has continued. We believe that the provision of decent employment is the primary means by which most companies can contribute to achieving inclusive economic growth and reducing poverty, and thus attaining key SDGs.

In the first half of 2020, 56% of our engagement actions covered social issues (see figure 3). Within this, 39% relate to SDG 8 (decent work and economic growth). At 36% of the total, social issues constituted the largest proportion of those engaged issues and objectives we set for companies in H1 2020.

> **It typically takes three-to-five years for a meaningful engagement objective to culminate in a delivered outcome.**

Figure 3. Engagement activity in H1 2020

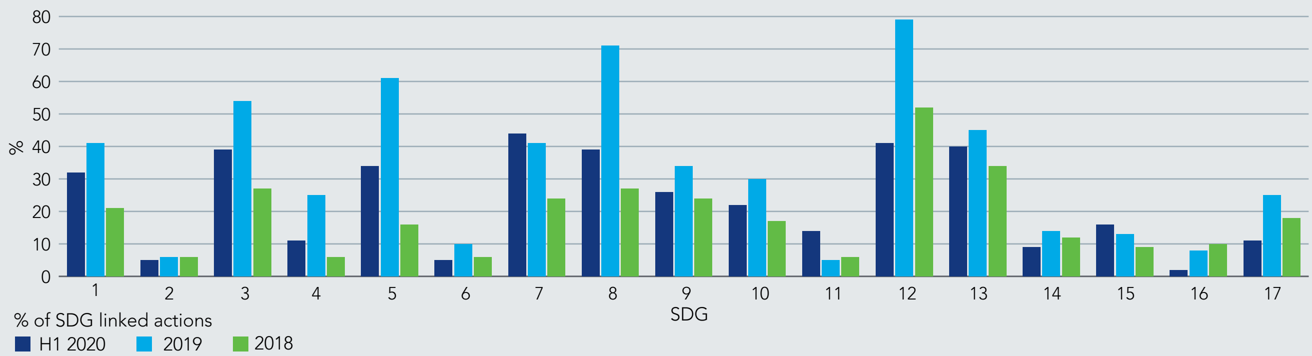


Source: Federated Hermes, as at June 2020.

Compared to the 2019 financial year, our SDG 8-related engagements in H1 2020 made up a smaller proportion of our total activity (see figure 4). This reflects the fact that we instigated engagements on the topic of decent work with a large portion of the portfolio – particularly our US holdings and those with a significant American presence – in March 2019.

More pertinently, the intensity of our engagements on SDG 12 also declined. This is because more of our engagements have matured and evolved beyond the initial discussions with companies around sustainability reporting, which featured in many of our early conversations as firms started to think about sustainability.

Figure 4. H1 2020 engagement intensity compared to previous periods

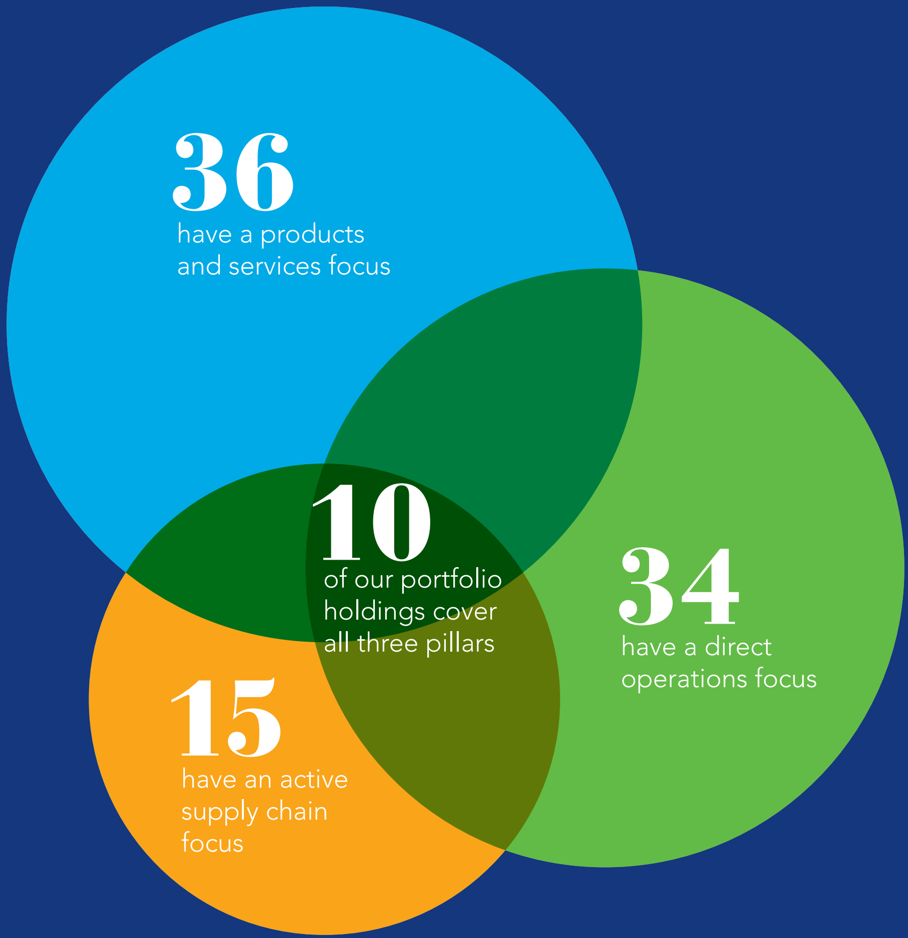


Source: Federated Hermes, as at June 2020.

Figure 5. Engagement highlights from 2020

Balance of focus

We hold companies across three pillars: supply chain, direct operations, product and services. Of 47 holdings:



Portfolio companies covering all three areas:

Fortune Brands Home & Security

1. **Supply chain:** sustainable timber sourcing
2. **Direct operation:** pressing for carbon-neutral production
3. **Products:** increasing the focus of marketing and research and development on water-efficient faucets

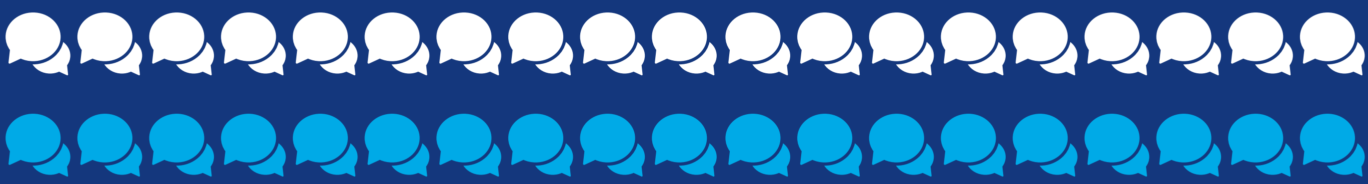
Glanbia

1. **Supply chain:** farm emissions and land use
2. **Direct operations:** decent-work provision and carbon-neutral production
3. **Products:** diversifying into plant-based proteins and promoting health and fitness

Huhtamaki

1. **Supply chain:** Sustainable fibre sourcing and living wages in the supply chain
2. **Direct operations:** living wages and carbon-neutral production
3. **Products:** 100% recyclability with greater recycled content

Developed markets v emerging markets



19 out of **47** portfolio holdings have an emerging-market angle

Investment review

The Fund's investment process has not changed since its inception and it remains focused on finding businesses that have good investment prospects and the potential to achieve positive societal impact that is aligned with the SDGs.

Hamish Galpin Lead Manager

Portfolio exposure

The Fund aims to maintain a broad range of exposures across industries, countries and SDGs. This tallies with our belief that the best relative risk-adjusted returns can be achieved by individual company selection, rather than by taking significant positions in specific industries or countries.

This is harder to achieve for our Fund, given that our desire to deliver positive impacts means we focus on companies with the greatest potential to achieve SDG-related targets. Many of these firms are in capital-intensive industries (ones that rely on physical and human capital) rather than in intellectual-capital sectors such as technology and healthcare.

We believe that many of our portfolio companies will emerge from the crisis in a better shape than their competitors.

Performance

This tension is reflected by the performance of the Fund over the first half of the year. The Fund is exposed to cyclical industrial companies, which declined by more than the overall market in the weeks leading up to the trough of the downturn in March, but then outperformed as markets recovered through to Easter.

Overall, the Fund lost about 1.13% in relative performance over the first quarter. It was held back more by consumer firms than industrial companies, as the revenues of travel and leisure stocks such as SSP, Samsonite and Cineworld were severely affected by global lockdowns.

Figure 6. Rolling five-year performance

Name	30/06/19-30/06/20	30/06/18-30/06/19	30/06/17-30/06/18	30/06/16-30/06/17	30/06/15-30/06/16	Since inception
Fund	-8.68	4.89	–	–	–	-2.41

Past performance is not a reliable indicator of future results. Source: Federated Hermes, as at 30 June 2020. Performance shown is SDG Engagement Equity Fund, net of all costs and management fees, relative returns calculated arithmetically. Benchmark is the MSCI All Country World SMID index. Inception date is 29 December 2017.

The period after Easter had a greater impact on performance, when the divergence between growth and value stocks was particularly marked and technology and healthcare companies – both of which are classified as growth stocks – delivered strong performance. While we do have some exposure to these sectors, there are relatively few opportunities to engage with such asset-light businesses. As a result, the Fund is unlikely to outperform its benchmark index when these sectors record significant gains – as they did over the second quarter.

Nonetheless, we continue to focus on creating value for shareholders over the long term (a period we see as up to ten years). Indeed, we believe that many of our portfolio companies will emerge from the crisis in a better shape than their competitors and should have the ability to continue to develop their business models (something that often happens during all market cycles, not just the current one). It is encouraging that we have been able to maintain our dialogue with holding companies on SDG issues over this period.

Turnover

Turnover was very low in the first half of the year, as we focused on assessing the status of our investments rather than making wholesale changes to the portfolio. In any case, making such changes would contradict our commitment to investing over the long term and maintaining engagement programmes which typically span multiple years.

No new companies were added to the Fund, as we have delayed investing in a few stocks until the coronavirus crisis has eased. Some of these were in India, where we had been looking to achieve greater exposure.

We sold five companies during the first half of the year. Petra Diamonds and Tullow were sold after they underperformed in 2019, which meant that they made up too small a proportion of the total Fund. Meanwhile, both Snap On and Middleby were sold after we decided that insufficient engagement progress had been made and that the investment cases had weakened.

Finally, we sold Movida after the company reached a number of key milestones, meaning there were fewer engagement opportunities. We were also concerned about the impact of the coronavirus on economic activity in Brazil, particularly as the firm had relatively high levels of debt.

ENGAGEMENT THEME:

Japanese employment: engaging for gender equality

Japan has one of the lowest unemployment rates in the world and its culture is synonymous with a strong dedication to work. However, working hours are lengthy, there remain two classes of employees, and women are significantly underrepresented in the workforce.

5 GENDER EQUALITY

8 DECENT WORK AND ECONOMIC GROWTH

An aging population and restrictive immigration policy mean that employers compete for talent and are reluctant to fire those they manage to hire. If cost-cutting is needed, companies tend to adjust wages rather than reduce headcount for fear of putting off future recruits. Despite these labour supply-and-demand dynamics, there is little upward pressure on wages or prices – something that is partly explained by the rising tendency of employers to seek out flexible workers.

In the Japanese corporate sector, the concept of lifetime employment can lead to long hours, a tendency not to take holiday and increased stress. This hard work is rewarded by job security and benefits – for those lucky enough to be regular, full-time workers – although they can often be used to justify a lower base wage. The fact that the Japanese have a term that means death from overwork – 'Karoshi' – is telling.

Unsurprisingly, the pandemic has even affected the Japanese labour market and the ratio of job offers to applicants fell to a five-year low in May. Much of the pain will be felt by part-time and casual workers, a large proportion of which tend to be female.

> **In the Japanese corporate sector, the concept of lifetime employment can lead to long hours, a tendency not to take holiday and increased stress.**

An ever-present glass ceiling

Japan has never fully benefitted from the pool of talent present among its female workers. Cultural stereotypes and a lack of day-care facilities and caregivers mean that nearly half of women quit their jobs after having their first child. In Japan, women earn 25% less than men on average – the third-highest gender pay gap in the OECD. There are encouraging signs: over the past decade, prime-age labour-force participation for women in Japan has exceeded that in the US. Nonetheless, much needs to be done before this results in improved diversity within more senior corporate positions.

Part of the problem is the type and quality of jobs that women are offered or incentivised to take. In 2018, 44% of employed women were part-time and temporary workers, compared to 12% of men. Despite many companies voicing diversity ambitions over the past decade, only 24 out of the 225 Nikkei 225 firms have a board made up of more than 20% women.

New legislation[7] which came into effect this April for large companies – and applies to smaller companies from 2021 – aims to ensure equal pay for equal work between so-called regular workers (permanent and full-time employees) and irregular workers (fixed-term employees, part-time workers and temporary agency workers).

Dualism: a yawning gap

The entrenched labour-market divide between regular and non-regular workers exacerbates the gender gap. In Japan, there are broadly two types of jobs: full-time and contingent. Full-time regular workers typically enjoy seniority-based wage increases and promotion, while contract and part-time irregular workers – of which companies have been hiring more of in recent years – do not.

[7] 'Ensuring fair treatment of workers irrespective of their employment types (revision of the part-time employment act, labour contract act and the worker dispatching act', published by the Ministry of Health, Labour and Welfare in 2019.

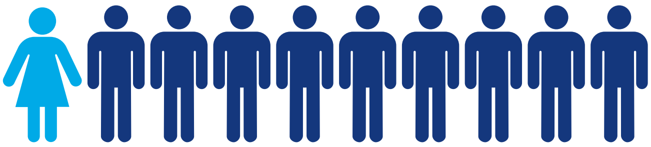
Even within the full-time category, there are two separate job types for newly hired female workers: a non-career track (Ippanshoku) and a career track (Sōgōshoku). The latter path is male dominated, largely because the degree of commitment required does not give women the time to raise children, which remains a strong cultural norm.

Fewer than half of women hold full-time positions, compared to 80% of men, while the Japanese tax and pension systems also incentivise women to give up work (or at least career progression ambitions) to ensure their spouses get a full tax deduction or that they do not pay pension contributions unnecessarily.

To create more than a crack in the ceiling, women need to be encouraged to move from part-time to permanent roles. Corporates should respond in an imaginative and proactive manner – something that is illustrated by the hiring push of PlayNext Lab, a Tokyo-based technology start-up, which took the unusual step of targeting women with young children.

Education: deeply rooted differences

The structural barriers to gender equality start early and are exacerbated by the gap in university attendance rates, where men account for 56% of enrolled students. Greater still is the gender gap in science, technology, engineering and mathematics (STEM) subjects: a report from 2017 showed that just 10.2% of engineering researchers were women.



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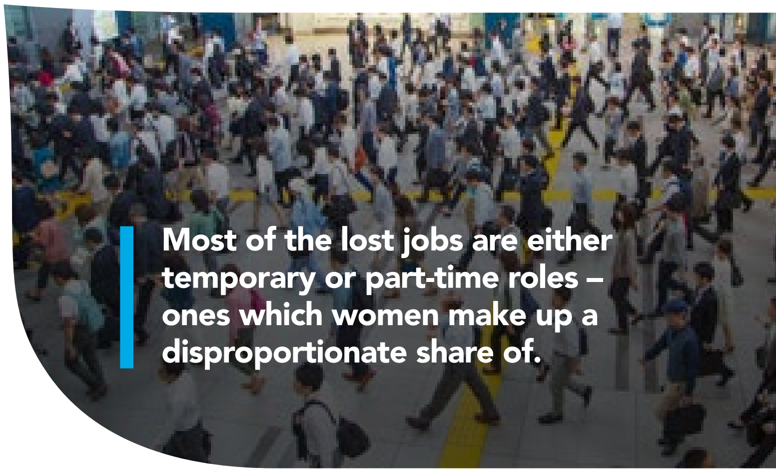
To tackle this inequity, we believe that companies should describe the degree to which their career paths are determined by entry qualifications – or disclose if they are prepared to help female recruits overcome apparent impediments to advancement. For example, Toyota Motor provides interest-free scholarship or loans to female STEM university students which do not need repaying if they subsequently join the firm.



Our demands: seizing the winds of change

It is likely that in the near-term, women will suffer the most from the impact of the coronavirus pandemic. Most of the lost jobs are either temporary or part-time roles – ones which women make up a disproportionate share of.

Companies have a considerable impact on individual lives and their practices can affect economic, physical and mental wellbeing. We believe that firms play a vital role in achieving the aspirations outlined in SDG 8, including that of full and productive employment and equal pay. To make progress, a spotlight should be shone on practices through improved corporate reporting.

In 2015, Japan's Diet approved new legislation that required companies with over 300 employees to set numerical targets for the hiring and promotion of female employees[8] and for all listed companies to disclose the female-to-male ratio of board members in their financial reports. However, progress has been slow, and the targets set often too modest.

In light of this, we would like to see greater reporting – and ambition – on the following issues, disaggregated by gender:

- Female representation by pay quartile and contract type (permanent and temporary).
- Employee-turnover rates.
- Annual employee hires (distinguishing whether they are graduate or mid-career hires).
- Return-work-rates:
  - The proportion of eligible males and females who take parental leave and the median length of leave taken.
  - The share who are working for the firm a year later.
  - The proportion promoted three years later.
- Paid-leave take-up rates.
- Investment in training and development.
- Descriptions of initiatives to resolve pipeline challenges, including financial support for academic qualifications or programmes which positively discriminate towards particular traits or characteristics.

[8] 'Abenomics is womenomics, by T. Mizuno, published by Discuss Japan – Japan Foreign Policy Forum in 2016.

Figure 7. The Fund's Japanese holdings: relevant initiatives

Horiba Ltd: The company launched the HORIBA Stained Glass Project Office, a diversity promotion unit, in 2017. This is responsible for connecting and aligning the top management, worksite employees and HR in promoting diversity, so the opinions of all parties are heard. There are modest targets to increase the ratio of women in management to 20% and among senior executives to 10% by 2021

Nifco Inc: The firm has created a development plan for management candidates and is implementing these measures through training, transfers and consultations with career advisors

Nissan Chemical: The company aims for 30% of new regular-position graduates to be women, as well as to expand the range of occupations held by women in each department.

Open House Co Ltd: The firm is enhancing internships in order to promote the active hiring of female technical staff. It has also developed a flexible employment system and career path for life events

Relo Group Inc: As part of its fringe-benefits service, the firm has a system in place to provide childcare support, housekeeping and nursing-care support services. The temporary childcare assistance system is well received by client companies.

Yaoko Co ltd: The company has a dedicated four-pronged action plan to support the hiring, promotion and development of female deputy store managers.

Next steps

The Japanese labour market remains characterised by low unemployment and the underutilisation of its female population. In light of this, we believe that companies should take a more courageous approach to hiring. The untapped talent of the country's female population has a clear opportunity cost, and we encourage firms to be innovative when reforming their benefits proposition and the associated take-up, tailoring their offerings to support the ability of women to work productively.

We recognise the positive elements of Japan's 'career culture' and encourage companies to invest in both the recruitment and subsequent promotion of female talent. Firms should ensure women are supported through their child-rearing years – something that will enable them to return to work and maintain an upwards trajectory throughout their careers.

CASE STUDY:

Engagement progress: Techtronic Industries

We are invested in and are engaging with Techtronic Industries Co Ltd, which designs, manufactures, and markets power tools, hand tools, accessories, outdoor power equipment and floor-care appliances for home and industrial use. The company continues to outpace its competitors by accelerating the transition to cordless tools and equipment.

Investment case

The company is attractive due to its exemplary record of innovation. This means it has rapidly gained market share in the specific industries it has chosen to target. From a financial perspective, if the company continues to release innovative products, gain more market share and expand into new markets, it should experience strong growth in the years to come. The company's revenue growth has been higher than its main competitors, such as Stanley Black & Decker and Makita, in every year since 2013.

Engagement themes

- **Cobalt mining**
- **Emissions-reduction targets**
- **Increased workforce diversity**

SDG alignment

- 5 GENDER EQUALITY
- 7 AFFORDABLE AND CLEAN ENERGY
- 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
- 8 DECENT WORK AND ECONOMIC GROWTH

Engagement theory of change

Cobalt mining

Power tools are increasingly wireless, a trend driven by Techtronic. In turn, cobalt is a key mineral in the batteries that power these wireless tools. Cobalt mining poses significant human-rights risks, including child labour and dangerous working conditions (especially in the less regulated artisanal mining sector).

Downstream companies such as Techtronic are several steps removed from cobalt extraction. Nonetheless, these firms can have a positive impact by carrying out stronger due diligence on human-rights issues and looking at whether mining operations comply with the law. Tackling unsafe working conditions and the risks of money laundering and tax fraud can support the livelihoods of communities and strengthen local institutions.

Emissions-reduction targets

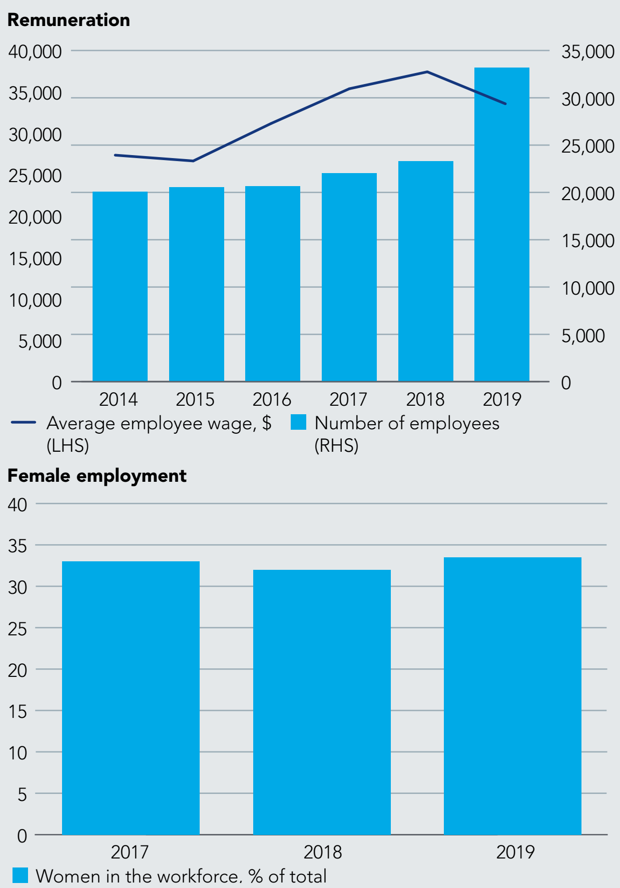
The company's strong focus on innovation and technological advancement allows it to gain market share at the same time as reducing its indirect carbon footprint. Techtronic is a leader in cordless technology and works to transform older technologies by using lithium ion batteries. In doing so, it helps its customers reduce their emissions.

Combined with its ever-expanding product innovations, a reduction in the company's own operational emissions – and an aspiration to achieve carbon neutrality – would allow Techtronic to credibly claim it is making "the world a better place"[9].

Increased workforce diversity

The firm operates in 40 jurisdictions and employs over 33,350 people with varied backgrounds, skillsets and experience, meaning it has a direct impact on thousands of lives every day. The group's workforce already displays a reasonable degree of gender diversity (see figure 8) although the board remains entirely male.

Figure 8. Techtronic's workforce



Source: Techtronic, Federated Hermes, as at June 2020.

Techtronic prides itself on a strong culture, as we saw during our company visits – and particularly at its Innovation Centre in Milwaukee. Increased levels of diversity help with the attraction, retention and development of talent, supporting the company's performance while lowering costs associated with employee turnover and addressing broader social issues of gender and racial inequality.

Practice of change

Cobalt

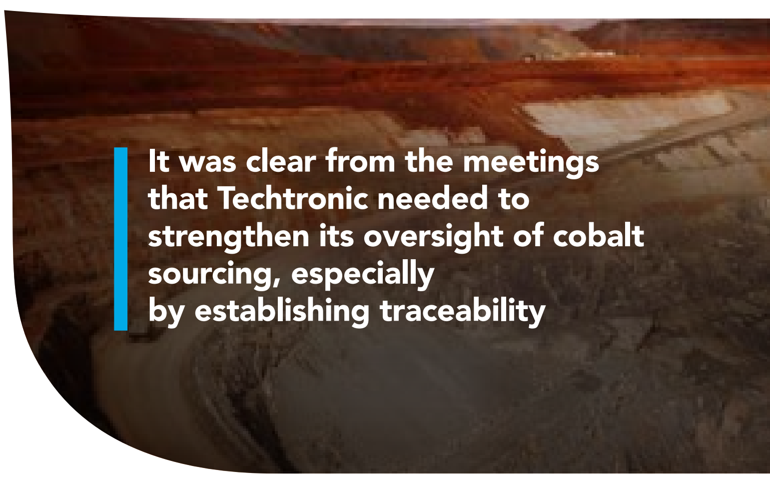
We have engaged with Techtronic on cobalt sourcing since April 2018. The first engagement focused on policy to bring its cobalt procurement in line with its modern slavery statement and align its due-diligence process with the OECD Due Diligence Guidance for minerals from conflict and high-risk areas. We started the engagement by sharing our feedback on the company's ESG report, which included disclosure on its approach to human rights in the supply chain.

In discussions across May and June, we advised on an effective approach to risks in the cobalt supply chain, and in particular the situation in the Democratic Republic of Congo. The firm's key suppliers are Samsung SDI, Panasonic and Sony, and it hopes to put more pressure on them to form an effective strategy.

It was clear from the meetings that Techtronic needed to strengthen its oversight of cobalt sourcing, especially by establishing traceability (something that was acknowledged by the firm). We helped to assess the current process and pointed to gaps in the OECD guidance on audits, including coverage and benchmarking findings with cases reported by civil society groups to assess the effectiveness of the audits.

We emphasised the need for assurance of audit results and shared our report on human-rights risk in the cobalt mining industry. We asked for cobalt to be explicitly included in the company's minerals procurement policy.

In 2019, the company produced a standalone cobalt-procurement policy which references OECD guidance and applies to all the company's own operations and its direct and indirect suppliers at any point of the supply chain.



[9] 'Annual Report 2019', published by Techtronic Industries in March 2020.

The company has committed to establishing a due-diligence framework to identify the circumstances of the processes through which cobalt is extracted and processed, and to identify, prioritise and respond to risks throughout the value chain. It also joined the Responsible Minerals Initiative, providing it with further resources and a network to improve its responsible sourcing programme.

Next steps

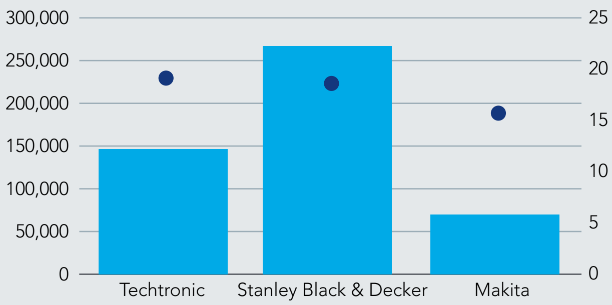
We continue our engagement with the firm and are now focusing on implementing the policy, with a special focus on cobalt traceability and the positive outcomes of monitoring and remediation of working conditions.

Emissions reductions targets

In October 2019, we provided feedback on Techtronic's sustainability reporting efforts and pushed it to expand the scope of its reporting and alignment with the recommendations of the Taskforce for Climate-related Financial Disclosures. We specifically asked for more detailed disclosures on identified climate-change risks to the business and for it to set quantitative targets with a set timeframe for emissions reductions in line with the Paris Agreement.

While the company has been at the forefront of pioneering the shift to cordless power tools – and by doing so has reduced aggregate emissions generated from product use – at the end of the 2019 financial year, it had a higher operational emissions intensity than its two principal peers, Stanley Black & Decker and Makita. Notably, Stanley Black & Decker (which is larger) aims to be at least carbon neutral in its operations by 2030 and has adopted Science-Based Targets.

Figure 9. Techtronic's 2019 emissions

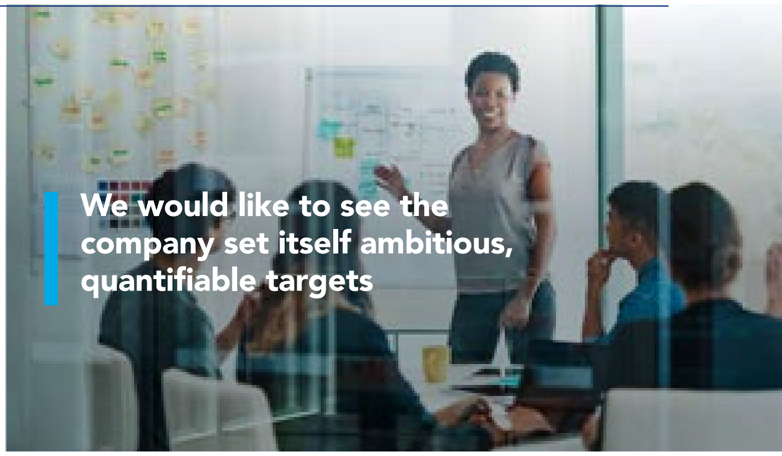


Total greenhouse gas emissions, tonnes of CO_2 equivalent (LHS)

Greenhouse gas intensity (total scope one and two emissions per $ of revenue) (RHS)

Source: Techtronic, Federated Hermes, as at June 2020.

In its 2019 sustainability report, Techtronic expanded the scope of its disclosures and included an overview of its strategic approach to sustainability. It is encouraging to see the company include among its key goals the aim to reduce



We would like to see the company set itself ambitious, quantifiable targets

energy consumption and greenhouse-gas emissions, alongside using more renewable energy and developing a climate-resilient strategy.

Nonetheless, we would like to see the company set itself ambitious, quantifiable targets, capturing the scope for further operational efficiencies, greater use of renewables and, if necessary, carbon offsetting to help move towards carbon neutrality.

Next steps

Our engagements are focused on the company setting quantitative, absolute emissions-reduction targets, as well as for it to further improve its disclosure of governance and risk management.

Increased workforce diversity

At the company's 2020 annual-general meeting, we communicated our concerns about the lack of board diversity. Nonetheless, we recommended a vote in favour of the board chair, as we recognised the need for a stable environment during the pandemic. We urged the company to set targets and timescales for diversity and pointed out that if there is no progress next year, we will likely vote against the board or nomination committee chairs.

Next steps

We also intend to encourage the company to set targets for gender and racial diversity and to review its policies and promotion of certain benefits. We applaud the firm for its granular disclosure around the take-up of parental leave. But although 44% of females across the whole group returned to work, the figure was less than 2% in North America. Moreover, few men take the option of parental leave, suggesting there is scope for meaningful improvement.

By tracking metrics like gender and racial diversity, the uptake of parental leave benefits, gender pay gaps and return-to-work rates, a more detailed picture can be achieved.

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