Shareholder Activism

"Shareholder Activism on Sustainability Issues," by Jyothika Grewal, George Serafeim, and Aaron S. Yoon examines the performance consequences of how firms respond to shareholder proposals as described in the following abstract:

Shareholder activism on sustainability issues has become increasingly prevalent over the years, with the number of proposals filed doubling from 1999 to 2013. We use recent innovations in accounting standard setting to classify 2,665 shareholder proposals that address environmental, social and governance (ESG) issues as financially material or immaterial, and we analyze how proposals on material versus immaterial issues affect firms' subsequent ESG performance and market valuation. We find that 58 percent of the shareholder proposals in our sample are filed on immaterial issues. We document that filing shareholder proposals is effective at improving the performance of the company on the focal ESG issue, even though such proposals nearly never received majority support. Improvements occur across both material and immaterial issues. Proposals on immaterial issues are associated with subsequent declines in firm valuation while proposals on material issues are associated with subsequent increases in firm value. We show that companies increase performance on immaterial issues because of agency problems, low awareness of the materiality of ESG issues, and attempts to divert attention from poor performance on material issues.

Fundamental Investors

"When Fundamental Investors Relieve Market Pressures on Management: Evidence from France," by Alexander Garel and Jean-Florent Rerolle describes the benefits to companies and the market of fundamental investors, those which hold shares on average for at least two years, as described in the following abstract:

In this paper, using an original database of investors operating on the French stock market, we investigate the real effect of ownership structure. We call a fundamental investor an investor who, on average, holds on average his shares for at least two years, is in the top quartile of a firm ownership, and has an active allocation strategy. We show that firms with greater fundamental investor ownership experience lower market reactions to earnings surprises and lower mispricing. Moreover, we show that a long/short portfolio

on fundamental ownership generates significant positive shareholder value over time. Our findings are consistent with greater fundamental ownership generating shareholder value by allowing management to focus on the long-term drivers of firm intrinsic value rather than on market sentiment. We finally look at the determinants of the presence of fundamental investors.

Climate Custodians

"The Climate Custodians" by Tim Youmans and me elaborates on the proposition we made earlier this year in the *Sloan Management Review* that the big global custody banks can be climate custodians. As stated in the abstract:

Can custody banks become key players in climate change? Custody banks joining the battle against climate change will signal a significant shift in governance ideology for this highly regulated industry so critical to the global financial system. While global custody banks provide the unseen but essential support system that ensures the proper functioning of the capital markets, they have great untapped potential to become change-makers in climate change. This paper expands on our idea of the "Climate Custodians" first presented in the MIT Sloan Management Review within the governance context of the "Statement of Significant Audiences and Materiality (The Statement)" for these subsidiaries of large bank holding companies. By focusing on the Big Three global custody banks — State Street, BNY Mellon, and JPMorgan Chase — we make the case for large custody banks assuming the role of climate custodians. In this role, these banks would report, among other things, a measure of carbon embedded within their institutional clients' assets under custody to help clients understand the climate risk in their portfolios.

Sustaining Sustainability

"Sustaining sustainability: What institutional investors should do next on ESG," by Jonathan Bailey, Bryce Klempner, and Josh Zoller discusses six ways in which institutional investors can ensure that ESG considerations are properly integrated into their investment decisions:

1. Require uniform corporate ESG-reporting standards based on the principle of materiality.
2. Build a shared ESG-rating system for external managers.
3. Work together to engage with corporations.
4. Stress-test portfolios for ESG risk factors.
5. Use a long-term ESG outlook to unlock new investment opportunities.
6. Confront the skepticism and misunderstanding that surround ESG head-on.

Global 500 GHG Emissions

"Global 500 Greenhouse Gases Performance 2010-2015: 2016 Report," by John Moorhead and Tim Nixon "shows for the first time that the Global 500 are beginning to grow their businesses and manage their emissions at a rate that follows the global scientific consensus on the risks of climate change. This is a change from previously tracked data and a sign of progress."

According to the press release for this report "These businesses currently represent roughly 28% of the world's GDP and collectively emitted 10% of the world's greenhouse-gas emissions over the last five years. Key findings in this report indicate a decoupling between economic performance and emissions output. Revenues for the Global 500 grew roughly 5% over a four-year period, while emissions increased by 1% which is a step forward to sustainable business growth.

Materiality

Following the May GRI conference in Amsterdam, Cornis van der Lugt wrote two pieces on materiality. The first, "Big Data and Materiality: Lost in Translation?" addresses the tensions that emerge as technical experts begin to play a role in a field traditionally shaped by stakeholders and the impact of big data on the concept of materiality. The second, "Materiality: Talking heads, talking numbers, and talking finance…" addresses three questions:

1. The **frequency or timeliness** of the materiality determination processes;
2. The **level** at which the process is conducted - for example from local community engagement to global "expert" stakeholder panels; and

3. The extent to which reporters build in a **forward-looking dimension** and ask stakeholders about "actual" versus "potential" significance.

Globalization and Self-Destruction

In his latest piece on *Huffington Post*, "Globalization: Four Ways To Avoid Self Destruction," Georg Kell reflects on the fact "that globalization is fragile and vulnerable to backlash from all the "isms" of our post-cold-war world: protectionism, populism, nationalism, ethnic chauvinism and terrorism." He explores four ways to secure a better future.

1. Firstly, we need to acknowledge that economic inequality and the resentment around it lies at the heart of current tensions between markets and societies in Western democracies. Investment in education for all is crucial.
2. Secondly, institutions created after WWII need to adapt better to our fast changing world.
3. Thirdly, business executives and investors have now a unique opportunity to earn a license to lead.
4. Lastly, we must all take personal responsibility in this new era of digital empowerment.

Georg concludes:

And so the race is on. In this uncertain world with its changing climate, rising inequality and increasingly polarized politics, the future now depends on our willingness to re-invent public policies for the people, on the desire to make international co-operation work, and on the ability of markets to be part of the solution rather than part of the problem. People have the power to make it all happen. We are the people.

Globalization and Technology

Along the same theme of the benefits and costs of globalization is a piece titled "Saving Globalization and Technology From Themselves: Imperatives for Corporate Leaders," by Rich Lesser, Martin Reeves, and Johan Harnoss. Reflecting on Brexit and the current political turmoil in the U.S. and other countries, they offer "a personal perspective on the root causes and implications of the current turmoil and what corporate leaders can do to shape conditions for continued prosperity." They identify seven opportunities for

corporate leaders to improve the economic landscape through lessening inequality and creating a fairer distribution of the wealth that is created by the corporate sector:

1. Shape the next wave of **globalization**.
2. Support entrepreneurial business **ecosystems**.
3. Leverage **technology** from front to back.
4. Invest in **human capital**.
5. Apply a **social business** mindset.
6. Rebalance and align **rewards**.
7. Renew and own the **narrative**.

Investor Leadership

In "Investor Leadership: The Unfinished Story of ExxonMobil and Chevron" published by *Institutional Investor,* I address the issue that whereas shareholder proposals on climate change disclosure received nearly 100% of the shareholder vote in the cases of BP and Royal Dutch Shell, they only received about 40% in the cases of ExxonMobil and Chevron. I note that:

Of particular interest are BlackRock, Vanguard, and State Street. They are the first, second, and third largest asset managers in the world with assets under management of $4.81 trillion, $3.38 trillion, and $2.26 trillion, respectively. These three firms represent nearly 16% of the AUM of the largest 400 asset managers in the world which, in turn, account for around 85% of total AUM. By virtue of their collective AUM and brand names, they are in a strong position to take a leadership position on climate change proposals and to be advocates for the Forceful Stewardship initiative of the non-profit organization Preventable Surprises.

Private Equity

In my latest post for Forbes, "Why Private Equity Can Take A Lead On ESG," I argue that the private equity industry is well-placed to lead on ESG integration. I also argue that it will reap substantial benefits from doing so. The average holding period of portfolio companies is now 5.5 years, compared to 8.3 months for public equities. This means that the general partners of PE firms have a real incentive to both minimize the risks and maximize the opportunities that can come from ESG integration.

I suggest that the work of the Sustainability Accounting Standards Board can be usefully applied in a PE context. "Because the sustainability topics identified by SASB are based on the resource intensity and sustainability risks and opportunities inherent in a particular industry, they're applicable to all companies of all sizes and regardless of their sources of funding."

News on Arabesque

As reported in Funds Europe, "Deutsche Bank has partnered with the 'world's first' quant asset management firm that specialises in environmental, social and governance (ESG) investing.
The bank is to employ Arabesque Partners indices to launch a range of new ESG stock-selection investment products."

In a press release, Deutsche Bank stated:

Deutsche Bank and Arabesque Partners today announced the launch of a new family of investment products that apply a proven quantitative stock selection mechanism to environmental, social and governance (ESG) investing.

The products will track the returns of the Arabesque Prime and Systematic indices which are designed and operated by Arabesque.

These indices mimic in a systematic transparent manner the trading strategies employed by Arabesque for their ESG-funds.