

## The case for engagement

The RBC Global Equity team

When challenged about environmental, social and corporate governance (ESG) aspects of investment choices, investors typically cite the need to engage with companies to effect improvements over time, ostensibly because changes in ESG-related issues cannot happen overnight due to companies' needs to respond both to their business environments and stakeholder expectations.

Critics of a more gradual, collaborative approach argue that it is impossible to 'engage' our way out of global challenges like climate change and that time spent manoeuvring for influence is essentially wasted. They favour taking a harder line in pushing for change, backed by the threat of divestment. Support for this approach can be vocal, particularly from those frustrated by the perceived lack of meaningful action in tackling increasingly tangible global problems.

To understand the case for engagement, it is important to recognise that it is not a tool for crisis management or deploying 'quick fixes'. Complex, systemic problems rarely have simple solutions, but demand deeper understanding and informed interventions. While engagement should always start with constructive discussion, the process may need to be reinforced through firmer measures, such as through voting, public statements or supporting or filing shareholder proposals. While divestment is sometimes necessary, it could be seen as a de facto admission that no improvement is possible. Worse, on selling out, the new investor buying the shares may have lighter ESG standards, making the gesture counter-productive.

On the other hand, engagement is a highly effective tool when faced with uncertainty. One of the complexities faced by companies and investors relates to the quality of the information available to manage non-financial risks. Not only does engagement open a line of communication to encourage fuller disclosure, it helps the investor understand the story behind the reported numbers.

It is noteworthy that the leading providers of external ESG related analysis regularly differ in their ratings. This may be a reflection of the qualitative aspects and uncertainties inherent in ESG issues. At the reporting level, while frameworks such as the Carbon Disclosure Project have improved the consistency of carbon measurement, there is still no unified approach to overall sustainability reporting. Investors, accustomed to globally applicable financial accounting guidelines, should be wary of looking for a quantitative short cut when interpreting ESG-related data as even the most transparent corporate disclosure requires interpretation and context.

For active investors, variation in information sources can create opportunities to identify alpha, each offering a piece of the overall picture and indicating where information gaps may lie. Bottom-up investment strategies invite investors to engage closely with companies to understand the overall business plan, querying those information gaps and any assumptions used in reporting performance. Over-borrowing from nonfinancial stakeholders like employees or the environment, creates contingent liabilities which will inevitably come to light. These can be more easily identified and addressed in advance through dialogue with the company.

With an active ownership mind-set, investors challenge gaps in information, poor forward planning, or weak risk management practices, all with a view to long-term improvement. This integrated approach to incorporating ESG factors can lead to more successful engagement, helping investors and companies to work together to deliver both financial returns and positive change for society.

---

This document is provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC GAM or its affiliated entities listed herein. This document does not constitute an offer or a solicitation to buy or to sell any security, product or service in any jurisdiction. This document is not available for distribution to people in jurisdictions where such distribution would be prohibited.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Global Asset Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

In Canada, this document is provided by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong.

This document has not been reviewed by, and is not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the above-listed entities in their respective jurisdictions. Additional information about RBC GAM may be found at [www.rbcgam.com](http://www.rbcgam.com).

This document is not intended to provide legal, accounting, tax, investment, financial or other advice and such information should not be relied upon for providing such advice. RBC GAM takes reasonable steps to provide up-to-date, accurate and reliable information, and believes the information to be so when printed. RBC GAM reserves the right at any time and without notice to change, amend or cease publication of the information.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

Past performance is not indicative of future results. With all investments there is a risk of loss of all or a portion of the amount invested. Where return estimates are shown, these are provided for illustrative purposes only and should not be construed as a prediction of returns; actual returns may be higher or lower than those shown and may vary substantially, especially over shorter time periods. It is not possible to invest directly in an index.

Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.

® / TM Trademark(s) of Royal Bank of Canada. Used under licence.

© RBC Global Asset Management Inc., 2020

Publication date: (November, 2016)

GUK/20/034/JAN22/A

