Engagement
Stewardship and Governance Code
Practical experience at Robeco

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For professional investors
In Asian equity markets

- Valuation is at a 15% discount to global averages
- Korea is the most serious case

Why
- Due to weak corporate governance in general and weak shareholder returns in particular

My mission
- Better governance leads to more focus on shareholder returns which lifts equity valuations and means better pensions for Asians

Source: MSCI, IBES, Morgan Stanley, Oct 31, 2017
Asset owners: The stewardship problem

Why is it difficult to become an active, long-term owner?

1. In-appropriate performance metrics → short-termism by asset managers

2. Excessive emphasis of quantitative data → at expense of qualitative factors

3. Excessive diversification → makes monitoring difficult

4. Long ownership chain → weakens an “owner” mindset


“We need to end short-termism… at least until next week”
Long ownership chain → weakens an “owner” mindset

Practical experience: Exercise shareholder rights

Stewardship issues

→ The rise of the passive manager
  → Low fees cannot include serious engagement, just (automated) voting

→ Engagement is “capital intensive”
  → Remuneration to active managers for stewardship services are limited.
  → Why ask for engagement if you don’t believe in the added value?

→ Integrated engagement
  → Better results when PM is involved. Like an activist: “This really matters to us”

→ Governance is closest to the heart of a fundamental investor.
  → Environmental and social engagement are more distant
  → Some companies hard to engage on G but can have useful E and S debate

→ I have a benchmark to beat and clients to please. I cannot promise to stick around
  → Passive investors actually can!
Practical experience: Challenging the corporates

Corporate Governance Code issues

→ Cultural (in)sensitivity: Capitalism with Confucian Characteristics
  It is MY company not YOURS
  Can investors really make a contribution from afar?
→ The CG code as a box ticking compliance exercise
  “Why does your PM join a meeting that is only about Governance?”
  Lame uninformed Independent Directors
  Weak uninformed Audit Committees
→ INEDs don’t get paid and liability/reputational risk is high and rising.
  Are we asking too much?
→ Lead Independent Director: the go-between investors and the Board
  Anybody want to try?
Engagement – some challenges for investors

1. Lack of proper incentives
   - Perceived regulatory barriers
   - Fragmented share ownership
   - Active investors are assessed on investment return (measureable!)
   - Conflicts of interest (lack of independence, compromised corporate access)

2. “Free-rider” effect
   - Active owners/engagers have to do all the work; extra costs
   - Engagement success & benefits enjoyed by ALL investors

Sources:
Improving Corporate Governance & Shareholder Engagement, Association of British Insurers, 2012
Robeco research, 2015
Engagement – overcoming challenges

1. Engagement is often uncomfortable
   - Desire to maintain good corporate relationships
   - “Activist” approaches vs. “Active Ownership”
   - Language & cultural factors (Confucian vs. Anglo-Saxon)

2. Corporate Japan
   - Dis-trustful of (foreign) institutional investors intentions
   - Skeptical of their knowledge and competence

3. Some solutions
   - Deep research, non-financial
   - Constructive; use “Active Ownership”, NOT “Activism”
   - Collaborate

What matters in engagement

Being there
- Vote your shares and explain why if you vote “No”
- Engage with portfolio companies regularly about ESG topics

Patience and persistence
- Do you rent or do you buy?
- Shareholders need to be seen as reliable partners: low portfolio turnover helps
- Lately there is much more fertile soil in Japan
- In Korea governance has become top of mind after forceful criticism

Bottom up but also top-down
- Make regulators aware of your concerns

Active but not activist
- To get media involved is counterproductive
Active Ownership with a “long-term horizon”

**FROM**

**Information requested:**
Mostly financial and short-term
(e.g. Quarterly earnings updates)

**Frequency and nature of interaction:**
From short and frequent
(e.g., quarterly analyst calls)

**Level of interaction:**
From mostly investor relations

**TO THIS:**

**Information requested:**
Longer-term and more strategic
(e.g. market share goals, 5Y capex plans)

**Frequency and nature of interaction:**
Longer and more in-depth
(for example, annual half-day management meetings)

**Level of interaction:**
Broader set of stakeholders (e.g. management, board members, clients)

Source: FCLT, Straight talk for the long term, March 2015
Investors’ views on stewardship and activism

Global survey of institutional investors:

- 76% had a favourable view of shareholder activism.
- 84% thought that it added value to targeted companies.

Institutions believed the benefits result in three outcomes:

i. providing a catalyst for change.
ii. aligning the interests of board and management with those of shareholders.
iii. forcing companies and boards to sharpen their strategic focus.

Response from investment managers

Mainstream investment managers (inc. Robeco)

- Managers not incentivised to influence corporate behaviour
- Easy to sell under-performing stocks (except passive funds)
- Conflicts of interests (e.g. compromised corporate access, business development)
- Engagement activity – mostly confined to voting, not influencing financial & strategic issues
- Governance teams do not make investment decisions.

Activism is dominated by US (hedge) funds (AuM 244bn)

- Massive gap in market as mainstream managers do little
- Incentives for success

Good models of active managers using constructive engagement

- Ownership Capital (Global equities, based in Amsterdam)
- Taiyo Pacific (Japan equities, based in Maryland)

Global Disclaimer

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