ESG & ACTIVISM

Has the heightened focus on ESG affected the way activists pursue value creation?

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Three letters seem to be on everyone's mind these days: E, S and G. Across the capital markets, from institutional and retail investors to corporate leaders and hedge fund managers, there is a growing interest in the impact of environmental, social and governance practices on a company's value. At the start of 2018, sustainable assets totaled $30.7 trillion globally, a 34 percent increase from just two years prior.

At the same time, there is a lot of uncertainty about the particulars of how ESG concerns will be borne out over subsequent proxy seasons. Lately, many of our clients have approached us about the potential implications of this trend. 'Could our ESG profile be a reason for an activist to try to move into our stock?' they wonder.

ESG-related campaigns increasing

Indeed, the data shows a steady uptick in ESG-related campaigns over the past five years – and much of it comes down to the G. As Wharton researcher Karl Valentini points out, 'the most common ESG considerations in activist campaigns relate to governance.'

And that makes sense: it's easy to draw a straight line between how a company is governed and how that, in turn, impacts the value it can generate. For this reason, executives at public companies are typically familiar with the prospect of governance pressures from activists. But with so much attention on ESG as a three-pronged premise, their eyes are opening to environmental and social pressures as well.

This development comes as multiple players are updating their positions on environmental and social issues. Major passive institutional investors like BlackRock and Vanguard have taken a greater interest in these issues, subscribing to ratings providers, and changing their positions to support certain E&S-related shareholder proposals in recent years.

An ESG identity

Activists understand that they need the support of these institutional investors for their campaigns, in terms of both credibility and voting power. For this reason, activists may be more inclined to use E&S tactics in campaigns going forward.

Beyond just tactics, some activists are integrating ESG into their identity. Jana Partners launched a dedicated impact fund, Trian updated its website to include a section on its ESG focus and offers literature on the

ESG activities of its portfolio companies, and Blue Harbour has published an ESG policy informed by the UN's Principles for Responsible Investment, which represented a major milestone in the evolution of ESG when they were introduced in 2005.

A couple of high-profile examples of activists turning this positioning into action come to mind. Green Century Capital Management, an environmentally and socially conscious mutual fund provider, has taken aim at Darden Restaurants, a restaurant group with holdings that include popular chains such as Olive Garden and LongHorn Steakhouse.

Green Century's campaign involved filing a notice of exempt solicitation urging support for its proposal, which called for Darden to evaluate and disclose to shareholders 'the feasibility of adopting a policy to eliminate the use of medically important antibiotics for disease prevention in its supply chain.'

Ultimately, this proposal failed to pass – as have others like it. But while support for such campaigns has historically been low, it is on the rise. Green Century made this proposal at three successive Darden annual meetings. In 2016 it received 8.6 percent support. By 2018, that figure had risen to 37.5 percent.

Social impact

In the social arena, activists are making headway by exerting direct influence over corporate leaders. Jana Partners teamed up with CalSTRS, the California teachers' pension fund, to push Apple to take direct action to battle smartphone overuse among children. The campaign, launched in January 2018, garnered plenty of headlines – and, ultimately, tangible results.

In September 2018 Apple announced new phone models and an updated operating system designed to help users manage the time they spend on their devices, with features like usage activity reports and 'downtime' settings. What started as activism quickly translated into socially beneficial offerings from a company with profound reach: the CNBC All-America Economic Survey 2017 found that two thirds of Americans own at least one Apple product.

Since 2017, environmental and social proposals have accounted for more than half of all shareholder proposal submissions per proxy season. And as previously noted, support levels for such proposals are steadily growing as time goes on.

Future activism

What all this suggests is that while ESG may not be the touchstone of hedge fund activism right now, it is certainly taking up more space in the activist playbook. As demographics change and environmentally and socially conscious millennials make up more of the investing public, it is likely activists will bring about more campaigns to address their definition of value.

From a company standpoint, it makes sense to evaluate one's own ESG profile to look for areas that might offer vulnerabilities to activism – but not only for that reason. In a review of 56 academic studies, Deutsche Bank found that 89 percent of them showed that 'companies ranked highly for ESG outperform the market in both the medium term (three to five years) and long term (five to 10 years).'

As such, it may be unsurprising to many that the market's collective increased focus on ESG is continuing to evolve the way in which passive and active investors are managing their portfolios.