Investment perspectives

Engagement case study

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Engagement is a critical step in the fiduciary value chain for asset owners which can drive real world change. Effective engagement demands accountability from asset managers and in turn company management. In this article we consider a case study of engagement activity by equity managers on the issue of child labour in the cocoa industry.

Stewardship is a tool that asset owners and asset managers have at their disposal to drive better outcomes. The Principles for Responsible Investment (PRI) identify that relationship-building between companies and investors can have many benefits, with engagement playing a key role in protecting long-term investment value for shareholders. They note that engagement should involve purposeful consideration, monitoring and intervention regarding ESG factors affecting investee companies. Asset owners' engagement with their managers is equally as valuable, its importance being emphasised through the new UK Stewardship Code and recent government-sponsored reports.

Case study

In Q1 2021, seven chocolate manufacturers were named as defendants in a lawsuit filed by eight children (now young adults) who alleged they were used as slave labour on cocoa farms in the Ivory Coast. This case represented the latest in a long history of allegations pertaining to child labour in the cocoa supply chain. This industry, like many others with raw material inputs, is heavily reliant on developing nations. Cocoa is sourced through a complex network of thousands of farms that are often operated by communities or individual families. With many steps in the supply chain, producers can often appear somewhat distant from the consumer although the importance of supply chains and the actions of their customers has been brought into greater focus over recent years.

Working practices is one of our own engagement themes for 2021, with child labour being one of many aspects that could be explored. In focusing in this particular topic ("the Issue"), we were keen to understand the extent to which global equity managers had engaged with companies on this subject, the actions they had taken and the outcomes that had been achieved. We spoke with nine global equity managers (seven active and two passive managers) primarily focusing our enquiries on one organisation ("the Company") and the extent to which there had been engagement with the Company on child labour issues. Through the exchanges, we broadened our enquiry into engagement on how child labour issues were being addressed more broadly, exploring concerns in other industries.

Our assessment

It would be inappropriate to judge a manager's stewardship capability through an assessment of their engagement on a single subject, rather assessing their efforts and the outcomes achieved across multiple topics. In particular, many managers will frame their own engagement priorities based on prevailing portfolio holdings and how they can use their resources to have a meaningful outcome. That said, we made some general observations on the managers' activities from the responses received.

- **The lawsuit was not a catalyst for engagement**. None of the managers had engaged recently on this specific lawsuit. Although perhaps disappointing, given the lawsuit relates to historic activities, any engagement would be better focused on understanding and changing current practices. Two managers had historically engaged with the Company on child labour issues, with one active manager having had direct and recent contact with the senior management team, reflective of their high ownership position.

- **Size and resource matter**: Larger active managers by level of assets generally provided stronger responses on the Issue, supported by genuine proprietary research that had informed thinking. We should be in no doubt that engagement and the research needed to support an informed dialogue demands resource. Managers providing poorer responses that were heavily reliant on third-party data and/or showed little evidence of engagement were generally smaller which may reflect the lower level of resource and smaller ownership positions.

- **Active managers demonstrated consideration of the issue within fundamental research**: Child labour clearly presents a financial risk for any investor, not least through reputational considerations. It was encouraging that portfolio management teams within managers who we rate positively for their ESG integration demonstrated consideration of the subject, and how it had been factored into decision making. Whilst perhaps not leading to active engagement on the subject, we suspect it likely to feature in ongoing dialogue between managers and the company, and valuations.

- **Passive managers did not demonstrate stronger responses**: In general, passive manager responses were weaker and did not comment on the Company but rather referenced the broader issue of sustainability in supply chains with limited evidence of engagement. This was disappointing given the higher level of resources and particularly the higher ownership stake (Chart 1 below).

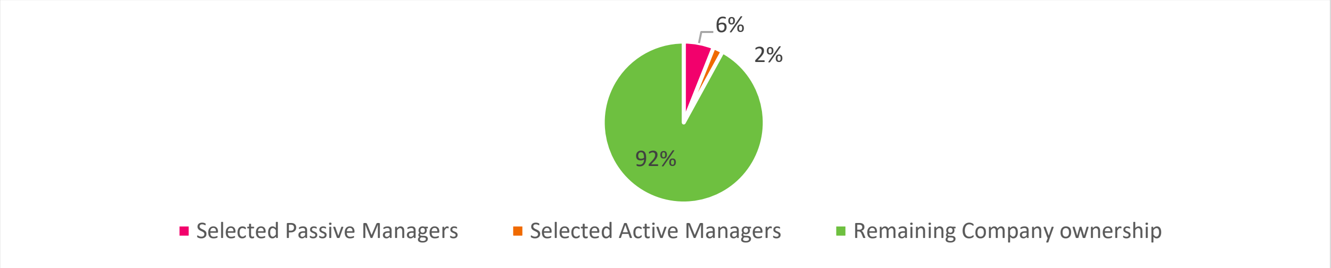
- **Disclosure is a critical tool that can support engagement**: Several managers pointed to the work being undertaken by NGOs such as the Fair Labour Association, the World Benchmarking Alliance's Corporate Human Rights Benchmark and ShareAction's Workforce Disclosure Initiative in this space which have improved transparency. Following the old mantra of "what gets measured gets managed", access to better data can ultimately lead to improvements in practices. A simple engagement goal may therefore be to demand clear reporting and disclosure of data on practices, demanding accountability where such data is not disclosed.

Our goal in this exercise was not to judge the efforts of the Company in tackling Child Labour issues, but to inform our own understanding of the extent to which asset managers had sought to engage. While this is a small sample of managers, we observed a wide variation in the extent and effectiveness of the engagement undertaken. It was clear from many responses that previous pressures had meant that the Company had made significant advances over recent years to address the issue by supporting policy, providing funding and putting in targeted programmes , collecting and reporting data and providing investors with transparency. Whilst action cannot necessarily be attributed to any single party, we believe it is vital for asset owners to raise issues with managers on potential issues of concern.

Can we have an influence?

One question often posed on stewardship is "how loud is my voice?", the assertion being that a single asset owner asking a question will be dwarfed by all those who haven't spoken. The same may be true of asset managers although as Chart 1 illustrates, the collective ownership of the Company by the managers in our case study is significant. Acting individually managers can raise important issues, but acting collectively, it is possible to exert considerable influence on companies. The importance of collaboration should not be underestimated.

Chart 1: Estimated level of ownership in the Company by the case study managers



Source: Bloomberg, data as at 30 June 2021

In summary, while much recent press attention has focussed on divestment we believe engagement can protect long-term investment value and drive better outcomes. We will continue to question managers on issues of interest. As environmental and social issues continue to gain importance with investors, this enhances the role of governance and stewardship, requiring asset owners and advisors to hold managers to account by engaging, asking questions, and demanding accountability.

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