

GOVERNANCE

engaging with company boards

Insight Investment has been concerned for some time that the governance of corporate responsibility at board director level is falling short of what is required. So it's taken the unusual step, with two influential partners, of setting up a project that has led to recommendations on the topic

For some time now, Insight Investment has been a leading exponent of the 'engagement' approach to socially responsible investment which holds that rather than boycotting controversial companies, as ethical investors have traditionally done, it is more effective to work with companies to encourage better corporate behaviour.

During the last three years Insight has conducted engagement programmes on issues as diverse as biodiversity in the mining industry, responsible supply chain management, sustainable housebuilding, offshoring, human rights, and climate change, as well as complex governance issues such as executive remuneration and succession planning.

Its basic approach is to try to understand how the best companies are dealing with corporate responsibility challenges; then conduct a gap analysis across their business sector, identifying laggards, encouraging them to catch up with the leaders, and so prompting the leaders to do even better.

This has brought a number of successes, not least in the UK housebuilding sector, where Insight believes its direct engagement with companies on sustainability issues – in conjunction with the international environmental network WWF – has led to a dramatic improvement in performance in recent years. Overall, Insight has found that companies welcome constructive approaches from their shareholders on corporate responsibility, particularly when they include detailed practical guidance of the kind that it provides.

However, while this approach works with some corporate responsibility issues, many of the most serious challenges have proved to be less tractable. Some social and environmental topics raise big strategic questions for companies and cannot therefore easily be addressed through incremental initiatives of the kind Insight has championed in the past.

Similarly, some problems arise from flawed incentives frameworks that are not in the power of corporate responsibility managers to address. For such issues, companies' boards alone can provide a solution.

Many companies are good at the 'housekeeping' aspects of corporate responsibility, but lack of effective board action means that they fail to address fully the strategic aspects of corporate responsibility, or do not make the necessary

the company

Insight Investment is the asset manager of HBOS Group. With more than £79 billion (\$139bn) of assets in equities, property and fixed income, it is one of the largest investment managers in the UK, holding about one per cent of the issued share capital of FTSE-listed companies. It:

- engaged with 200 companies in 2004 on CSR issues, with at least 30 of the meetings leading to 'substantial policy and management improvements'
- has an eight-person corporate engagement team whose members each have on average 13 years' experience of governance and corporate responsibility issues
- was one of the first institutional investors to start publicly reporting its voting recommendations and engagement activity
- has developed best-practice principles for companies transferring jobs overseas. These have been sent to 43 UK firms in the banking,

■ on some corporate responsibility issues, such as executive remuneration, Insight believes only action at board level can provide long term solutions



CORBIS

changes to incentives. Insight has therefore decided to change its engagement approach to allow it to tackle corporate responsibility challenges at this level.

As a result, the asset manager set up the ground-breaking Boards and Corporate Responsibility project in April 2005. Run in conjunction with the equity index provider FTSE Group and the industry network Business in the Community, the project has broadly taken the form of a public inquiry. A combination of desk-based research, interviews with companies and roundtable discussions with board directors has led to recommendations on how companies might strengthen the role of their boards in fulfilling the social and environmental responsibilities of the business.

The first step was to review the literature on governance and corporate responsibility, as well as on wider economics and public policy, while the project team – consisting of staff provided by Insight, FTSE and Bitc, with support from the UK consultancy Acona – has held meetings with more than a dozen companies, among them Insight’s parent company HBOS, and also Boots, BP, GlaxoSmithKline, GUS, National Grid Transco and Vodafone.

Company chairmen, executive and non-executive directors, company secretaries and senior figures in accounting and corporate responsibility attended three roundtable discussions chaired by Lord Stevenson of Coddenham, non-executive chairman of HBOS, Sir Derek Higgs, deputy chairman of British Land, and Mark Makepeace, chief executive of FTSE Group. These proved to be a fertile source of views and information and a useful testing ground for hypotheses and ideas arising from the project’s initial research.

The views of corporate responsibility and governance specialists from other organizations were also sought, with the emphasis on best practice and not just areas where boards are failing. All those taking part have been asked a series of questions about what boards must do to ensure that companies address corporate responsibility effectively, and Insight believes the findings will represent a consensus on what constitutes board best practice in UK public companies.

Insight, along with other investors, has been quite successful at engaging boards on topics other than corporate responsibility over the last decade or more. Investor engagement has played an important part in strengthening governance in UK companies, and investors have been able to do

effective board action on corporate responsibility helps long-term investors by reducing risk

this in part because of the development of the Combined Code on Corporate Governance. However, the Combined Code, until recently, said nothing about corporate responsibility. Insight believes its project will help to develop a common agenda on corporate responsibility, which will enable investors to be more fully effective at engagement on corporate responsibility at board level.

A report of the project’s initial findings and recommendations will be published later this year. Insight plans to use the findings as the basis for a new programme of engagement with companies at board level. It hopes that the report’s recommendations will contribute to the development of a common agenda between boards and their institutional investors on the governance of corporate responsibility.

The report’s other sponsors also plan to put the report to use. Business in the Community will explore how to include the recommendations in its Corporate Responsibility Index during 2006, and the findings of the report will contribute to informing the development of FTSE Group’s FTSE4Good indices. The sponsors also hope the report will contribute to the development of standards and guidance in this area.

‘There’s a lot riding on effective board action on corporate responsibility’ says Craig Mackenzie, head of investor responsibility at Insight. ‘Not only is it important to long-term shareholder value creation, but it also determines the extent to which companies deserve public trust, and, in turn, the extent to which the public should leave companies free to regulate their own behaviour. We’ve already begun to engage companies in discussions on the project’s recommendations, particularly on reporting and short-term incentives. The important

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comment INSIGHT INVESTMENT

The values and commitments underpinning corporate responsibility need to be an integral part of overall business strategy, if they are to bring maximum benefit. Insight Investment’s project to identify good practice and governance will help companies progress this. It will also enable boards to understand their role in the formal stewardship of corporate responsibility.

points to note from this project are:

- the research has been informed by the experience of executive and non-executive board members
- stewardship of corporate responsibility needs to be a focus of boards as a whole – not just individual members
- there are practical ways of ensuring the delivery of non-financial objectives – for example, incentivization through the remuneration of senior executives and raising the profile of corporate responsibility in shareholder communications

NICOLE DANDO, INSTITUTE OF BUSINESS ETHICS