DEGREE PROJECT IN INDUSTRIAL ENGINEERING AND MANAGEMENT,
SECOND CYCLE, 30 CREDITS
*STOCKHOLM, SWEDEN 2020*

# Bang for the Buck

## Achieving effective shareholder engagement through dialogues

**YLVALI BUSCH**

**KTH ROYAL INSTITUTE OF TECHNOLOGY**
**SCHOOL OF INDUSTRIAL ENGINEERING AND MANAGEMENT**

# Bang for the Buck

## Achieving effective shareholder engagement through dialogues

by

Ylvali Busch

Master of Science Thesis **TRITA-ITM-EX 2020:349**

KTH Industrial Engineering and Management
Industrial Management
SE-100 44  STOCKHOLM

# Aktieägarens inflytande

## Hur blir påverkansdialoger effektiva?

av

Ylvali Busch

Examensarbete **TRITA-ITM-EX 2020:349**

KTH Industriell teknik och management

Industriell ekonomi och organisation

SE-100 44  STOCKHOLM

KTH Industrial Engineering and Management

**Master of Science Thesis TRITA-ITM-EX 2020:349**

# Bang for the Buck

## Achieving efficient shareholder engagement through dialogues

Ylvali Busch

| Approved | Examiner | Supervisor |
|---|---|---|
| 2020-06-01 | Anna Jerbrant | Thomas Westin |
| | Commissioner | Contact person |
| | Söderberg & Partners | Johanna Påhlson |

## Abstract

The consolidation of corporate ownership into the hands of large institutional investors has resulted in growing expectations that actors in the financial system should leverage their positions of ownership to improve corporate sustainability. In other words, institutional investors are expected to take a greater responsibility for the transition towards a greener economy by becoming *active* owners. However, active ownership is not a uniform concept. Instead, the term can imply many different strategies and tools, raising questions of how investors become active owners in a way that yields maximum influence while economizing their resources.

Among all the tools investors have available, shareholder engagement through dialogues is suggested to have many advantages. However, previous research has not provided a clear-cut account of the mechanisms by which shareholder engagement through dialogues unfold successfully. Therefore, this thesis aims to contribute to the understanding of when and how engagement dialogue becomes a powerful tool for shareholders in order to improve corporate sustainability. The study is performed in the context of actively managed equity funds, with interviews from both funds and companies.

In order to understand how actively managed equity funds can effectively leverage their ownership through engagement dialogues, the focus of this study has been twofold. First, the research has focused on understanding how the internal structures within funds should be designed to support the engagement process. Second, the research has focused on pinpointing the mechanisms that make engagement dialogue between Swedish equity funds and their portfolio companies successful. This has resulted in the development of three frameworks, aiming to facilitate funds to make conscious decisions regarding how they work with shareholder dialogues.

**Keywords:** Shareholder engagement, engagement dialogues, equity funds, corporate sustainability

**KTH Industriell teknik
och management**

**Examensarbete TRITA-ITM-EX 2020:349**

# Aktieägarens inflytande:

## Hur blir påverkansdialoger effektiva?

Ylvali Busch

| | | |
|---|---|---|
| Godkänt<br>2020-06-01 | Examinator<br>Anna Jerbrant | Handledare<br>Thomas Westin |
| | Uppdragsgivare<br>Söderberg & Partners | Kontaktperson<br>Johanna Påhlson |

## Sammanfattning

Aktieägare har en nyckelroll när det kommer till att påverka bolag till att ställa om till en mer hållbar verksamhet genom att praktisera ett *aktivt* ägandeskap. Att vara en *aktiv ägare* kan dock betyda många olika saker, och investerare kan använda sig av en uppsjö av olika strategier och verktyg. Därmed väcks frågan hur investerare praktiserar ett aktivt ägandeskap så effektivt som möjligt.

Bland de verktyg som investerare har tillgängliga för att bedriva aktivt ägande så föreslås påverkansarbete genom dialog ha många fördelar. Tidigare forskning har dock inte fullgott redogjort för de mekanismer som gör att investerares påverkansarbete genom dialog blir framgångsrikt. Mot den bakgrunden så är syftet med den här uppsatsen att fördjupa förståelsen för hur påverkansdialog blir ett kraftfullt verktyg för investerare när de försöker påverka företag till att bli mer hållbara. Studien har genomförts i den svenska kontexten med fokus på aktivt förvaltade aktiefonder. Genom intervjuer på både investerar- och företagssidan har studien rörts sig i interaktionen mellan fonder och dess portföljbolag.

För att förstå hur aktivt förvaltade aktiefonder kan få inflytande genom påverkansdialoger har studien haft ett tudelat fokus. Fokus har legat på att försöka förstå dels hur interna strukturer bör utformas för att stötta påverkansdialoger på bästa sätt, och dels på vilka mekanismer och kritiska faktorer som behövs för att påverkansdialoger ska bli framgångsrika. Detta har mynnat ut i tre ramverk som alla syftar till att underlätta för fonder att göra medvetna val kring hur de arbetar genom påverkansdialoger

**Nyckelord:** Aktieägarinflytande, påverkansdialoger, hållbara företag, aktivt förvaltade aktiefonder

*"As financial actors, you see the effects of poverty, inequality, and conflict at an early stage. You see the human and economic catastrophes caused by climate change. You know what these problems cost – but even more importantly, you know how much more there is to gain from investing in a sustainable future."*

- HRH Crown Princess Victoria, speech at the conference Building back better

# Table of contents

Acknowledgements .......... 9

1 Introduction .......... 10

**1.1 Background .......... 10**

1.1.2 Actively managed equity funds .......... 11

**1.2 Problematization .......... 11**

**1.3 Purpose .......... 12**

**1.4 Research question .......... 12**

**1.5 Delimitations .......... 12**

**1.6 Contribution .......... 13**

2 Fundamental concepts .......... 14

**2.1 ESG, CSR and Greenwashing .......... 14**

**2.2 Pathways to responsible investments .......... 14**

**2.3 Actively managed equity funds .......... 15**

3 Theoretical framework .......... 16

**3.1 Forms and roles of shareholder engagement .......... 16**

3.1.1 Shareholders as norm entrepreneurs? .......... 17

3.1.2 Classification of engagement based on intensity .......... 17

**3.2 Internal structures to support engagement dialogues .......... 18**

3.2.1 Dispersed ownership .......... 19

3.2.1 Investment mandate and incentives to engage .......... 19

3.2.3 Resource limitations .......... 20

3.2.4 Internal conflicts of interest .......... 21

**3.3 Mechanisms by which engagement dialogues successfully unfolds .......... 21**

3.3.1 Shareholder characteristics .......... 21

3.3.2 Target firm characteristics .......... 25

3.3.3 Communication characteristics .......... 27

4 Methodology .......... 29

**4.1 Research design .......... 29**

**4.2 Information gathering .......... 31**

4.2.1 Literature study .......... 31

4.2.2 Interviews ........ 34
**4.3 Data analysis ........ 38**
**4.4 Research quality and ethics ........ 39**
4.4.1 Research quality ........ 39
4.4.2 Research ethics ........ 40
5 Empirical findings ........ 41
**5.1 The role and form of engagement dialogue in the Swedish context ........ 41**
5.1.1 The role of dialogue: Dialogue at the heart of ESG-engagement ........ 41
5.1.2 Different forms of dialogue ........ 42
5.1.3 Proactive vs. reactive dialogues ........ 44
**5.2 Internal structures to support engagement dialogues ........ 45**
**5.2.1 Organizational approach ........ 45**
5.2.2 Evaluating the effect of engagement dialogues ........ 52
**5.3 Mechanisms by which engagement dialogues successfully unfolds ........ 53**
5.3.1 Shareholder characteristics ........ 54
5.3.2 Target firm characteristics ........ 57
5.3.3 Communication characteristics ........ 58
5.3.4 Leveraging other engagement tools in dialogues ........ 63
6 Discussion ........ 66
**6.1 The role and form of shareholder engagement through dialogues ........ 66**
6.1.1 The role of dialogue in shareholder engagement ........ 66
6.1.2 Shareholders as norm entrepreneurs? ........ 67
6.1.3 Different forms of dialogue: Classification through a maturity matrix ........ 67
**6.2 Internal structure to support engagement dialogue ........ 70**
6.2.1 Investment mandate and incentives to engage ........ 70
6.2.2 Dispersed ownership ........ 71
6.2.3 Resource limitations ........ 73
6.2.4 Internal conflicts of interest ........ 74
6.2.5 Framework for the organizational approach to engagement dialogues ........ 74
**6.3 Mechanisms by which engagement dialogue successfully unfolds: how is shareholder salience created in the Swedish context? ........ 77**
6.3.1 Shareholder characteristics ........ 77
6.3.2 Target firm characteristics ........ 78
6.3.3 Characteristics of the communications ........ 80

6.3.4 Leveraging other tools of engagement ........ 83
6.3.5 A framework of how shareholder salience is achieved in the Swedish context . 84
7 Conclusion ........ 86
8 References ........ 89
Appendix I – The different approaches illustrated by four cases ........ 96

# Figures

Figure 1 ........ 19
Figure 2 ........ 29
Figure 3 ........ 44
Figure 4 ........ 47
Figure 5 ........ 69
Figure 6 ........ 74
Figure 7 ........ 76
Figure 8 ........ 86

# Tables

Table 1 ........ 24
Table 2 ........ 25
Table 3 ........ 26
Table 4 ........ 34
Table 5 ........ 37
Table 6 ........ 38
Table 7 ........ 38
Table 8 ........ 79
Table 9 ........ 81
Table 10 ........ 84
Table 11 ........ 85
Table 12 ........ 97

# Acknowledgements

I am grateful for the opportunity given by Söderberg & Partners to write a thesis within such an interesting topic. I would especially like to thank my supervisor Johanna Påhlson and Lingyi Lu for their continuous support and valuable insights. I also want to thank my supervisor at KTH, Thomas Westin, as well as my seminar leader, Anna Jerbrant, for supporting and guiding me throughout the research process.

To all the professionals that took the time to sit down with me and share their views, opinions, and experiences: Thank you. Your input was invaluable, and I appreciate that you were able to set aside time to answer my questions, even during a crisis brought about by a pandemic.

Finally, I would like to thank Emma Sjöström, for not just writing a great report that was very valuable for my work, but also for taking the time to share her experiences of doing research within this field.

# 1 Introduction

## 1.1 Background

In recent decades, corporate ownership has consolidated into the hands of large institutional investors, resulting in a mounting expectation that institutional investors can, and should, influence the actions of the companies they invest in (Ryan and Schneider 2003; Ivanova 2017). Especially in the realm of sustainable development, the financial system is expected to play a key role in the transition towards a green economy (European Commission 2019; Finansinspektionen 2016).

From the investor side, the mounting expectations of responsible investments has translated into a growing commitment to leverage positions of ownership to engage with portfolio companies on ESG-issues (Environmental, Social and Governance), moving from passive ownership to active ownership (Rivoli 2003; Sjöström 2009; Gifford 2010; Sjöström 2020). In this context, being an active owner implies that shareholders use their ownership position to influence and improve the practices of their portfolio firms, but the manner of this engagement can take many different forms (Hamilton and Eriksson 2011). Within the investor toolbox for active ownership, an investor could for example pursue strategies of relational or confrontational nature, through public or private forums. Additionally, the effectiveness of different engagement tools depends on the contexts and circumstances in which they are applied (Gifford 2010; Ivanova 2017). As a result, active shareholders need to navigate a complex landscape in the intersection of corporate sustainability and shareholder influence, facing difficulties in assessing the efficiency of the different engagement strategies that they have available (Sjöström 2020).

Among all the tools investors have available[1], shareholder engagement through dialogue is a fundamental part of being an active owner. In previous research, engagement through dialogues have proven to have many advantages, where dialogue allow shareholders and corporate management to understand each other's constraints and address reciprocally meaningful issues (Proffitt and Spicer 2006; Logsdon, Rehbein, and Van Buren III 2007; Goodman, Louche, and van Cranenburgh 2014; Scherer and Palazzo 2007). However, previous research has not provided a clear-cut account of the factors and mechanisms that allow shareholder engagement dialogue to reach successful outcomes (Ferraro and Beunza 2019).

---

[1] Including: divesting, filing resolutions on annual general meetings, raising concerns in the media etc.

### 1.1.2 Actively managed equity funds

In order to study the mechanisms by which engagement dialogue successfully unfolds within the Swedish context, actively managed equity funds are a suitable unit of analysis. Of the equity listed on the Swedish stock market, 12 % is owned by funds, a figure that has doubled over the last 25 years (Nordström 2020). Furthermore, with 80% of Swedes saving in funds, nowhere else in the world is fund-saving an equally popular savings-format. This implies that funds do not only have a significant ownership stake within the Swedish stock markets, but also a strong consumer orientation. As the interest for sustainable investments increase among consumers, funds need to live up to increasing expectations of being responsible investors.

Regarding equity funds specifically, they have been shown to have more pronounced practices for responsible investing than other types of funds (Lu, Nacksten, and Brundin 2019). This makes equity funds especially interesting to study, as learnings might emerge that other types of funds could benefit from. Furthermore, as active and passive funds have very different requirements for portfolio size, fund manager mandate, divestment options and investment strategy, it is also suitable to delimit the study regarding management style. As actively managed equity funds have opportunities to influence corporations through both portfolio exclusion and inclusion, as well as engagement, they are in a good position to impact investee companies with a wide set of tools. This enables the interaction between different tools of responsible investments to be studied.

## 1.2 Problematization

A central question to any fund company trying to leverage their shareholder position to improve corporate sustainability should be: Why do some attempts of engagement prove successful, while others fail? As it turns out, this is not an easy question for shareholders to answer. As Sjöström (2020) puts it: *‘Faced with a toolbox of strategies for active ownership, and a range of different contexts and circumstances in which it can be used, shareholders could struggle to assess the efficiency of different methods and what works when.’*

The easy choice for funds might be to exclude or divest rather than engage with companies to improve their practices. Compared to an exclusion strategy, an engagement strategy is harder to communicate to fund customers and it requires more time and complex relationship building. Furthermore, an exclusion strategy better controls the reputational risk of investors (Hamilton and Eriksson 2011). In addition, an engagement strategy might be difficult due to structural tensions between owners and their investee companies, caused by the information asymmetry that resides between the management and the owners of a company. As Ferraro and Beunza (2019) put it: *How are shareholders and corporations expected to* *simultaneously cooperate and confront each other?*' However, if the goal is to make a substantiated impact on ESG-issues, engagement might be the better choice. As Bill Gates noted in a Financial Times interview in the autumn of 2019 *"divestment, to date, probably has reduced about zero tonnes of emissions"*. While engagement is suggested to be a viable pathway for investors to invest responsibly, it is vital that investors understand how they should engage with companies to yield maximum impact while economizing their resources, protecting their brand and controlling for financial risk.

## 1.3 Purpose

The purpose of this paper is to enable Swedish equity funds to better contribute to the transition towards a green economy as well to expand the research horizon when it comes to shareholder engagement. This is done by enhancing the understanding of the mechanisms and critical factors by which engagement dialogues successfully unfolds between Swedish equity funds and their portfolio companies.

## 1.4 Research question

The research question is formulated as follows:

*How can actively managed equity funds effectively leverage their ownership through shareholder dialogues to improve corporate sustainability?*

Furthermore, the research question above is split into two sub-questions:

- *What are the mechanisms by which ESG-related engagement dialogues successfully unfolds between actively managed equity funds and their portfolio companies?*
- *How should the internal processes be designed to support engagement dialogues?*

## 1.5 Delimitations

As the influence of passive mutual funds has been studied in the literature (Appel, Gormley, and Keim 2016), this study is delimited to only explore actively managed mutual funds. Hence, no literature of the influence of passive institutional investors will be included, as the practices and action space of passive and active owners are different. Furthermore, the paper only includes domestic Swedish funds and their engagement with domestic Swedish corporations.

As the objective of the study is to explore the processes of engagement dialogues, the paper will not explore why or if equity funds should engage in shareholder activism, nor will this paper try to explain the passivity of some equity funds. In addition, the paper will not try to compare the effectiveness of dialogue to other types of engagement tools, such as shareholder resolutions or voting at annual general meetings (AGMs). However, the other tools in the shareholder engagement toolbox might be discussed in relation to their impact on engagement dialogues.

## 1.6 Contribution

By delimiting the study to actively managed equity funds in the Swedish context, three contributions can be made to the existing literature on shareholder engagement.

First, the study expands the knowledge of shareholder engagement within equity funds, contributing to understanding differences within the group of institutional investors when it comes to shareholder engagement. Previous literature on shareholder engagement often focuses on institutional investors as a somewhat coherent group, although researchers like Ryan and Schneider (2003) and Rubach and Sebora (2009) have urged researchers not to treat institutional investors as a homogenous group. When studies do acknowledge the differences within the group of institutional investors, they often focus on pension funds, leaving the specific context of mutual funds relatively unexplored in the shareholder engagement literature. Hence, this study can contribute to a better understanding of shareholder engagement dialogues in the context of actively managed equity funds.

Second, shareholder activism is highly affected by its country-specific context. Different regulations and corporate governance cultures forms the engagement dynamics, leaving institutional investors with different sets of possible actions depending on what country they operate in (Ivanova 2017). As most of the research has been conducted in a US or UK context, questions remain whether previous conclusions regarding shareholder engagement are also valid for Swedish investors (Ivanova 2017; Sjöström 2009, 2020). Hence, this study contributes to a better understanding of shareholder engagement outside of the US and UK context.

Third, the paper provides a more fine-grained analysis of shareholder engagement by studying engagement dialogue in-depth, for instance by studying reactive and proactive engagement dialogues as separate concepts (Sjöström 2020).

# 2 Fundamental concepts

## 2.1 ESG, CSR and Greenwashing

Corporate Social Responsibility (CSR) is a term used to describe a form of self-regulation where companies try to have a positive impact on their stakeholders. ESG (Environmental, Social and Governance), on the other hand, is a term used to evaluate a company's overall impact on key aspects of sustainability. While CSR is a term used within corporations, ESG is more commonly used among investors to evaluate future financial performance and corporate sustainability. Therefore, this study will use the term ESG when describing corporate sustainability. However, in research from a couple of years back, CSR is a commonly used term. Hence, whenever previous research is referred to that uses the term CSR, the term will also be used in this paper.

Relating to CSR and ESG is the concept of Greenwashing. Greenwashing is a form of corporate deceit, where consumers are misled regarding any aspect of a company's level of sustainability (Karliner, 1997). The term is derived from the phrase "environmental whitewash" and implies that companies selectively disclose information that reflect their operations or products more sustainable than they really are (Parguel et al., 2011; Delmas and Burbano, 2011). In relation to shareholder engagement, greenwashing could imply that investors could benefit from the 'good name' of engagement, without doing any of the work. In fact, shareholder engagement could just be used as a cover to reduce the need to divest in morally or environmental shady companies.

## 2.2 Pathways to responsible investments

In the literature, three different pathways to achieve responsible investments are discussed. First, by pursuing an *exclusion strategy*, investors avoid investing in companies that do not adhere to certain standards (Uysal 2014; Kuna-marszałek and Kłysik-uryszek 2020). Second, by pursuing an *inclusion strategy*, investors actively allocate capital to companies that contribute to the green transition. Third, by pursuing an *engagement strategy*, investors try to influence portfolio companies through formal and informal channels of communication (Polla 2012; Hamilton and Eriksson 2011). In the scope of this paper, responsible investments will only be studied in the context of engagement. However, the paper separates between divestment and exclusion, where divestments can be used by funds in relation to engagement dialogues, either as a consequence of an unsuccessful dialogue or as a tool being leveraged within the dialogues.

## 2.3 Actively managed equity funds

A mutual fund pools money from investors which is in turn invested into various securities, such as stocks, bonds, or other assets. When customers buy shares of a fund, they buy into the underlying holdings of the funds. The customers also buy into the investment strategy of the fund, as the individual fund customers do not have a saying in how the fund manages their investments. Instead, the fund is managed by one or several professional managers, so-called fund managers, that allocate investor assets according to a fund mandate and investment strategy. As an example, a fund often belongs to a certain fund style, restricting the fund to invest in a certain type of security, industry, company-size, risk-level, and/or geographical market. A fund's investors can be divided into retail investors (individuals) and institutional investors (e.g. insurance companies or asset managers). In exchange for the fund customer 'outsourcing' their investment decisions to a fund and fund manager, the customer pays a fee to the fund.

Generally, a fund is part of a larger fund company that can have multiple different funds, run by different fund managers and with different investment strategies. Fund companies allow funds to share infrastructure and support functions, but the fund managers of each fund usually have high autonomy when it comes to the actual investment decisions.

Equity funds are a subcategory of mutual funds, principally investing in stocks. This means that the value of the fund is dependent on the value of the underlying stocks. A fund can also be either actively or passively managed. In an actively managed fund, the fund managers continuously make decisions on how to allocate fund assets as they are trying to yield maximum return while conforming to their investment mandate. In a passively managed fund, the fund allocates assets according to a specific market index. On average, actively managed equity funds underperform passive funds (e.g. French, 2008; Gruber, 1996). However, actively managed funds have been shown to provide hedging opportunities, outperforming the market in recessions (Wermers, 2000; Kosowski 2011).

In Sweden, there are around 50 fund companies that manage around 90 percent of the total assets allocated in funds. A third of funds available to Swedish investors have their domicile in Sweden, and these funds account for around 80 percent of the fund stock (Fondbolagens Förening, 2020).

# 3 Theoretical framework

In any situation of shareholder engagement through dialogue, there are always two sides of the interaction. First, the shareholder needs to engage in activism, and second, the company needs to accommodate shareholder expectations. As a result, the theoretical framework will explore the challenges for engagement dialogue from a shareholder perspective, as well as the determinants of response from the target firm.

The chapter is structured as follows: First, the forms and roles of shareholder engagement are discussed to create a common understanding of the concept in the context of this study. Second, previous literature relating to the internal processes among shareholders to support engagement dialogue are explored. Third, the mechanisms by which engagement dialogue successfully unfolds between shareholders and their target firms are discussed.

## 3.1 Forms and roles of shareholder engagement

In the literature, there is often a distinction between shareholder activism and shareholder engagement. When researchers describe shareholder activism, the interaction is centered around a conflict of interest between the company and the shareholder. Subsequently, the research is often focused on traditional channels and issues of corporate governance, like shareholder resolutions. On the other hand, shareholder engagement is used to describe a wider engagement from the shareholder's side, where a shareholder will try to steer the corporation to improved ESG practices through more informal channels of communication (Hamilton and Eriksson 2011).

In the context of this study, the term shareholder engagement will be used, and is defined as any situation where a shareholder tries to leverage their position as owners to improve the sustainability practices of their investee companies (Ferraro and Beunza 2019). This often implies some form of direct interaction between the shareholder and the company, either through formal processes, such as active participation in annual general meetings (AGMs), or through informal processes, for example through dialogue. Shareholder engagement can also be classified in terms of public or private interactions, where media appearances and AGM voting can be classified as public interactions, while private interactions include dialogues. Furthermore, shareholder engagement can be either confrontational or relational, where the former will be based on adversary strategies, while the latter will try to strengthen relationships as a mean to steer corporations in the desired direction (Ivanova 2017; Rubach and Sebora 2009; Gifford 2010). In addition, engagement can be classified as either proactive or reactive, where a reactive dialogue stems from incidents or obvious misconduct from target firms while a proactive engagement is focused on improving a firm's position, for instance in relation to ESG-challenges (Sjöström, 2020; Semanova and Hassel, 2018).

### 3.1.1 Shareholders as norm entrepreneurs?

Apart from the perspectives of shareholder engagement as a way to directly influence the actions of companies, other research has highlighted the indirect effect of shareholder engagement. In fact, when shareholders utilize their ownership position to initiate change regarding corporate sustainability, they are part of forming the perception of what corporate sustainability is, and what it should be. Hence, shareholder engagement can reach beyond the impact of a single engagement effort and instead contribute to shaping the norms of corporate responsibility in general (Sjöström 2010). As a result, Sjöström (2010) suggests that shareholders could analytically be understood as *norm entrepreneurs*, defined as an actor who actively pursues to convince others of the superiority of new norms.

Other studies have shown that spillover effects from shareholder engagement leads to proactive changes in non-target companies, allowing engagement to influence norms and practices in a wider context (Wook Lee and Park 2009; Dyck et al. 2019). Research by Uysal (2014) supports the idea that shareholder engagement can have an effect outside of single shareholder demands within corporations, as an initial reactive response to a shareholder demand can induce proactive measures where the company even exceeds societal expectations. Furthermore, shareholder engagement can act as a cue to corporations of emerging societal expectations and norms, functioning as ‘the canary in the coal mine’ (Uysal 2014).

### 3.1.2 Classification of engagement based on intensity

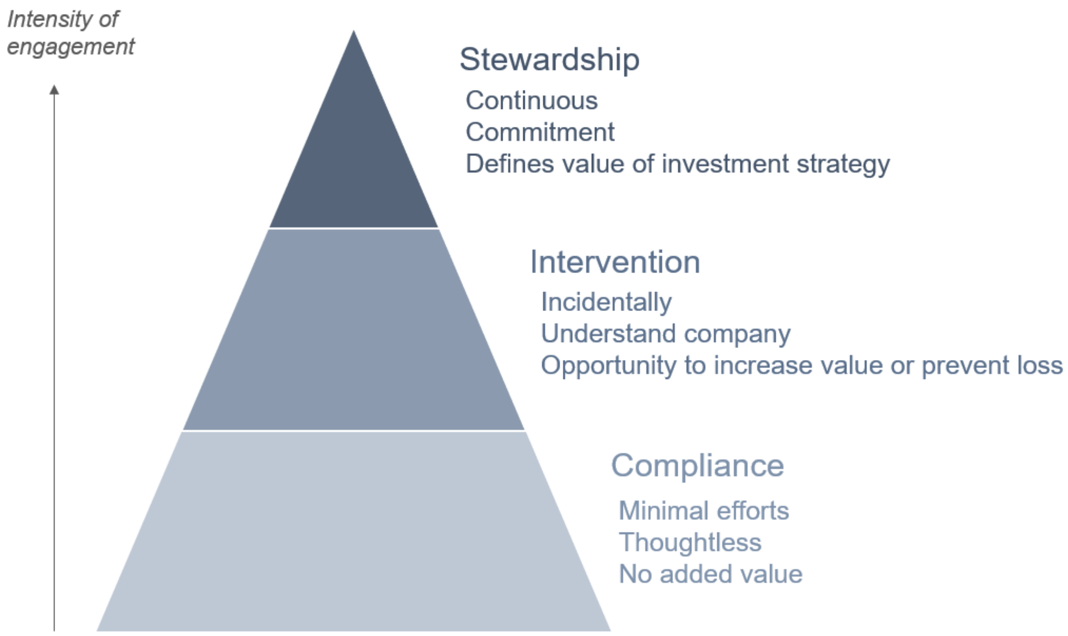
Shareholder engagement is a broad term, used to describe a wide range of investor-corporation interactions. In other words, the scope of the shareholder engagement can vary, meaning that investors can allow engagement to include different purposes, processes, and target firms. Winter (2012) proposes three distinguished levels of shareholder engagement that encase different views and approaches to engagement, namely; compliance (1), intervention (2) and stewardship (3).

If shareholder engagement takes the form of compliance, it is effortless and thoughtless. Investors have little understanding of shareholder engagement as value-adding. Instead, engagement is merely conducted as it is required by law or expected by customers. As an example, voting rights at AGMs will be exercised through a general voting policy and with the input of proxy advisors.

When it comes to shareholder engagement as an intervention, the investor will engage in dialogues with investee companies if the situation requires it. However, the engagement is incidentally, driven by preventing losses or capturing opportunities relating to undervalued assets. Although this type of engagement requires knowledge of the target firms and a willingness to engage in dialogue, it is coupled to a single issue. Subsequently, when the issue is resolved, the shareholder engagement wanes. Winter (2012) suggests that ESG-issues in particular will give rise to intervention-type engagement.

Engagement through stewardship is detached from a single issue or timespan. Instead, the engagement is continuous, aiming to create value in the long-term. By holding shares for a longer time horizon investors require more understanding, information and engagement with the investee companies to protect and enhance the value of their position (Winter 2012).

*Figure 1. Classification of engagement dependent on the level of intensity*



## 3.2 Internal structures to support engagement dialogues

In order to understand how internal structures among shareholders impact prerequisites for engagement dialogues, the general structure of the financial markets needs to be understood. Although individual investors cannot alter the market structure, they can design their internal structure to mitigate the risks and shortcomings of the market. The market structure is therefore important to review in order to understand some of the key challenges that funds have when it comes to shareholder engagement, and how these challenges impact how the internal processes need to be designed. Below, previous research is described along four market challenges relating to shareholder engagement, namely: Investment mandate and incentives to engage, Dispersed ownership, Resource limitations and Internal conflicts of interest.

### 3.2.1 Dispersed ownership

*"Modern Portfolio Theory (…), the intermediation by asset managers and their understanding of their fiduciary duty (…) and the persistent pressure from the investment industry to trade shares rather than hold them, all of this makes a meaningful engagement in investee companies an illusion for the mainstream of institutional investors."* - Winter (2012)

As Winter describes in the quote above, there are structural problems in the market which creates difficulties for investors to pursue strategies of engagement. Specifically, Winter (2012) argues that Modern Portfolio Theory (MPT) has transformed shareholders of listed companies into distant investors. A fundamental concept within MPT is *portfolio diversification*, leaving institutional investors with only a small fraction of ownership in each company in their portfolio. Winter (2012) argues that portfolio diversification *'diverts the investor's attention away from the choice of individual shares to the composition of the portfolio as a whole'*. This, together with the pressure to outperform competitors in the short-term, leads to a constant re-calibration of portfolios through selling and buying of shares. Hence, *shareholders* are becoming *shareowners*, where the average holding time per stock has dropped drastically in the last decades. This prohibits the long-term focus that is necessary for shareholders to motivate engagements (Winter 2012). In addition, the small ownership share in each company limits the influence of institutional investors to impact the companies they invest in (Ivanova 2017; Winter, 2012).

### 3.2.1 Investment mandate and incentives to engage

Another problem in the market is the misalignment of interest within the investment chain (Ivanova 2017), where asset managers[2] have developed into the 'ruling class' of the investment chain as they increasingly function as financial intermediaries (Ivanova 2017; Ryan and Schneider 2003; Winter 2012). Although this consolidates shareholder power, and hence increases the outlook for powerful shareholder engagement, it also introduces problems. For instance, asset managers (as well as fund managers) are often incentivized based on short-term performance. This creates discrepancies between the long-term interests

---

[2] Asset managers manages client portfolios, investing in a wide range of traditional and alternative financial products on behalf of their clients. As such, asset managers differ from fund managers in their flexibility and service offering.

of the beneficiaries, and the short-term focus of the fund or asset managers. Adding to this is the fee structure, which is often based on assets under management rather than performance. This implies that the focus of asset or fund managers might be diverted from engagement as a strategy to increase the performance of the underlying stocks, and redirected to marketing, sales-meetings and window-dressing (Winter 2012).

Furthermore, Winter (2012) describes how the competition between asset managers (which also holds true for fund managers) creates a focus on short-term benchmarks which introduces a ‘herd behavior’. The herd behavior stems from a risk of client losses if a deviation from the mainstream investment strategies results in a poor relative performance. This enforces the pressure to diversify portfolios, which diverts the attention away from the performance of single companies and dilutes the ownership power (Ivanova 2017; Winter 2012).

Additionally, the increase of asset managers acting as financial intermediaries has consequences for the fiduciary duty of mutual funds. Increasingly, any decision to invest ends up with an asset manager rather than with the retail investor or pension fund. Hence, the view of the fiduciary duty among asset managers becomes important, as this will dictate the mandate given in turn to the fund managers (Winter 2012). According to Winter (2012), the fiduciary duty among asset managers is often understood as ‘don’t underperform your competitors’. This implies a short-term focus on relative performance that does not leave room for shareholder engagement as a strategy to improve the long-term performance of investee companies. Hence, shareholder engagement is not included in the mandate given by asset managers to fund managers. This is reinforced by a wider client inertia towards ESG issues, including both large clients, such as pension funds, as well as retail investors. As long as the clients do not include sustainability into the investment mandate, nor encourage or demand active engagement with the investee companies to promote sustainability, asset and fund managers are deterred from engagement practices (Ivanova 2017; Winter 2012).

### 3.2.3 Resource limitations

The dispersed ownership discussed above also contributes to the passive ownership of institutional investors by introducing resource problems where investors simply do not have enough capacity to monitor and engage with all holdings within a portfolio (Ivanova 2017; Wen 2009; McCahery, Sautner, and Starks 2016). Due to such resource limitations, institutional investors also tend to rely on narrow streams of information, such as ESG-ratings or annual reports (Winter 2012; Ivanova 2017). This is problematic, as annual reports have previously been shown to be insufficient sources of information when assessing a company’s ESG performance (Revelli and Viviani 2015; Perks, Rawlinson, and Ingram 1992; Harte, Lewis, and Owens 1991). Hence a key challenge becomes the lack of knowledge among investors about ESG issues in company-specific contexts.

Adding to this problem is the insufficient transparency of target firms on ESG issues. This includes poor disclosure on ESG matters, difficulties with quantifying the financial impact of ESG issues and following up intervention in a credible way (Ivanova 2017). As a result, shareholders are increasingly asking for general codes of conduct instead of specific measures when they engage with companies, as they do not have the resource capabilities to extract and analyze sufficient information from all of their holdings (Proffitt and Spicer 2006).

### 3.2.4 Internal conflicts of interest

The organizational structure and culture of an investor is suggested to play a critical role as internal conflicts of interest can hinder efficient engagement. These internal conflicts stem from the separation of different departments in the organizations of institutional investors. For example, if the ESG team is separated from the equity team, potential communication problems and divergence are created. The equity team might then suffocate the ESG team's efforts to engage with a portfolio company due to a fear of hurting the relationships with the management of the target firm (Ivanova 2017).

## 3.3 Mechanisms by which engagement dialogues successfully unfolds

In the context of shareholder activism through dialogue, it is pertinent to understand the factors driving a corporation to cater to the demands of certain shareholders, but not others. A CEO cannot meet the expectations of all shareholders interacting with the company due to limited resources and divergence of shareholders' opinions. Hence, the underlying mechanisms that make a CEO prioritize certain shareholders and their claims need to be understood to achieve successful engagements (Gifford, 2010; Sjöström 2020).

The mechanisms that make target firms adhere to shareholder expectations in dialogues are discussed below according to three categories, namely characteristics of the shareholder (1), characteristics of the target firm (2) and characteristics of the communication (3).

### 3.3.1 Shareholder characteristics

A fundamental concept regarding the outlook for successful dialogue is *shareholder salience*, defined as the priority given to the competing claims of various shareholders by the target firm management. A shareholder's salience is suggested to depend on three shareholder attributes; power, legitimacy and urgency (Mitchell, Agle, and Wood 1997).

Building on Weber's (1947) and Pfeffer's (1981) definitions, power is defined as a shareholder’s ability to influence a company’s action in a direction that would not otherwise have been taken. Legitimacy is defined as the degree to which a shareholder’s claims are in line with the current social norms, in line with definitions from Weber (1947) and Suchman (1995). Urgency is defined both in terms of time and criticality, and a claim is deemed urgent when it is perceived as both important and time sensitive.

In a shareholder setting, legitimacy is suggested to be the most important attribute to achieve salience, at least when it comes to engagement through dialogues (Gifford, 2010). However, the relative importance of the attributes is not static through situations and contexts. Instead, the relative importance of the three attributes is subjected to both a temporal and spatial dimension. Regarding the temporal dimension, shareholders seem to enforce power-related actions only after legitimacy-based actions have been exhausted. Hence, as the engagement process escalates, the attributes are applied sequentially rather than in parallel (Gifford 2010). Concerning the spatial dimension, previous research has shown a difference between the composition of the different attributes between salient shareholders in the US and UK. This would suggest that a cultural variable plays into shareholder salience. Since the shareholder rights are weaker in the US compared to the UK, shareholders have less options of engagement. This, in combination with a more confrontational corporate culture, leads to coercive forms of power, such as shareholder resolutions, being more frequently used in the US than in the UK (Gifford 2010; Ivanova 2017).

#### 3.3.1.1 Shareholder legitimacy

In a shareholder setting, legitimacy can be divided into four dimensions, namely individual, organizational, pragmatic, and societal legitimacy.

The individual legitimacy concerns the expertise, status and credibility of the individuals associated with the shareholder. Although individual legitimacy is important to achieve salience, it is not necessarily associated with the age or background of the individual. Rather, it concerns the seniority of the engager, as well as their efforts to understand the specific company context (Santos, Sealey, and Onuoha 2014; Gifford 2010)

The organizational legitimacy concerns the credibility of the engaging company. This is impacted by the organizational reputation as well as the size of the claim that a shareholder has in their portfolio firms, both in terms of stake and risk. Furthermore, the organizational legitimacy is dependent on coherent communication from the shareholder organization and an alignment of the interest between the shareholder and the company (Gifford 2010).

Pragmatic legitimacy implies that the shareholder has a strong argumentation of why their claim is beneficial to the company, i.e. the claim has a strong business case. Empirical research has suggested that this would be one of the most critical factors to achieve a successful shareholder engagement. Shareholders can strengthen the business case of their claims by providing new information to target firms or building arguments on peer pressure. The societal legitimacy on the other hand, meaning that the claim is in line with societal norms and regulations, is not suggested to be a significant tool to enhance stakeholder salience in engagements (Gifford 2010).

*Table 1. Sources of shareholder legitimacy (Gifford 2010)*

| ***Level of legitimacy*** | ***Sources of legitimacy*** |
|---|---|
| *Individual* | Credibility, expertise, experience and status of the individual engaging with the company |
| *Organizational* | Legitimate claim on the company (e.g. large shareholding, high-risk state)<br>Alignment between shareholders' interest and those of the company (shareholder has the best interest of the company at heart)<br>Perception that the shareholder organization is a credible and respected member of the investment community<br>Consistency of messaging from different parts of the shareholder organization |
| *Pragmatic* | The shareholder has a strong argumentation for why the proposed action is in the interest of the company<br>The shareholder provides new information to the company |
| *Societal* | The shareholder embodies of reflects a position widely accepted in society<br>Existence of norms or codes of conduct<br>Supportive political and policy environment |

### 3.3.1.2 Shareholder urgency

While some empirical research suggests that legitimacy is the most critical attribute to achieve salience (Santos, Sealey, and Onuoha 2014; Gifford 2010), other research suggests that the urgency provides the extra push that will secure the CEO's attention, and is therefore the best predictor of shareholder salience (Agle, Mitchell, and Sonnenfeld 1999).

Urgency in terms of time-sensitivity implies that shareholders can use different types of deadlines to increase their salience. However, previous research suggests that urgency does not necessarily enhance shareholder salience (Gifford, 2010). Most shareholder engagement processes, especially when it comes to sustainability issues, are not of a 'crisis management'-nature. Therefore, an approach to dialogue where the shareholders take the time to work through the problem together with the target firm management is suggested to be more efficient compared to applying a time-pressured strategy (Gifford 2010).

In a shareholder setting, the other dimension of urgency, criticality, is defined as the shareholder's persistence and willingness to apply resources. Like time-sensitivity, it is not always evident that 'criticality-enhancing' actions, like filing shareholder resolutions, unequivocally increases shareholder salience. Instead, such actions could be interpreted as hostile acts by the target firm, resulting in deteriorating shareholder salience through diminished legitimacy (Gifford 2010). Applying an intensive approach to shareholder engagement could therefore be counterproductive. For instance, it could result in a hardening stance from the target firm, both on the issue and towards the shareholder, where the target firm directs resources to resist the shareholder claim rather than focusing on improving their sustainability practices (O'Rourke 2003; Vandekerckhove, Leys, and Van Braeckel 2007; David, Bloom, and Hillman 2007).

*Table 2. Sources of shareholder urgency (Gifford 2010)*

| ***Level of urgency*** | ***Sources of urgency*** |
|---|---|
| *Time-sensitivity* | Shareholder resolutions at AGMs<br>Benchmarks with deadlines for response<br>Use of other types of deadlines to create time pressure |
| *Criticality* | Assertiveness of tone<br>Persistence<br>Willingness to apply resources |

### 3.3.1.3 Shareholder power

Shareholder power can be separated according to Peterson and Etzioni's (1965) dimensions of coercive, normative and utilitarian power. Coercive power is the use, or threat of using, formal governance processes. Examples of such formal processes could be AGM voting, CEO replacements, legal procedures to enforce shareholder rights or divestments. Normative power includes activities that affect the reputation of the target firm or an individual manager, such as utilizing the media to draw attention to the shareholder claim. The final dimension of power, utilitarian power, is mainly related to investment decisions where empirical research indicates that divesting is not a tool used by investors as a way to increase their shareholder salience (Gifford, 2010). Overall, the empirical research suggests that the use of formal power can support shareholder engagement, but that it could also harm the organizational legitimacy (Gifford, 2010).

*Table 3. Sources of shareholder power (Gifford 2010)*

| ***Level of power*** | ***Sources of power*** |
|---|---|
| *Coercive* | Use of formal shareholder rights through resolutions<br>Replacement of directors or CEOs<br>Legal proceedings to enforce shareholder rights<br>Successful lobbying for regulation |
| *Utilitarian* | Provision or withdrawal of capital or other resources from companies (Investment, divestment) |
| *Normative* | Public or private statements, shareholder resolutions or other activities that affect the company's or individual manager's reputation |

#### 3.3.1.4 Moderating factors

There are also several moderating factors that do not fit into the framework of stakeholder salience as described by Mitchell et al. (1997), but still impacts the shareholder salience. For instance, a supportive political environment is suggested to enhance the salience of a shareholder claim. Furthermore, a shareholder's total assets under management is suggested to impact the shareholder salience even more than the level of ownership in an individual company, unless the stake is particularly large (Gifford 2010).

The investment horizon will affect the shareholder salience as long-term investors have been found to be more salient than short-term investors. The intensity of the engagement also affects the salience, where more activity, both in terms of frequency and coordination with other shareholders, implies more influence (Neubaum and Zahra 2006). As such, coalition-building with other investors, NGOs or policy makers is an efficient strategy to enhance stakeholder salience (Gifford 2010).

### 3.3.2 Target firm characteristics

Unlike the shareholder attributes discussed above, shareholders cannot impact the target firm characteristics. This is unfortunate from a shareholder perspective as previous research suggests that the outcome of shareholder engagement is contingent on certain target firm characteristics. However, investors could make choices of what kind of company to target in order to maximize their efforts (Sjöström, 2020).

When it comes to the characteristics of the target firm, research by Logsdon, Rehbein, and Van Buren III (2007) suggests that company size, board composition and corporate visibility affect the willingness of target firms to engage in shareholder dialogues. The study suggests that dialogue is more likely to be initiated between shareholders and company if the company is small, has a well-known brand and has a board with independent directors. Regarding the firm size, smaller companies are suggested to lack the capabilities and expertise to resist shareholder demands. They are also more likely to appreciate the advice and support that shareholders can offer as they lack the in-house competence present in larger corporations. Regarding the brand visibility, a well-known brand makes companies more exposed to unwanted media attention, and hence keener to avoid public adversary tactics by shareholders (Logsdon, Rehbein, and Van Buren III 2007; Dimson et al. 2015). Hence, target firms within consumer-facing industries will typically be easier to impact through dialogue (Dimson et al. 2015).

Dimson et al. (2015) find that successful dialogue is harder to achieve with industry leaders and that previous engagements with a target firm increases the outlook for a successful engagement. In addition, a greater financial slack within the target firm is also suggested to be a predictor of successful engagements (Dimson et al. 2015).

A company's response to shareholder dialogue is also contingent on the culture of the target company as well as the values of the target firm's management (Hoffman 1996; Adams, Licht, and Sagiv 2011). Adams, Licht and Sagiv (2011) propose that CEOs and directors that favor entrepreneurial values, such as power, self-direction, low-universalism and high achievement, are more *'pro-shareholders'*. Successful dialogues are also contingent on supportive individuals in key positions. For instance, a CEO change is proposed as a key enabler to revive stalled dialogues (Hoffman 1996; Hebb, Hachigian, and Allen 2012; Gifford 2010). Furthermore, the personal values of a manager are often closely related to their personal reputation. This opens up for an important point of leverage connected to the attribute of normative power, where managers with outspoken values are more vulnerable to reputational damage caused by divergence between their values and actions (Gifford 2010).

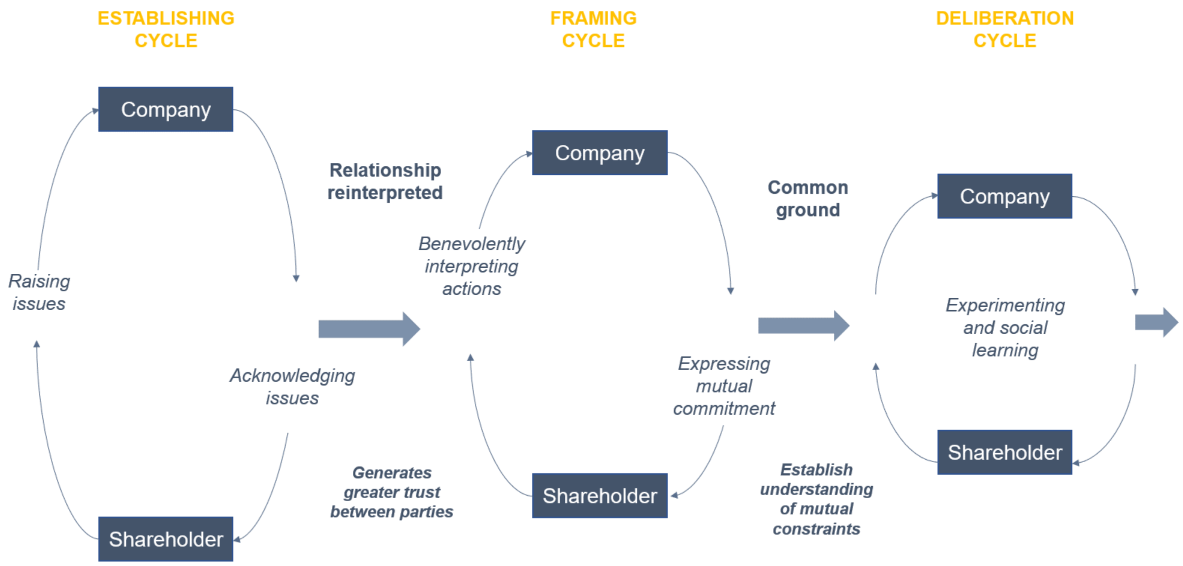
### 3.3.3 Communication characteristics

In engagement through dialogues, the style of communication is an additional factor for dialogues to unfold successfully. Specifically, the scrutinizing and questioning role of the shareholder creates a structural tension between the shareholders and the target firm that needs to be resolved to achieve efficient dialogues (Logsdon and Van Buren 2009; Ferraro and Beunza 2019).

Due to this structural tension, Ferraro and Beunza (2019) suggest that a strict negotiating style of dialogues, where parties push to advance their distinct opinions, will not yield efficient dialogues. Instead, shareholder engagement dialogues need to build on a collaborative approach, where the aim is to build a common ground of how the issues and challenges are understood. Logsdon and Van Buren (2009) suggest that effective shareholder dialogue is achieved through parties *"addressing mutually meaningful issues, develop flexibility in working together, and understand each other's constraints"*. Building on this, Ferraro and Beunza (2019) suggest that shareholders and target firms can achieve collaboration through dialogues and overcome initial opposing views by undergoing three successive cycles in their dialogues:

1. The first cycle entails a redefinition of the shareholder-company relationship, which happens when a member of the company acknowledges the issue that shareholders try to raise and voice a desire to engage the shareholders on this issue. Hence, an internal champion with the company is key for the relationship to evolve and for trust to be created.
2. In the second cycle, a common ground is established between the shareholders and the company, meaning that the framing of the problem of each side needs to be combined into a shared framing of the problem, rather than one side holding on to their framing, hoping that the other side will adopt their point of view.
3. The third cycle is the deliberation cycle, which includes experimentation and social learnings in order to find a solution to the problem. The joint considerations of the options and consequences facilitates the processes of agreeing to an acceptable solution, where shareholders can gain a deeper understanding of the corporate constraints.

*Figure 2. Three cycles to achieve efficient engagement dialogue*



# 4 Methodology

## 4.1 Research design

Shareholder engagement has almost exclusively been studied in the context of the US and UK and the research is seldom fine-grained enough to understand shareholder engagement for different types of institutional investors (Ivanova 2017; Sjöström 2020). Hence, conclusions from previous research are not necessarily valid for Swedish equity funds. Because of this, an inductive research approach is applied to mitigate corrupting the empirical research with preconceived perceptions about efficient shareholder engagement. This implies that concepts and tentative relationships are allowed to emerge from the empirical data, instead of these being conceptualized beforehand as a set of hypotheses to be tested.

The study takes the form of a qualitative case study, as important prerequisites proposed by Yin (2003) for when a case study design is suitable are met in relation to the aim and setting of this study. First, the aim of this study is to explore a phenomenon in-depth in order to answer questions of "how" and "why", rather than "how many" or "how often". Second, the behavior of the participants of the study cannot be manipulated or observed. Third, as several previous researchers within the field of shareholder engagement have pointed out (Ivanova 2017), the context of the engagement is pivotal in order to understand the processes and its responses.

Furthermore, the case study is of an exploratory nature, as the aim of the study is to contribute to the understanding of shareholder engagement for actively managed equity funds, rather than simply describe the characteristics of the process, which would make it a descriptive case study (Yin 2017). A potential critique of the case study approach is the risks of limited external validity due to the idiosyncratic nature of the cases being studied (Blomkvist and Hallin 2014; Eisenhardt 1989). According to Eisenhardt (1989), as an inductive case-study's primary goal is to contribute to theory rather than to test it, a case-study approach can still provide empirically grounded conclusions, contributing to the accumulation of understanding in relations to a specific phenomenon.

Miles and Huberman (1994) defines a case as, "a phenomenon of some sort occurring in a bounded context ". In this study, the unit of analysis, or the 'case', is determined to be shareholder engagement through dialogue by Swedish actively managed equity funds, directed towards Swedish portfolio companies. This implies that the case is centered around the interaction between the fund company and the target company. The 'case' therefore includes the actions and decision-processes of the individual fund representative that conduct engagement dialogues, the processes in place for shareholder engagement at the individual fund company and the perspectives of the receiving side of the interaction.

When it comes to the data collection, most engagement dialogues occur behind closed doors. As a result, the interactions between shareholders and target firms are hard to observe from the outside. Because of this, it is pivotal to gather information directly from individuals involved in the processes (Ivanova 2017). In order to capture the nuances of the engagement process, interviews are proposed as an appropriate approach, as this allows for the collection of in-depth answers. This implies that the study is of a qualitative nature, which is in line with the purpose of the study, being to study the perceptions and ideas of engagement dialogue among mutual funds, rather than describing the phenomena through quantitative data. The adoption of a qualitative research approach is in line with the conclusions of Alvesson and Deetz (2011) as the study is of an exploratory nature.

In relation to the inductive approach, Gioia et al. (2013) makes a point out of not knowing the literature before engaging in interviews, while Kathy Eisenhardt argues that the literature should be known before even trying to formulate a research question (Gehman *et al.*, 2017). Although knowing the literature makes the inductive approach harder, as it is easier to be tainted by existing theory if one knows the theory well, a literature review was continuously performed before and in parallel with the interviews in order to make the research relevant, instead of ‘reinventing the well-ridden wheels’ (Gehman et al. 2017).

Knowing the literature also facilitated an overlap of the data analysis with the data collection, in line with Eisenhardt's (1989) framework of building theory from case studies. An overlap between the analysis and collection of data allows for flexible research with freedom to probe emergent themes. In her article. Eisenhardt's (1989) comments this flexible approach by saying: *‘This flexibility is not a license to be unsystematic. Rather, this flexibility is controlled opportunism in which researchers take advantage of the uniqueness of a specific case and the emergence of new themes to improve resultant theory’.*

The final remark regarding the research design is in relation to the positioning of the researcher along the insider-outsider continuum. The researcher of this study is an insider when it comes to cultural, language and educational aspects. However, with no previous work experience in relation to the mutual funds industry nor the investee companies, the researcher acted as an outsider regarding business-specific knowledge and previous relationships. This allowed for a research process that was more objective in terms of the researcher having less preconceptions about what the interview participants should or should not answer, facilitating an open and curious discussion in the interviews. Furthermore, this naïve approach during the interviews allowed for a questioning terminology taken for granted, probing for the real meaning behind doctored phrases.

## 4.2 Information gathering

In order to increase the validity of the findings, data triangulation was used to develop *converging lines of inquiry* (Yin 2017). Although interviews were the main method of data collection, other sources of information have been used to deepen the analysis. These include written material such as news articles, reports and documents from fund companies. The material from fund companies was collected both from their websites but also from material provided by the funds in relation to the interviews. The material included funds' own sustainability reports, their public records of shareholder engagement and PPTs used in client presentations. Furthermore, insights from quantitative data was retrieved from a report on Swedish funds' sustainability practices (Lu, Nacksten, and Brundin 2019). The above material was complemented with observational research at a seminar with Swedish institutional investors on shareholder engagement, where the internal discussions within the investor community on active ownership was observed.

In addition, a literature review was performed in order to collect relevant prior research to form the theoretical framework of this study.

### 4.2.1 Literature study

When concepts and models are developed from case data, Eisenhardt (1989) argues that it is essential to continuously compare these findings with existing literature. Literature with similar findings provide validity and wider generalizability of the findings, while literature with conflicting findings provides an opportunity to engage in a more creative thought process than would otherwise have been achieved (Eisenhardt 1989). While literature comparison is important in most research, Eisenhardt (1989) argues that it is especially important when it comes to case studies, as findings often rests on few cases in a limited context. As such, the corroboration offered by comparing findings with existing literature is an important improvement of the validity and generalizability of the research (Eisenhardt 1989).

Eisenhardt (1989) also suggests that case research is a highly iterative process, making it fundamental to be familiar with a broad range of literature throughout the research process, as this facilitates the identification of concepts and constructs that should be tested in the data gathering or included in the analysis. However, it is important to keep in mind that the literature cannot dictate the research in the inductive approach, merely help identify potential areas of interest to be investigated (Eisenhardt 1989).

In order to develop a broad theoretical foundation for this thesis, a literature study was conducted in parallel with the development of the research design and data gathering. The literature was compiled based on the Systematic Literature Review (SLR) approach. The aim of this approach is to allow transparency and replicability in the research synthesizing process (Tranfield, Denyer, and Smart 2003). Hence, the literature review was designed along the following six steps, described by Durach, Kembro, and Wieland (2017):

1. *Defining the research question*
   The initial research question was defined as follows: *How can Swedish funds achieve efficient shareholder engagement?* This research question created several interesting focus areas for the literature review, such as shareholder engagement in general, but articles relating to the Swedish context or the mutual funds industry were deemed especially interesting.

2. *Determining the required characteristics of primary studies*
   In order to create a relevant sample of primary studies, several exclusion and inclusion criteria were formulated. For a study to be included in this review, it had to meet all the inclusion factors and could not meet any of the exclusion criteria.

   The inclusion criteria stated that the primary studies had to focus on (1) sustainable investments for institutional investors or (2) shareholder engagement or investor activism in general or in relation to sustainability. They were excluded if they were (1) reviews, (2) not peer-reviewed, (3) focused on shareholder engagement from the perspectives of individual investors or activist groups, such as NGOs, or (4) focused on perspectives of shareholder engagement not relevant to this study, such as the financial performance of target firms or the performance of mutual funds dependent on ESG. However, studies focusing on other types of institutional investors, such as pension funds or hedge funds, were included. Furthermore, the language of the included studies was set to be English.

3. *Retrieving a sample of potentially relevant literature*
   Key words were selected and the subsequent search on KTH Primo and Google scholar generated a large pool of articles on which the inclusion/exclusion criteria was applied. The search results were sorted by citations, and the primary pool of articles was narrowed down by judging the title. If, by judging from the title, the article clearly was not relevant, the articles were disqualified. By judging an article by the title, there is a risk of missing important studies. However, in unclear cases, the articles were included rather than excluded, in order to allow an additional judgement based on the content of the article. The keywords used are presented in Table 4. Furthermore, the report *Active Ownership on Environmental and Social Issues: What Works* by Emma Sjöström (2020) was used to identify additional relevant articles.

*Table 4. Keywords used in the systematic literature review*

| ***Keyword(s)*** | ***Year*** | ***Type*** |
|---|---|---|
| *"activism" AND "shareholder" OR "investor" AND "sustainability"* | 1990-2020 | Journal articles |
| *“mutual fund” AND “activism” OR “ESG” OR “CSR”* | 1990-2020 | Journal articles |
| *“Shareholder” OR “investor” AND "sustainability" OR "Corporate social responsibility" AND “activism”* | 1990-2020 | Journal articles |
| *“shareholder engagement” OR “shareholder influence” AND “strategies”* | 1990-2020 | Journal articles |

4. *Selecting the relevant literature*
   From this, 22 primary studies were selected. A content analysis was performed in order to evaluate if the articles were related to shareholder engagement. 7 of the articles were omitted because it was, upon reading, revealed that they did not meet the selection criteria. The final pool, consisting of 15 primary studies, was used as the foundation for this review. Upon reading the chosen articles, a snowballing approach was used to identify additional relevant articles. This approach included both reviewing the articles that cited the chosen articles, as well as reviewing the citations in the chosen articles.

5. *Synthesizing the literature*
   The literature was synthesized along two steps. First, a broad range of literature was synthesized along several emerging themes, were the purpose was to include information than exclude it. The aim was to provide a full range ‘theoretical palette’ to be available in the data analysis. Second, after the analysis of the data was complete, the literature was re-synthesized, where only the relevant themes for the findings in the empirical study of this thesis were kept, either because the literature conflicted with the empirical findings, or because they corroborated with them.

6. *Reporting the results*
   The re-synthesized literature review resulted in the theoretical framework presented in this thesis.

### 4.2.2 Interviews

The interviews were conducted in a semi-structured way, as this is a more flexible form of information gathering than strictly structured interviews (Wilson 2012). In her research, Ivanova (2017) points out that the complex nature of shareholder engagement creates a need for a flexible research approach, and semi-structured interviews are therefore appropriate. Adding to this, several other studies in the field of shareholder engagement have designed their research approach in a similar way, including Ivanova 2017; Sjöström 2009b; Hoffman 1996 and O'Rourke 2003.

A guiding interview questionnaire was designed to make sure that the core questions of interest were covered but the format of the interviews varied depending on the interviewee's position and knowledge. The aim of the semi-structured interviews was to explore the issue at hand with an open mind and avoid tainting the questions asked with own expectations and theoretical foundation (Gioia, Corley, and Hamilton 2012). Hence, the guiding questions were carefully crafted to be open ended and not leading.

Furthermore, the research was based on the notion that the interview questions must change as the research progresses, i.e. so-called interpretational research (Gioia, Corley and Hamilton, 2012). Potential critique to this approach would be that the interview protocol needs to be standardized for the research to achieve consistency. However, as Gioia, Corley and Hamilton (2012) argues that following *'wherever the informants lead us'* allows for a more open-minded research process, which is where new concepts and ideas emerge. This is in line with the research design described above, where the aim was for concepts and tentative relationships to emerge from the interviews, without biases and expectations 'tainting' the interviews and subsequent analysis. This resulted in an increasing focus on engagement through dialogues as the interviews proceeded, as this turned out to be not just the most important tool of shareholder engagement among Swedish equity funds, but also the most ambiguous one.

As new questions arose when the research progressed, there was a need for emerging themes to be explored more in-depth. Hence, as the research went along, the interviews were split up in two parts: open-ended questions were asked in the first phase of the interview, and towards the end of the interview, more specific questions were asked relating to information given in previous interviews.

Due to the sensitive nature of the conversations with both fund companies and target firms, the interviews were not recorded. The sensitivity stems from the relationship between funds and the commissioner of this thesis, where the commissioner has an annual sustainability rating of fund companies. However, it also stems from the fact that sustainability is a sensitive subject in itself, with the public image of the interviewed companies and funds on the line. The issue of recording the interviews was discussed with professionals and researchers in the field, and a decision was made that the risk of interviewees censoring their answers if they were recorded, if not intentionally then subconsciously, was simply too significant. However, the interviews were noted down in detail. If the interviewees provided interesting quotes, these were noted down word-by-word.

As the goal was to understand the effectiveness of shareholder engagement strategies, both mutual funds and target companies were interviewed, in order to get the perspectives of both sides of the interactions. The study began with fund interviews, allowing for the results from these interviews to be ‘tested’ in the subsequent interviews with target firms. Between the two rounds of interviews there was a two-week intermission to allow for reflection and analysis of the empirical findings hitherto. However, during the intermission, the turbulence and restrictions of Covid-19 exploded, resulting in the interviews with target firms being affected. As a result, fewer interviews were held with target firms (due to the stressful situations for target firms, which made it hard for them to prioritize an interview), and all of the interviews were held by telephone (due to recommendations by the Swedish public health authority).

Concerning the selection of funds to interview, the selection occurred in two steps. The first step aimed to provide a list of funds that met several selection criteria. First, it was decided that the funds must originate from Sweden, as it has been suggested to matter if a fund is Swedish or foreign in terms of sustainability performance and shareholder engagement (Lu, Nacksten, and Brundin 2019). For practical reasons, funds also needed to be based in Stockholm to facilitate face-to-face interviews. As the thesis focuses on how mutual funds impact Swedish companies, the funds also needed to have at least one actively managed equity fund with a significant part of its holdings in Swedish companies.

The second step of selection aimed to provide a final sample with a broad range of funds concerning size, investment strategy and sustainability practices. The funds were reviewed using their websites, and their sustainability practices were further analyzed based on Söderberg & Partners sustainability analysis of Swedish funds (Lu, Nacksten, and Brundin 2019). All funds that met the selection criteria and were evaluated to be among the industry leads within shareholder engagement were approached. This purposeful sampling (In line with Eisenhardt, 1989) was used as the purpose of this study was not to map out the entire landscape of shareholder engagement among funds but rather to understand what best practice looks like. Hence, a prerequisite for a relevant interview was that the funds had extensive experience of shareholder engagement.

In total, eleven funds were approached, of which ten accepted an interview. The initial invitation to the interviews were submitted by the commissioner, as this increased the opportunities to access key informants. It also ensured that all invited fund companies were fully aware of who the commissioner of this report was. After the initial invitation, all communication was handled by the author of this report.

With the funds, the aim was to interview an individual with experience in, or responsibility for, shareholder engagement. In some cases, the fund companies suggested that the interview should include two individuals with different roles, in which case a joint interview was held.

All interviews except three were conducted face-to-face. The average time of the interviews were between 60 to 90 minutes. Table 5 outlines the fund companies that were interviewed.

*Table 5. List of interviews from fund companies*

| ***Fund company*** | ***Position of interviewees*** |
|---|---|
| *Spiltan Fonder* | (1) Fund manager and (2) Communications manager |
| *Catella Fonder* | Fund manager |
| *Odin Fonder* | (1) Fund manager and (2) Regional manager |
| *Norron Fonder* | (1) Fund manager and (2) Relationship manager |
| *Carnegie Fonder* | CIO |
| *Handelsbanken Asset management* | ESG-specialist |
| *Nordea Asset Management* | ESG-specialist |
| *Öhman Fonder* | ESG-specialist |
| *SPP Fonder* | Fund manager |
| *Enter Fonder* | (1) Fund manager and (2) ESG-specialist |

Concerning the selection of target firms, listed companies on the Nasdaq stock exchange were approached. Since large companies, with the same nationality as the shareholder, have been shown to be targeted by shareholder engagement efforts from institutional investors, without any particular sector bias (Sjöström 2009), interview companies were selected from the large- and mid-cap list of OMX Nordic Exchange. This approach is similar to how Sjöström (2009) chose her sample of companies to interview. Furthermore, one unlisted company, Ahlsell, was approached, as they have a unique position from their recent buyout from the stock exchange. This enables them to compare shareholder engagement when being listed and when being PE-owned, which can shed light on important differences between shareholder engagement from different types of owners.

At every target firm, the goal was to interview an individual with experience of the shareholder engagement from funds in relation to ESG. This resulted in the interview was either held with the individual responsible for investor relations or with the individual responsible for ESG-issues. The interviews were conducted by telephone due to Covid-19 and the average time of the interviews was around 60 minutes.

*Table 6. List of interviews from listed companies*

| ***Target Firm*** | ***Position of interviewee*** |
|---|---|
| *Gränges* | Head of investor relations |
| *Ahlsell* | Sustainability manager |
| *Assa Abloy* | Head of Investor relations |
| *Rottneros* | CEO |
| *Telia* | Sustainability Manager |

In addition, Two AP-funds were approached, as they have experience in shareholder engagement at the same time as they do not have the same incentives to use sustainability as a sales pitch as other funds. Hence, their answers were used to triangulate and nuance the information given by the fund companies. The researcher Emma Sjöström also contributed with her advice on how to conduct research within the field of shareholder engagement and provided insight into the current state of the research within the field.

*Table 7. List of other interviews*

| ***Organization*** | ***Position of interviewees*** |
|---|---|
| *Fjärde APfonden* | Head of Corporate Governance |
| *Sjunde APfonden* | Project lead – sustainable investments |
| *Mistra Center for Sustainable Markets at Stockholm School of Economics* | Research manager (Emma Sjöström) |

Ideally, additional interviews would have been held until the theoretical saturation was reached, i.e. when the marginal benefit of adding more interviews would have been minimal in terms of new concepts or ideas emerging from additional interviews (Eisenhardt 1989). However, interviews were planned ahead due to the constraints of time in the 30-credit thesis format. This is in line with Eisenhardt (1989), who suggests that planning the interviews ahead may be necessary if the research is constrained by time or resources, although it is not ideal.

## 4.3 Data analysis

According to Yin (2017), an important part of any case study research is to organize and document the collected data by establishing a case study database. Therefore, a database was constructed where the interview notes, field notes, documents and coding procedures were collected. A database provides reliability to the research, as the conclusions presented in the report can be backtracked to the raw data (Yin 2017). Thus, the aim of the database was twofold. First, the database allowed the researcher to keep track of the collected data, and easily review and compare it throughout the research process. Second, the database allowed for a chain of evidence to be maintained, as it functioned as the link between the raw material and the conclusions presented in this thesis.

One problem that is frequently discussed in case study literature is the staggering volume of data that is obtained, which can make it hard for researchers to process the raw data into insightful conclusions (Yin 2017; Eisenhardt 1989). To mitigate this, within-case analysis was applied, meaning that a short case study write-up was done after each interview, as suggested by Eisenhardt (1989). This included synthesizing impressions and thoughts after each interview with external material from websites as well as information given during the interview. In order to not leap to conclusions, the write-ups constituted of a purely descriptive part, followed by a separate part of loose thoughts and potential conclusions. The aim of this was to allow for the unique patterns and context of each fund to emerge, prior to attempting to generalize patterns across different funds. Having a descriptive part and a reflective part in the write-ups also facilitated the overlap between the collection and analysis of data, as suggested by Eisenhardt (1989) and Glaser and Strauss (1967).

In order to achieve ‘qualitative rigor’ in the research process, a consistent methodology to analyze the data needed to be applied (Eisenhardt, 1989). The methodology to transform the raw data into insights and conclusions was based on the coding procedure proposed by Gioia, Corley and Hamilton (2012), described below.

The first step was to develop first order codes, where the interviews were analyzed by assigning in-vivo codes to the raw data. This approach facilitates the understanding of the respondents, as their own terminology is used. Trying to stay close to the respondent’s experience and perception of the world is argued by Gioia, Corley and Hamilton (2012) to mitigate getting blindsided by already existing theory. As the interviews were not recorded, the in-vivo codes were created from the research notes. A potential risk with this way of coding is that the informants’ views are adopted without putting them in the context of the informants’ own agenda or previous experience. This would inhibit applying higher-level perspectives, which is required to critically reflect upon the gathered data. Therefore, within-case analysis was used to mitigate this problem.

The subsequent step was to develop second order themes. The in-vivo codes were grouped into themes by looking for similarities and differences among the codes. The themes were labeled by utilizing respondents' own terminology as much as possible. This phase allows narratives, relationships and concepts to emerge. A risk with this step is to be blindfolded by existing theory, implying that the codes are grouped according to the researcher's own biases and expectations of what to find. In this phase, the within-case analysis was used to support the conclusions as it allowed the information from the interviewees to be put in context. This allowed for a process similar to what Eisenhardt (1989) describes as a cross-case searching tactics, where comparisons between the contexts and answers from each fund was compared in order to investigate potential similarities and differences. The process was a highly iterative one, based on the suggestions of Eisenhardt (1989) to constantly *'systematically compare the emergent frame with the evidence from each case in order to assess how well or poorly it fits with case data'.* This process resulted in what Gioia, Corley and Hamilton (2012) calls aggregated dimensions, which were used to structure the presentation of the findings in this thesis.

## 4.4 Research quality and ethics

### 4.4.1 Research quality

The above chapter was written with the intent of achieving transparency regarding the methodological considerations and choices of this research. The framework developed by Aguinis and Solarino's (2019) facilitated this, as it describes necessary criteria for a methodology chapter to be sufficiently transparent to enable replication.

Apart from achieving transparency, the above chapters have also put forth arguments of how the methodology ensures that the quality of the research is high. By reviewing methodological literature, much consideration was put into finding a good match between the chosen method and the research question and context, resulting in a balancing act between the ideal situation described by researchers like Eisenhardt (1989) and Yin (2017), and necessary adaptation due to time constraints or to the specific research context. One such adaptation in relation to time was the ahead planning of interviews. Another adaptation in relation to the research context was the choice to not record interviews.

Following Yin's (1994) framework for how to achieve high quality in exploratory case studies, the discussion on the quality will adhere to the dimensions of the construct validity, the external validity and the reliability. The construct validity concerns the data collection and treatment and is improved by utilizing multiple sources of information as well as establishing a clear chain of evidence. Both these measures are described in the above chapter. The external validity concerns the generalizability of the results. The research was designed to improve the external validity by including interviews with both sides of the engagement interaction – to avoid the problems of biases incurred by only including fund managers – as well as actively keeping the sample as diverse as possible. The reliability mainly concerns the replicability of the study, which has been targeted in two ways. First, the framework of Aguinis and Solarino's (2019) was applied when writing the methodology chapter to ensure transparency. Second, a case study database was developed to maintain a chain of evidence.

### 4.4.2 Research ethics

As this research does not include socially or financially vulnerable groups, have direct consequences on people's employment, such as studies of re-organizations or automation could, and is not subject to any unhandled conflicts of interests – such as the researcher being employed to drive a certain agenda, the potential ethical issues of this thesis mainly concerns the data treatment.

The largest concern of the data treatment was to secure the anonymity of the participating interviewees, both as this was promised during the interviews, but also because case study research is built on trust (Yin 2017). Therefore, the anonymity of the interviewees was of the highest priority as the answers could be, and most likely would be, affected by interviewees having concerns about the anonymity of the conversations. This is especially true in this case, as the commissioner of this thesis performs an evaluation, and subsequently publishes a score, of Swedish funds' sustainability efforts. Hence, every interview was initiated with a conversation of the data treatment: where no individual or company identities would be connected to any specific empirical findings, neither in the thesis nor in the conversations with the commissioner or any other party.

# 5 Empirical findings

Below, the key takeaways from the empirical research is presented. The findings have been synthesized from the interviews with funds, corporations, and pension funds as well as from written material such as articles, reports and documents from fund companies.

The structure of the chapter follows the same structure as the theoretical framework, to facilitate the subsequent discussion. First, findings regarding the form and role of engagement dialogue among Swedish funds are presented. Second, the chapter presents the findings relating to the internal structure and processes for engagement dialogue. Third, findings regarding the mechanisms by which engagement dialogue successfully unfolds in the interaction between shareholders and their target firms are presented.

## 5.1 The role and form of engagement dialogue in the Swedish context

The findings regarding the role and form of dialogue in shareholder engagement among Swedish funds will be presented along three themes. First, the general role of dialogue compared to other tools of shareholder engagement will be presented. Following this are the findings regarding different forms of engagement dialogues discussed by the interviewed funds. Third, findings regarding the differences between proactive and reactive dialogue among funds will be presented.

### 5.1.1 The role of dialogue: Dialogue at the heart of ESG-engagement

In the interviews, fund companies described a common set of ‘engagement tools’. These tools were identified to be dialogue, participating and voting at the AGMs, participating in election committees, publishing sustainability analysis of target companies, and actively participating in coalitions and platforms with other investors. The only tool used by all interviewed fund companies was dialogue.

From the interviews, it became evident that fund companies place dialogue at the heart of their engagement efforts. Interviewees also described dialogue to be the most effective tool for shareholder engagement. The emphasis on dialogue in engagements was described to stem from the access that the funds have to the executives of Swedish listed companies. For fund managers, one-on-one meetings with company representatives occur on a regular basis, giving them a strong platform to express their views and opinions. Even smaller funds experienced that target firm executives pay attention to their opinions and views in engagement dialogues, despite their small ownership stakes.

Interviewees also expressed that there has been a change in recent years of what kind of access that is derived from raising sustainability issues in dialogues. A couple of years back, sustainability issues was described to have been handled by a detached sustainability team within the target firms. Today, dialogue was described to have become a more powerful way to impact investee companies, as ESG-issues was described to imply access to top management

However, from a target firm perspective, one investor relations (IR) manager expressed that funds seldom directed questions relating to sustainability to the CEO or CFO. This would indicate that sustainability is still secondary to strategic and financial issues in the dialogues funds have with top management. The IR-manager had even encouraged investors to direct more sustainability questions to the top management in order to put sustainability issues on the agenda.

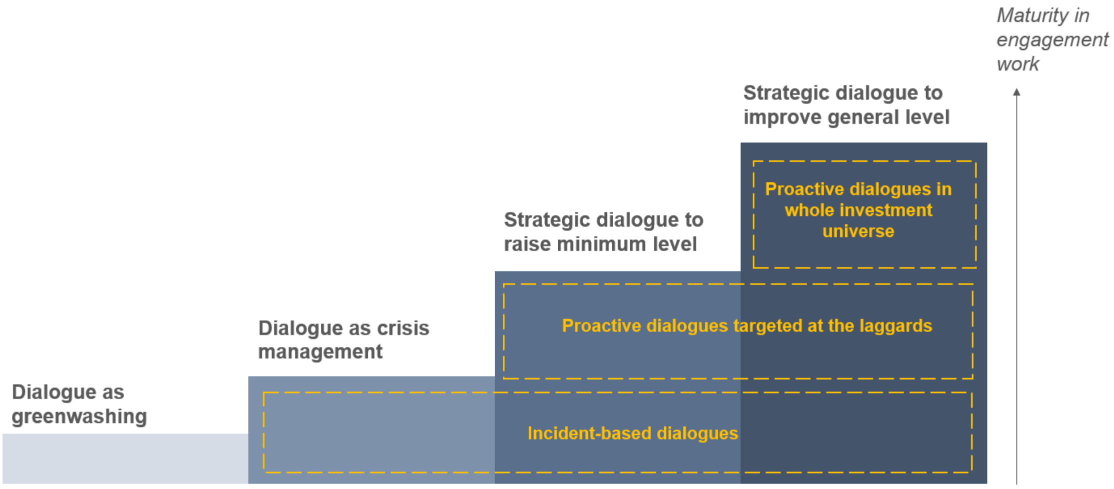
### 5.1.2 Different forms of dialogue

Even though dialogue was generally expressed as a powerful tool of engagement, the opinions were divided among the interviewed funds regarding how and with whom engagement dialogue should be conducted. Building on the different ways of talking about, and doing, engagement dialogues between the interviewed fund companies, four different categories of engagement dialogue were identified. These four categories entail different purposes and scope of engagement dialogues and are classified as Dialogue as greenwashing (1), Dialogue as crisis management (2), Strategic dialogues to raise minimum level (3) and Strategic dialogues to raise general level (4).

A conclusion from the empirical material is that these four categories do not entail equal levels of competence and understanding of ESG-related engagement. Instead, the categories can be organized in a hierarchy depending on the maturity that funds showcased concerning ESG-engagement. The introduction of a hierarchy was motivated by the fact that fund companies on the higher levels had an understanding for the shortcomings of the lower level categories, while the opposite did not become equally evident. The fund companies on the lower levels of the maturity ladder could even show a misunderstanding of the meaning or relevance of certain questions during the interviews, as it was too far away from their perceptions of their responsibilities as shareholders. For instance, one fund manager stated: *"Funds will not be the ones to ask companies the hardest questions. All companies already have sustainability on their agendas."* when asked how funds could contribute more to the ESG-work of portfolio companies.

From this, it became evident that as funds develop a deeper understanding for the added-value of engagement, they will move 'up the ladder' of the different ways to view engagement dialogue. This hierarchy of maturity is displayed in figure 3, forming what I call a maturity ladder.

*Figure 3. A 'maturity ladder' of how funds set the scope of their dialogues, developed from the empirical research*



When dialogue is done as greenwashing, it is reduced to a strategy that exists only on paper, allowing investors to keep owning 'bad companies'. In such cases, the primary purpose of the dialogue is to avert exclusions or divestments, rather than achieving an actual change. Interviewees stated that red flags arise if engagement transparency is low regarding taken measures and achieved change.

When dialogue is done as crisis management, fund companies focus on incident-based dialogue. Hence, little or no proactive dialogue is present, which is motivated by a 'conscious' investment strategy: By including only 'good' companies in the portfolio, proactive dialogue becomes superfluous.

Strategic dialogue occurs when fund companies do not only engage reactively, but also engage proactively to exploit untapped potential or mitigate risks. When it comes to strategic dialogue to raise the minimum level, fund companies primarily target proactive dialogue efforts at industry laggards. This is motivated by the fact that industry leaders do not *'need help'* to improve. At the highest level in the maturity ladder, fund companies understand that there is room for all companies to improve, even industry leaders. As a result, proactive dialogue is used throughout the portfolio of such funds.

The interviewed fund companies were all identified to be on the top three levels. However, the level *dialogue as greenwashing* was added as the interviewees expressed experience of this type of dialogue among other funds.

### 5.1.3 Proactive vs. reactive dialogues

When it comes to the differences between reactive and proactive dialogues, two main themes emerged from the empirical material. First, funds that engaged more proactively showcased a larger degree of maturity regarding ESG-engagement than funds with less proactive engagement, as described above. Second, the internal processes among the fund companies were shown to differ between reactive and proactive dialogues.

As reactive dialogues might also imply a damage of trust between the owner and the company. However, fund companies emphasized that it is not the unexpected incident in itself that usually evokes distrust. Rather, distrust is created from any subsequent failure from the target firm to acknowledge the problem, present a clear plan to mitigate the consequences of the ongoing situation and show a commitment to improve their practices. As a result, fund companies described the importance of *how* the target firm management talks about the incident in reactive dialogues, and specifically, if it is done in a way that evokes trust. Exactly how this is evaluated by fund companies was more unclear. In fact, the evaluation of target firms during reactive dialogues was often described to boil down to a gut feeling regarding the target firm culture and willingness to improve.

The threat of damaged trust associated with reactive dialogues was described to result in more clear-cut and urgent expectations of improvements compared to proactive dialogue. There was also described to be a more immediate threat of divestment if the target firm does not meet expectations, due to the fact that a failure to meet expectations in a reactive dialogue would imply that the fund company can no longer trust that the target firm will act as promised, raising concerns of the risks involved in the ownership. However, if a dialogue would come to the point of divestment, it was emphasized that the processes is not necessarily binary. Instead, a fund company might reduce their holdings successively as long as the dialogue is not fruitful.

As mentioned, fund companies demonstrated higher maturity, in terms of processes and standards, when it came to reactive dialogues compared to proactive dialogue. From the empirical material, an explanation to this would be that reactive dialogues are directly material to funds in a way that proactive dialogues are not. In a reactive dialogue, the value of the portfolio as well as the trust between the fund and the target firm is under a much more direct threat. As a result, funds need to take on a defensive role to protect their assets. Hence, fund companies have more clear-cut expectations and processes in place for reactive dialogues than they do for proactive ones.

## 5.2 Internal structures to support engagement dialogues

The internal structures for engagement dialogues were found to not only relate to the actual organizational structure, but also to the approach funds had to engagement dialogues. Below, findings are presented regarding funds’ organizational approaches, meaning how funds can create efficient workstreams and maximizes responsiveness from target firms in dialogues through the right approach. In addition, the empirical material points to a need to have processes in place to evaluate engagement dialogues in a way that enables learning and continuous improvement. Therefore, findings regarding evaluation will be discussed separately towards the end of this section.

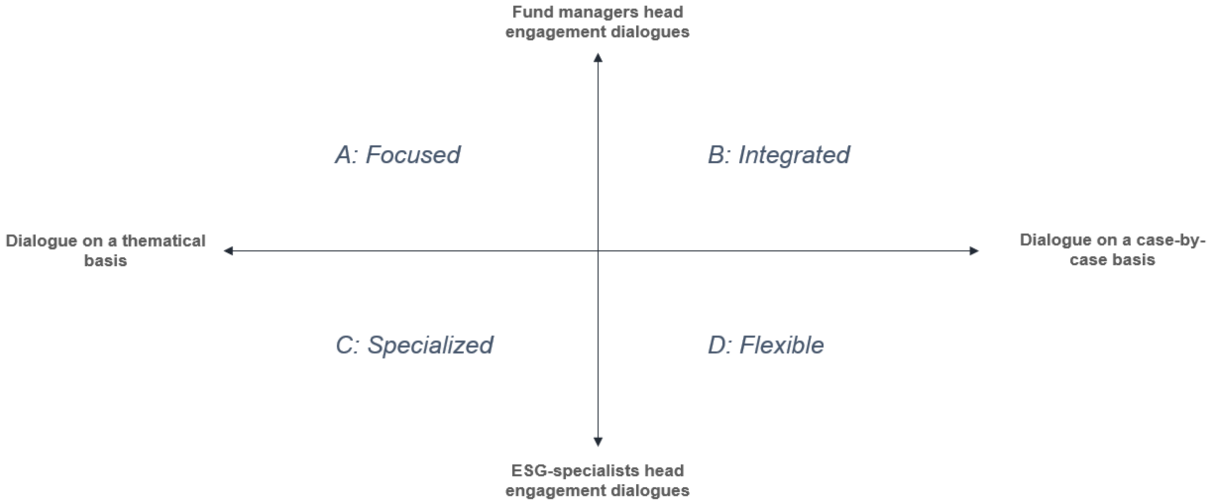
### 5.2.1 Organizational approach

From the interviews, two key questions emerged that all fund companies had considered in relation to engagement dialogues, namely Should we have a thematic or case-by-case approach? (1) and Should a specialized team or a fund manager drive the dialogue? (2)

The two identified questions give rise to two main dimensions along which fund companies were found to organize their proactive dialogues. The first dimension concerns the division of labor. A fund company can either choose to have a separate sustainability team in charge of the proactive dialogues, or it can choose to have fund managers in charge of the dialogues. The second dimension concerns the structure of how problems are approached and prioritized, which could either be done on a thematic or case-by-case basis. Regarding the thematic approach, some fund companies based their thematic approach on the UN SDGs, which implies a long-term commitment to focus on a few global challenges. Other fund companies based their thematic approach on different sectors and focused their proactive dialogues on one sector at a time, before continuing to the next sector.

By applying these two dimensions, four distinct strategies for how Swedish funds organize their engagement dialogues emerge, outlined in figure 4.

*Figure 4. The different strategies of engagement dialogue identified through interviews*



A. *The focused strategy*
The focused strategy implies that the fund managers are responsible for the proactive dialogues, but the proactive dialogues are done thematically to allow for a clear resource prioritization.

B. *The integrated strategy*
In the integrated strategy, the proactive dialogues are managed by fund managers on a case-by-case basis. This allows for the proactive dialogues to be fully integrated into the investment process, as the fund managers are not directed by any themes but can choose to engage where they see the biggest needs.

C. *The specialized strategy*
In the *specialized* strategy, a dedicated ESG-team works thematically, which allows for a clear resource prioritization and building expertise.

D. *The flexible strategy*
The fourth strategy is the *flexible* strategy, where a separate team is in charge of dialogue, but does so on a case-by-case basis, allowing for a more flexible cooperation between the sustainability team and the fund manager compared to the specialized strategy.

However, there are notable differences between proactive and reactive dialogue, where the above matrix is more applicable to proactive dialogues. As reactive dialogue is driven by incidents, fund companies cannot predetermine the issues to center the dialogue around. Therefore, the first question (1), concerning how to focus and prioritize dialogues. is not equally relevant for reactive dialogue as it is for proactive dialogue, where funds have more freedom to choose the approach of the dialogue.

The second question (2) concerns how the dialogue should be organized in terms of labor division. Although this question needs to be answered for reactive dialogue, the issue of resources is more crucial for proactive dialogue for two main reasons. First, funds take on a defensive role in reactive dialogue as their assets are under a more immediate threat, making resources for engagement easier to prioritize. This is for instance illustrated by the fact that fund CEOs were found to be more involved in reactive dialogues than in proactive dialogues. Second, the possible engagements in proactive dialogues are potentially unlimited in a way that do not hold true for reactive engagement. This makes the issue of resources a key issue when it comes to proactive dialogue.

In addition, it should be mentioned that the choice between the four different set-ups are not binary, and a fund can choose to have a combination of a thematic and case-by-case approach, as well as having the sustainability team support the fund managers to various degrees, or vice versa. It should be emphasized that the different choices cannot be ranked in terms of effectiveness. Instead, each fund company must evaluate what strategy they believe to be the most efficient depending on factors such as their organizational structure, their in-house competence, their time horizon and relationship with portfolio companies. However, each strategy has both upsides and potential problems. For the interested reader, four cases are outlined in appendix I, describing how four different fund companies were found to work according to the different approaches.

Below, the tradeoffs that were found along the two dimensions are expanded upon.

### 5.2.1.1 Tradeoffs along the y-axis

Fund companies that had fund managers in charge of dialogues emphasized how sustainability directly affects the investment alpha. Sustainability was therefore described as an essential part of the investment process, making proactive dialogues inseparable from the role of the fund manager. Furthermore, the funds emphasized that proactive ESG-dialogues can benefit from the fund managers’ existing relationships with portfolio companies. As the fund managers have built up trust and legitimacy by continuous interactions with portfolio companies on other matters, ESG-dialogues were described to be facilitated.

However, whenever the fund manager was responsible for proactive dialogue, the time and ESG-related knowledge of the fund manager was described to be the delimiting factors. Interviewees stated that ESG becomes increasingly important to fund customers, at the same time as the financial sector faces more legislative demands on being responsible investors.

As such, the extra work related to ESG was described to be added on top of the regular work of the fund manager, placing a heavy responsibility on the fund manager to make time for engagement.

When the dialogue was organized through a dedicated sustainability team, the time of the fund manager was no longer the delimiting factor. This was described to removes some practical problems of dialogues, as a fund company can simply enlarge the sustainability team if resources or knowledge are scarce. Fund companies that organized their dialogues through a specialized team also emphasized that the fund managers simply do not have sufficient time or ESG-knowledge to manage the dialogue processes in a satisfying way.

*“There are large benefits of having ESG-specialists in charge of engagements, as we can work more dedicatedly compared to fund managers. Having the fund managers do engagements might be rationalized by their continuous interactions with corporations. However, that kind of sustainability discussions stay on a general, shallow, level. To be able to call a discussion an engagement dialogue, there needs to be structures, clear purposes, goals and deadlines. Fund managers have their background and competence, but engagement requires a certain competence and experience that fund managers do not have.”- Fund ESG-specialist*

This view was also shared among the interviewed target firms:

*“Fund managers usually have support by ESG-specialist when discussing ESG-issues with us, or the discussion is held separately with ESG-specialists. There are not many fund managers that are sufficiently knowledgeable within ESG to be able to have such a discussion on their own” – Target firm representative*

Interviewees stated that a key challenge of having a separate team managing the dialogue is that the sustainability team needs legitimacy, both internally and externally. With high internal legitimacy, dialogues are more easily integrated into the fund management, which was described as important for two reasons. First, it ensures that the dialogues are centered around material issues to the fund company, and hence contributes to increased portfolio value. Second, the outcome of a dialogue must result in consequences for the investment decisions if necessary, otherwise the dialogue lose its credibility. As it is the fund manager, and not the ESG-specialists, that has the ultimate decision to invest or divest, interviewees emphasized that the ESG-team must be both integrated and respected in the organization. Otherwise, a fund manager might not be prepared to let unsuccessful dialogues have consequences in their investment decisions.

*The fund management needs to be up to speed with the engagement dialogues. For us to be serious in stating that we conduct engagement dialogues, the dialogues need to have* *consequences in our investments. Therefore, there needs to be a strong consensus within the organization on these issues – Fund ESG specialist*

When it comes to external legitimacy, a separate sustainability team might not have the natural legitimacy among target firms as fund managers, since they do not have the same continuous dialogue on a wide range of issues that allow fund managers to create trust and legitimacy over time. In addition, they do not have the same opportunity to develop a deep understanding of specific companies or sectors that fund managers receive from a continuous dialogue with a target firm's executives. As one ESG-specialist put it: '*The ESG-team simply do not interact with corporations the same way as fund managers do.'*

### 5.2.1.2 Trade Offs along the x-axis

*"The challenge is to do as much as possible with as little as possible. A lot of the work relating to fund management will be automatized, but sustainability and responsible ownership will only become more important. We therefore need to dedicate more resources to do more"* – Fund ESG-specialist

A thematic approach was not only described to help funds prioritize resources of engagement, but also that it enables individuals to acquire expertise in the chosen area. Interviewees stated that this facilitates dialogues, as the individual will have more knowledge about the issue, and hence will be able to ask the right questions, provide portfolio companies with better advice and more fine-tuned demands or suggestions.

However, a thematic approach was suggested to create a detachment from the fund management, as the individuals doing engagement dialogue work according to themes rather than allowing the fund management and target firms to guide the dialogue. Hence, interviewees emphasized that it is integral to have a solid materiality analysis when themes are chosen to make sure the dialogue is meaningful to the fund as well as to target firms. In a case-by-case approach, the dialogue was described to become more flexible to align with fund management: If the fund manager heads the dialogue, he or she can choose to engage in issues where they have the greatest expertise or assess the needs to be the greatest. If a specialized team is in charge of the dialogue, a case-by-case approach allows for a more flexible dialogue and cooperation with the fund management.

As the potential proactive dialogues are practically unlimited with a case-by-case approach, interviewees emphasized the importance of establishing frameworks and supporting infrastructure to choose the most impactful cases. Furthermore, a case-by-case approach was described to make it harder to build the necessary depth of ESG-expertise needed to achieve impactful dialogue in each case.

#### 5.2.1.3 Improving the internal structure

Several of the fund companies discussed how they work to improve their internal structures to support engagement dialogues better. For the funds with fund managers in charge of engagement dialogues, improvements of the internal structures were mainly shown to focus on relieving fund managers' workload. For fund companies that organized their dialogues through an ESG-team, improvements were found to mainly target the integration of engagement dialogue in the fund management.

Funds that had a separate ESG-team (regardless if they had a supportive role to fund managers or were in charge of engagement themselves) emphasized the importance of close collaboration between the ESG and investment teams. Five main factors were mentioned to facilitate collaboration. First, funds emphasized the advantages of having the ESG and investment teams working in close physical proximity to enable knowledge transfer and informal collaboration. Second, assigned teams consisting of both sustainability specialists and fund managers working each 'dialogue case' helped create formal channels of collaboration. Third, having a cross-organizational body that discusses ongoing dialogues was also said to facilitate the integration of dialogue into fund management. Fourth, emphasis was put on creating knowledge transfer through technical solutions, such as routines for information sharing or by setting up databases. Finally, funds emphasized that there must be consensus in the organization on how sustainability is valued, and what role it should play in the investment processes. Through this, disagreements between the fund management and the ESG-team can be used constructively as cues of when to initiate dialogues.

*'You do not always agree with the fund management. If anyone told you that there are no clashes between the ESG and fund management team, they are lying. But many dialogues stem from such divergency, as the ESG-team might see the ESG-challenges while the fund managers see an interesting investment case. Then you know you should try to engage with that company to reduce the sustainability risks.' – ESG-specialist*

Relating to the importance of technical solutions, funds frequently highlighted the importance of having supporting infrastructure to facilitate the engagement processes, especially by enabling employees to free up time for actual dialogues. Such supporting infrastructure could aim to integrate ESG in the investment analysis, sort through public information or track and evaluate dialogue processes. A key piece of infrastructure that most funds claimed to have was a database allowing fund managers or ESG-specialists to track and evaluate their own and others dialogue processes to facilitate cross-organizational learning. Another key piece of infrastructure was described to be standardized tools and frameworks for ESG-analysis.

The interviewed funds described a flood of ESG-information from third party service providers, news outlets and portfolio companies. As a result, especially fund managers described that they struggle with keeping track of, and sorting through, the available information. Therefore, infrastructure that facilitate sorting through the available information was described to allow individuals to prioritize resources towards dialogues rather than acquiring information. As an example of this type of infrastructure, one fund company was in the process of developing a text analysis tool aiming to analyze information from news channels, social media and regulatory bodies to detect trends and potential risks. An important aspect of this tool was described to be its ability to illustratively depict information and categorize it as either an E, S or G issue, allowing fund managers to easily overlook developments and trends on a company and industry level.

In the interviews, funds also acknowledged that the role of the fund manager is changing in terms of the requirements of ESG expertise (especially if the fund manager heads ESG-engagements). Apart from having supporting infrastructure and a supporting ESG-team, engagement dialogue was said to benefit from additional measures that help fund managers prioritize engagement dialogues.

*"Fund managers do not need financial incentives to be risk averse, it is their job to be risk averse. However, incentives nudge them to prioritize ESG-issues and engagement among all the other things they need to do" – Fund manager*

The quote above illustrate the fact that fund companies that are serious about engagement dialogue through fund managers should align their incentives to support fund managers that engage. Despite this, very few of the interviewed fund companies had incentives for proactive dialogue in place. Another potential issue with the fund managers being responsible for engagement dialogues was described to be their (insufficient) knowledge about ESG-related issues and dialogues. Having supporting infrastructure helps, but the interviews also suggested that fund companies must equip their fund managers with the knowledge they need in order to identify relevant sustainability issues for each company, and discuss these in an informed way with target firm management. Interviewed fund companies pursued this through education or by enabling knowledge transfer between fund managers and internal or external ESG-specialists.

Concerning engagement dialogues through ESG-specialists on the other hand, funds especially emphasized three things to mitigate the problems of external legitimacy of the ESG-team. First, by involving fund managers in their dialogues, the ESG-team can draw on fund managers' existing legitimacy and established relationships with target firm management as well as their firm-specific knowledge. Second, by participating in the regular meetings between fund managers and target firms, the ESG-team can build legitimacy, firm-specific knowledge, and relationships of their own. Third, working through investor platforms and coalitions enables the ESG-team to draw upon the legitimacy of these external platforms and organizations.

### 5.2.2 Evaluating the effect of engagement dialogues

Although most interviewed funds kept track of their actions related to engagement (such as companies responding to letters, number of dialogues or AGM participation), fewer recorded the effect of these actions. The general truth of *what gets measured gets done* therefore introduces problems when it comes to shareholder engagement through dialogues, as it became evident in the interviews how difficult it is for funds to quantify and measure the *effect* of their dialogues. Without a solid method to evaluate engagement dialogues, funds can neither learn from nor incentivize engagements in an effective way.

In the interviews, two main problems were brought up relating to the measurement of the effect of engagement dialogues. First, the dialogues were described to stretch over large time spans, with any implemented changes often being a compromise of the suggestions brought up in the initial discussion. This was suggested to create difficulties for funds in determining when an engagement is successful. Second, difficulties were described in relation to determining which company action that originates from the engagement efforts of a specific shareholder (or even stakeholder), making it hard for funds to evaluate the effectiveness of their separate engagement strategy.

Funds stated that when they pursue tangible company actions in dialogues, such as KPI fulfillment rates or the introduction of new policies, it is easier to follow the progress over time. However, measuring the effects of dialogues was usually described to be more problematic. One fund company expressed that they measure the results of their dialogues in relation to the goals and purpose that were set up when they initiated the dialogue. Another fund company expressed that they measure the long-term development of the stock price as they believe that a target firm that manages sustainability well will also yield better return. Although this is an expression for a holistic view on sustainability in relation to target firm performance, it makes it hard to evaluate the effectiveness of specific engagement strategies.

Furthermore, interviewees emphasized that different types of sustainability issues have different levels of standardization and measurability. While certain environmental aspects are easy to quantify, social issues such as human rights are harder to measure, calculate and evaluate, making the dialogues less tangible and harder to follow-up. At the same time, environmental issues can lack a standardized way to measure, which makes it hard to compare performances between companies and sectors. For instance, the fact that the carbon footprint of a company can be calculated in many different ways was one such challenge that was highlighted throughout the interviews. One fund manager even argued that before the entire financial sector has a unified way to quantify $CO_2$-equivalent emissions and transfer these to monetary values, fund companies will not prioritize climate-related engagements enough.

From a target firm perspective, one possible approach to the issue of evaluation was suggested to be a joint evaluation by target firms and funds of an agreed topic:

*"It could be valuable to set a common goal between companies and investors, with a clear KPI that would be reported and evaluated on a quarterly basis. In that way, we would be 'forced' to report to the investor, which would result in a continuous relationship. In that way, the investor would show that they are committed and interested. They also get something to comeback to, centering dialogues around why we miss the target (if we do so)"*
– Target firm representative

Overall, the empirical material suggest that any evaluation of engagements dialogue need to be qualitative rather than quantitative. Interviewees themselves directed criticism towards their own providers of ESG-analysis, deeming their approach to evaluation corporate sustainability too simplistic and quantitative. The lack of qualitative components within such evaluation was highlighted by virtually all fund representatives as a problem, as a purely quantitative evaluation did not accurately reflect the level of sustainability within a target firm. Likewise, funds themselves should not exercise a black and white approach to engagement evaluation in order for their customers to correctly evaluate the level of sustainability within a fund. Hence, rather than only counting the number of dialogues held or number of companies responding to a letter, qualitative components should to be present in the evaluation.

## 5.3 Mechanisms by which engagement dialogues successfully unfolds

From the interviews, it is evident that both funds and target firms believe owners are salient stakeholders. As such, funds, as owners, were described to have large opportunities to influence companies they invest in. As one firm representative stated: "*We listen to our owners, and they are probably the most important stakeholder to us when it comes to our sustainability practices."*

However, the empirical material also made it clear that shareholder salience does not come without effort. Instead, several critical factors and mechanisms were discussed by interviewees in relation to what makes shareholder dialogues unfold successfully. These mechanisms, that make target firms adhere to shareholder expectations in dialogues, are described below, according to the same three categories as in the theoretical framework, namely; the characteristics of the shareholder (1), the characteristics of the target firm (2) and the characteristics of the communication (3). In addition, the empirical findings include an additional theme, namely how funds leverage other engagement tools in dialogues to achieve adherence.

### 5.3.1 Shareholder characteristics

In order for engagement dialogues to unfold successfully, interviewees emphasized the importance of funds having the necessary understanding of ESG issues in the specific company context to be able to ask the right questions. In fact, the ESG-expertise and credibility of the fund representative was the main shareholder characteristics mentioned in the interviews in relation fruitful dialogues.

#### 5.3.1.1 Asking the right questions

When it comes to asking the right questions, there is inevitably a knowledge-gap between funds and target firms regarding sustainability, and interviewees described that it is hard for investors to be adequately initiated with the next steps of a company's sustainability development to ask sharp and concrete questions. In fact, one fund ESG-specialist expressed that firm representatives often become surprised when asked *concrete* questions about sustainability, implying that target firms are simply not used to having funds (or other investors) ask concrete questions about ESG issues. Instead, the empirical material suggest that funds usually ask more general and norm-based questions about sustainability.

To explain the tendency for funds to rely on general norm-based sustainability questions in their shareholder dialogues, two issues were raised. First, fund companies were described to face difficulties in accessing the right information (1). Second, fund companies (and especially fund managers) were suggested to lack sufficient competence to transform this information into relevant questions (2).

Concerning the information issue (1), a fundamental problem was described to be insufficient transparency regarding the sustainability challenges, goals and practices of target firms. Especially for smaller target firms, sustainability disclosure can be inadequate, leading to an engagement dialogue centered around increasing target firm transparency. Even for larger companies with comprehensive sustainability reporting, there is an issue of target companies framing the information given. During several fund interviews, Ericsson and Swedbank were used as examples to highlight the problem of accessing the *right* information, even though target firms release extensive sustainability reporting. In the cases of both Ericsson and Swedbank, investors did not see the respective bribery (2014) and money laundry (2019) scandal coming, despite having access to extensive sustainability reporting. This highlighted the problem with target firms having an interest in keeping up the appearance, deterring disclosure of important sustainability challenges (that funds would want to engage around), both internally and externally.

Concerning the competence issue (2), the view among target firms was generally that fund representatives lack sufficient knowledge to address ESG-issues through dialogues in a meaningful way. However, interviewees also emphasized examples of funds that “do their homework” and are well versed with the specific challenges of target firms. The common denominator for these examples were either that funds had knowledgeable and influential ESG-specialists or that the fund manager had a strong personal engagement regarding ESG-issues. Concerning funds with insufficient ESG-knowledge, three main problems of how funds conduct engagement dialogues were discussed.

First, target firms expressed that fund companies mainly seek reassurance in dialogues rather than trying to understand the specific ESG-challenges at hand. A couple of interviews also pointed to the fact that the sustainability knowledge among shareholders such as funds is very low, resulting in shallow or irrelevant questions being raised by these shareholders.

*“My experience is that fund companies mostly want to rate us, giving us a three or a five to be able to communicate some important percentage around their portfolio. They just want to be reassured and check things off their list. Also, they never bring us suggestions”* – Target firm representative

*“We should be asked to verify everything we say with documents. But no fund company has ever asked me for ‘proof’ that we actually follow through on what we say.”* – Target firm representative

Second, target firms experienced that fund companies rely too heavily on checklists. This was described to lead to dialogues where funds focus on ‘ticking a box’, rather than focus on understanding the material ESG-issues or providing suggestions. When fund companies conduct dialogues in this way, target firms expressed that it becomes harder to be transparent with their ESG-challenges. One target firm described such dialogues as *“showcasing what we do good rather than talking about our opportunities to improve”*. In fact, the target firm representative stated that “*no fund company has ever ‘seen through’ this kind of framing in dialogues and been able to identify the significant weaknesses of our sustainability work*.” Hence, conducting a dialogue based on checklists seems to imply that funds lose out on valuable information.

*“I understand that funds would want to check things off their lists, but that is to cut corners. You also have to be able to see through the fancy presentations and identify the weaknesses. The dangers of checklists and ratings are that the whole discussion become too simplified”* – Target firm representative

Third, target firms expressed that fund companies are often too focused on a specific set of predetermined ESG-issues, which might make them miss the real challenges. As an example, one company described a meeting where a fund manager had been completely focused on waste and recycling in the dialogues. For this firm, waste was only a small fraction of their environmental footprint, which made the discussion almost irrelevant, as there were far greater challenges to discuss.

*"Instead of caring about the essential problems and challenges for our company, they might pursue some predetermined ESG-issue really hard, without understanding that that problem is totally irrelevant for us compared to our other sustainability-challenges."* – Target firm representative

#### 5.3.1.2 Mitigating the knowledge-gap

In order to mitigate the knowledge-gap between investors and target firms, three things were highlighted in the interviews.

First, emphasis was put on the fact that dialogues need to be the end result of a thorough sustainability analysis, otherwise funds will have a hard time asking sharp questions. An important aspect of a such a thorough sustainability analysis was mentioned to be data triangulation. For instance, only relying on the ESG-reports by third party service providers was criticized[3].

Second, one fund ESG-specialist highlighted that funds can identify relevant issues to initiate dialogue around by tracking *how* target firms communicate regarding their sustainability targets. To further explain this method, the Swedish company AAK was used as an example. AAK set an ambitious goal to reach one hundred percent traceability in their supply chain in order to avoid unethical palm oil. This ambitious target earned AAK a reputation as a business-leader within sustainability, which drove a lot of interest from investors. However, AAK was constantly missing the target, as it was extremely difficult to achieve those last percentages of traceability. Gradually, AAK started changing their communications around this target, making it evident, for anyone following AAK's communication regarding its sustainability targets, that complete traceability had lost its former importance. Hence, by tracking *how* firms communicate around their sustainability goals instead of only tracking the actual goals, key information can be gained to center an engagement dialogue around. However, the empirical material suggests that this opportunity is often overlooked by investors, creating an area of untapped potential for funds to improve their practices of identifying relevant areas to initiate dialogue around.

Third, funds were encouraged to better use the opportunity to learn from the sustainability teams of their investee companies. Specifically, one sustainability manager urged funds to reach out to the sustainability teams of their holdings, asking for help to learn more about effective shareholder engagement from the target company directly. For instance, by asking

---

[3] The criticism was centered around the fact that the data is not only lagging, but also inadequate. As these tools are built on 'ticking a box' without assessing the underlying quality of a company's sustainability work, such tools do not provide sufficient guidance to evaluate a target firm's sustainability work. Interestingly, while some funds raised strong criticism towards the binary analysis of third-party service providers, other funds used their purchases of such tools as an argument for their commitment to responsible investments. This illustrates the discrepancies between different funds on what constitutes a good strategy to mitigate the knowledge gap between funds and target firms.

what types of ESG-questions a target firm usually gets from investors, funds can avoid asking the same stereotypical questions themselves. The sustainability manager stated that he would happily have such conversations with investors, saying it would be an excellent way for funds to mitigate the knowledge gap.

### 5.3.2 Target firm characteristics

An important target firm trait for successful engagement dialogues was described to be target firm culture.

*'The company culture is the key to everything. How the company reacts when they face problems, if they are careful with their resources etc., it all comes down to culture. Are company representatives talking about sustainability in a genuine and interested way, or are they just talking from a script? Understanding the culture is key to understand if a company live as they learn'* – Fund manager

*'If we identify a good leader, we stay with that leader because of the culture we know he or she can create. This means that we can follow that leader in our investments when they change company, if they are known to create good corporate cultures.'* – Fund manager

From the interviews, it also became evident that there is no single model of engagement or dialogue that fits all target firms. Instead, a common answer in the interviews was *'it depends on the target firm' and* interviewees emphasized that an important factor to successful engagement is to take on the *'right role'* in each dialogue.

From the interviews, the *right role* was often said to be dependent on the needs of the target company. In turn, the needs were generally said to depend on the size of the firm, as size was thought of as a good indicator of a firm's experience in ESG-issues and investor relations. In addition, the size of the ownership stake was said to impact the approach funds must have in engagement dialogues.

#### 5.3.2.1 The right role depending on target firm size

When it comes to sustainability, funds expressed that they have more to offer smaller firms in terms of experience and knowledge. For a small firm that might be inexperienced in sustainability reporting or practice, the dialogue was described to mainly function as a forum to raise and test ideas. For example, one fund manager described their role in dialogues with small companies as that of a "*sounding board"*, where the fund brings new competences and perspectives to the discussions, to the benefit of the target firm.

*"In the Swedish context, it is easier to get adherence in dialogues with small companies that haven't worked with ESG-issues before. They start from a low level of knowledge at the same time as it is easier for us to establish relationships with the management. Also, smaller*

*companies are more agile and fleet-footed, so it is easier for them to implement changes. With larger corporations, you have to get through IR, and large cap companies executives might not respond, even when it is our CEO that sends them a letter.”* – Fund ESG specialist

For larger companies, funds describe that they have less to offer in dialogues, as the target companies themselves have dedicated teams working with ESG-issues. Hence, the role of the funds was therefore described as more normative rather than consultative, where they, by conveying their expectations on sustainability and raising concerns, can help steer or nudge the direction of larger companies. However, many interviewees emphasized that the normative power is bound to the larger investor community, where the power lies in the fact that there are many investors asking the same questions.

### 5.3.2.2 The right role depending on the ownership stake

From the interviews with both funds and target firms, it became evident that the outlook to influence portfolio companies is bound to the ownership stake. Although this was said not to be a linear relationship, both the interviewed funds and target firms agreed that the ownership stake plays into how funds can impact their portfolio companies. One fund manager described it as: “*A company would not cater to radical suggestions if you do not own something like twenty percent. If you are a small shareholder who puts forward such a proposition, the company would listen to your suggestion, but nothing would happen.”*

Interviewees described that large owners have a better outlook to push hard and more radical demands, while smaller owners have to adopt a coaching role. As one investor relations manager stated: “*If you have one percent of the shares, you will have a hard time impacting large strategic decisions. However, you can still push at the edges and if you provide suggestions in a coaching manner, I will listen.”*

## 5.3.3 Communication characteristics

In order to achieve successful dialogues, all interviewed fund companies agreed that the dialogues need to be based on collaboration and contribution rather than on complaints and hard demands. Although some fund companies advocated for dialogues based on concrete demands, while others advocated for an approach based on nudging and encouragement, all interviewees agreed that the style of communications needs to be friendly rather than aggressive. Furthermore, a key approach to successful dialogues was described as centering the communications around a strong business case and focusing on creating a consensus regarding the problem definition.

#### 5.3.3.1 Contributing in engagement dialogues

*"Almost all interactions with funds are passive interactions. For example, we can be evaluated by Sustainalytics, allowing funds to use that information in some analytical model. Among the active interactions, these are mostly related to information-gathering. For instance, we can be asked to answer three questions in an email, fill out an excel-sheet or be asked to give our view on a recent event. Funds seldom try to offer us suggestions."* – Target firm representatives

When asked how to achieve influence as shareholders, interviewees among both funds and listed companies emphasized the importance of shareholders having something to offer in engagement dialogues. If a shareholder does not have formal power to offer in a dialogue (through a large ownership share), the shareholder needs to contribute with either knowledge or information. For instance, one firm representative highlighted how a small fund, with a minimal ownership stake, had gained influence through engagement dialogues: *"They make tough demands at the same time as they are realists, they are friendly, knowledgeable, constructive, and know what they are talking about".* The firm representative contrasted this against shareholders that offer nothing in dialogues: *"Passive owners sending mass emails and surveys do not contribute anything to us, so why should we listen?"* In fact, several target firms described a similar reasoning, where they often get mass emails or surveys from funds where they are asked to check boxes or provide general information, which rather deteriorate their perceptions of fund companies as committed and knowledgeable when it comes to sustainability. Such communication was even described as *lazy* by one investor relations manager, as the surveys or emails would often ask for information that could easily be found elsewhere, such as emission data from the annual reports.

Furthermore, it was suggested that small funds with extensive ESG-knowledge can offer more than the knowledge itself in dialogues. One company highlighted the importance of listening to ESG-oriented funds, even if they have a small ownership stake, as they provide a cue of what will be the important sustainability issues in the future. Hence, dialogues with such funds was described to provide an opportunity for target firms to get in the front of new norms regarding ESG in their industry.

From a target firm perspective, funds were encouraged to try to contribute to the sustainability work of their portfolio companies more actively. For instance, one sustainability manager suggested that funds could utilize the opportunity to provide feedback better, for instance by reaching out with: *"We have some feedback on your sustainability report - let's discuss".* The benefits of being an active owner was highlighted by several target firms. Not only because it resulted in more interaction overall, but because active owners were described to be the owners that target firms reach out to themselves when they want feedback or support. Therethrough, opportunities for funds to have an impact on material issues for target firms increase.

### 5.3.3.2 Having a strong business case

From the interviews with both funds and listed companies, the business case of any suggestion put forward emerged as one of the most important factors in order to achieve adherence in engagement dialogues[4]. Most interviewed target firms even agreed that arguments trump ownership stake in most cases.

*There has to be a business case for your suggestions. You have to show what others do, and create peer-pressure from competitors. Then suggest a way forward for them to become industry leaders, or at least not industry laggards* – Fund ESG specialist

From a fund company perspective, the most common way to communicate the business case was described to be through activating a peer-pressure mechanism, either by presenting the target firms with the risks of becoming laggards and losing customers, or by presenting them the opportunities to achieve best practice in the industry. Funds also described how they try to leverage the common interest between them and their portfolio companies. By leveraging the common interest, mainly by conducting dialogues with benevolence and an understanding of the company context, the target firms were described to become more likely to acknowledge the benefits of the suggestions put forward.

Several fund companies described their most important task as owners as conveying to portfolio companies how and why sustainability is value-adding. Through this, funds argued that they can have a wider effect than a single ESG-issue, as companies will accelerate the transition on their own when they see the added value of sustainability in a single area (for instance in terms of their cost of capital). A prerequisite for starting this ‘chain-reaction’ was described as funds being able to present a ‘proof of concept’ of the added-value of sustainability, meaning an initial suggestion for improved sustainability with a strong business case. Hence, the business case was described to allow funds to use their ownership position to initiate a larger process of change, rather than only making target firms listen regarding a single ESG-issue.

---

[4] Target firms stated that a major challenge in order to be responsive to investor demands is the associated investments. For example, if investors raise demands of a reduced carbon footprint, it will most likely require large investments from the target company. These investments will entail large uncertainties in the investment calculations, especially as green investments often have a long payback time. Such uncertainties regarding profitability create difficulties in motivating investments for target firms. This highlights the importance for investors of having a strong argumentation to why any suggestion makes sense business-wise, outside of vague arguments of long-term changes in legislation and demand, in order for companies to adhere to their suggestions.

### 5.3.3.3 Consensus regarding the problem definition

Several fund companies described that without a common problem definition[5], there is no point of engagement, as there is simply no outlook of mutual understanding. In such cases, divesting was considered the obvious choice in most situations.

*'We had a dialogue with an international company on their environmental impact, but our views on the issue was just fundamentally different. Therefore, any dialogue would have been pointless. There needs to be a common view on the problem for a constructive dialogue to be possible whatsoever.'* – ESG-specialist

### 5.3.3.4 Communicating with the right person

From the empirical material, it is suggested that the 'right communication' also needs to be directed towards the 'right' individual within the target firm. As one ESG-specialist put it when asked about key factors to achieve a successful dialogue: *"It can be as simple as establishing a good connection with the right individual within a company. For instance, I recently met an individual at an investment conference, it happened to be the right person to approach, and we had mutual interest in improving the same issue".*

To facilitate this, funds described the importance of having a clear strategy of who to approach to gather the right information, and how to escalate the process throughout the organization. In addition, a fund's ability to approach the right person was described to depend upon their understanding of the issue, as the 'right person' could turn out to be radically different than what first had been expected. As an example, one of the pension funds described how they had been focusing on the slave-like working conditions within the supply chain of a certain food. By traveling to the farms and factories, they understood that the driving force behind the slave-like conditions were not greed and misconduct of some 'bad apples' among the owners of the farms. Instead, the relentless price pressuring from Swedish grocery suppliers (among others) limited the opportunities of fair pay. In order to raise this issue, they realized that any engagement dialogue was necessary to target at the purchasing departments within the grocery suppliers. A dialogue targeted anywhere else would not have the desired effect. Furthermore, they realized that in order for the issue of slave-like working conditions to be mitigated, the price pressure would have to cease from

---

[5] The general alignment regarding the problem definition for different ESG-issues was described to vary, leading to different ESG-issues having different prerequisites for engagement dialogues. While issues related to governance was described to have been discussed for decades, climate-related issues more recently gained traction in the owner-company dialogues. Hence, the problem definition was described to be more widely shared between stakeholders when it comes to governance issues, facilitating dialogues. However, the interviewed fund companies agreed that companies have recently become much more responsive when it comes to climate issues since the problem definition has been aligned globally, whereas social issues are still more dependent on local culture and politics.

the entire industry. Hence, they needed to get the purchasing departments of the big industry players in the same room to address the issue together.

#### 5.3.3.5 The right time to end the dialogue

From interviews with fund companies, *knowing when to end* engagement efforts emerged as a key challenge in engagement dialogues. In other words, how long should you give a company the chance to improve before you decide time is up, and what compromise is acceptable? Some fund companies pointed to the risk of losing credibility in engagements if there are no consequences for companies neglecting investor demands or expectations throughout dialogue. As one fund ESG-specialist put it: *“There is legitimacy in knowing when you cannot do more.”*

However, it can be hard to decide when to end an unsuccessful dialogue from both a personal and financial point of view, and what the consequences should be. One fund ESG-specialist especially highlighted the difficulties from the personal perspective. As time and effort have been put into the engagement dialogue, there are high personal barriers to terminate the project, either on an unconscious or conscious level.

#### 5.3.3.6 Using transparency wisely

Interviewees emphasized transparency as the most important factor to safeguard from engagement being used as greenwashing. Therefore, several interviewees opposed using vague or hollow communications around engagements.

*“I experience that there is a lot of greenwashing when it comes to shareholder engagement. When working with this, as I do, you realize that other funds do not always do what they say. If you argue that you are a responsible owner due to the fact that you sit in election committees, you also have to have clear communications of what you actually accomplish, and what your expectations and demands are. “*- Fund manager

In order to move from a diffuse or vague communication of their engagement efforts, best practice was described as making everything easily available on the website, including the initial engagement plan, strategy and expectations. Presenting the questions raised together with the company response and outcome of the dialogue was also suggested. However, transparency was described as a balancing act, as too much transparency regarding ongoing dialogues could hurt the dialogue. However, as the ‘right dose’ of transparency was described to push target firms forward in engagement dialogues, transparency was discussed as something that can both enhance and damage the outlook for successful dialogue.

### 5.3.4 Leveraging other engagement tools in dialogues

Although engagement through other tools than dialogue is not in the scope of this study, the other tools can be leveraged to enhance the outlook for successful dialogues. The findings regarding this is expanded upon below, where the roles of AGMs and coalitions in relation to engagement dialogues are discussed.

#### 5.3.4.1 Leveraging Annual General Meetings

##### i. AGMs as a catalyst for dialogue

Several of the interviewed fund companies highlighted AGM-participation as an important engagement strategy in their public communications regarding responsible ownership. However, the interviews made it clear that AGMs are not viewed as a forum where funds try to influence company actions. This is a result of the AGMs having been preceded by dialogues where consensus has most often already been reached, at least with the largest shareholders.

Several fund companies even expressed that they do not want to use their voting rights to vote against target firm management, as this would indicate a dysfunctional dialogue between the owner and company. One fund company even stated that they would consider divesting before voting against any company management, as such a vote would indicate radically different views on the future of the company between the fund and company management. Instead, the fund expressed that they want companies to improve their practices before the AGM, as a result of the preceding dialogue.

Although AGM voting might not be viewed as an effective tool for engagement in itself, it can have a supporting role as AGMs give rise to intensive preceding dialogues, which offers shareholders a platform to impact target firms.

##### ii. The wider role of AGM participation to build legitimacy

Although voting was not viewed as an effective engagement strategy, interviewees expressed that participation in AGMs can increase a shareholder’s credibility in the subsequent dialogues due to two reasons.

First, the AGM is an important forum to the company. One fund manager described it as being the *‘graduation day’* for companies, where their hard work is presented and evaluated. Therefore, target firms were described to appreciate fund managers that participate in the AGMs, acknowledging them as interested and serious owners. As one fund manager put it: *‘Participating in the AGM builds trust with the portfolio companies and contributes to improving the subsequent one-on-one dialogue’.*

Second, AGMs was described to offer access to target firm representatives, such as the board, that are not otherwise as accessible. Interviewees also described that AGMs offer more informal access to representatives that are otherwise only met under formal conditions (for instance during associated mingles). This allows relationships to be built or deepened on different levels of the target company.

### iii. Changing expectations of AGMs as a forum for public dialogue

In the interviews, the lack of clashes and public arguments between owners and target firm management at AGMs were attributed in part to the prevailing consensus culture in Sweden and in part to the access Swedish investors have to target firm management. This was described to reduce the importance of AGMs as a forum to raise shareholder concerns, as funds rather conduct dialogues through private channels.

However, several of the interviewed fund companies expressed an ambition to better utilize AGMs as a forum for engagement as it allows engagement dialogue to be taken public, potentially increasing the pressure of target firms to adhere to shareholder suggestions. For example, one fund company expressed that they are in the process of evaluating how AGMs could be effectively used as a platform for engagement and dialogue, although they had not yet reached any conclusions of how this could be achieved. The fund company acknowledged that AGM participation is costly in time at the same time as they had concerns if public dialogues at AGMs would really be efficient. The fund company raised the example of Folksam, a Swedish insurance company pursuing public dialogues through AGM participation. Folksam does this by asking two questions relating to sustainability at each AGM. Although this strategy is a ‘loud’ one, the fund company questioned how effective this strategy would really be when it comes to creating real change within the target firm.

However, in an interview with a listed firm that had been subjected to Folksam’s AGM strategy, it became clear that this type of public dialogue cannot be discarded as inefficient with certainty. As the firm knows they will get two questions from Folksam at each AGM, the firm management needs to be prepared. Folksam sends the questions one day in advance to the target firm, which means that the firm allocates resources to understand the questions and prepare their answers. Hence, the two questions were described to steer the focus of the target firm management towards the issues raised by Folksam. The firm illustrated the effect of Folksam’s dialogue strategy by comparing it to a middle-school classroom, where the loudest kid will get the most attention: By being loud, investors can make sure that companies pay attention to their opinions and dialogue-attempts. However, the firm emphasized that this strategy does not automatically mean that they will adhere to investor opinions, but it was described to surely get the investor and their questions more attention.

#### 5.3.4.2 Dialogue through coalitions

When it comes to dialogues through coalitions, collaboration was described to facilitate shareholder dialogue in several ways. First, coalitions with multiple shareholders were described to increase the likelihood of companies adhering to the suggestions put forward. Second, target companies were said to appreciate investors joining forces around a common interest as it becomes much easier for companies to manage a cooperative dialogue rather than managing each investor dialogue separately. Third, interviewees stated that cooperation creates continuity in the dialogues as common goals are set, the work is shared, and the progress is continuously discussed.  Fourth, cooperation was described to enable knowledge dispersion, where investors can learn from each other.

*"When working through coalitions, the combined, larger, ownership stake is not the main benefit. Instead, it is the continuity that we get in the engagements that is the largest benefit, derived from common goals, structures and the sharing of the workload"*- Fund ESG specialist

# 6 Discussion

The discussion aims to combine the theoretical and empirical findings to outline the contributions of this paper. Therefore, the purpose of this chapter is to discuss the empirical findings in the light of previous research and theory.

First, the forms and role of engagement dialogue among Swedish funds are discussed, resulting in a framework to categorize different forms of engagement dialogue. This framework can facilitate both the quality evaluation of engagement dialogue between different funds, as well as provide a roadmap to funds on how to improve their engagement practices.

Second, the organizational approach among shareholders to engagement is discussed, resulting in a framework of the tradeoffs between different ways to approach and structure engagement internally. The framework aims to facilitate funds to align their internal structure and approach with their specific prerequisites for engagement.

Third, the mechanisms by which engagement dialogue successfully unfolds are discussed, aiming to outline how shareholder salience is achieved in the Swedish context.

## 6.1 The role and form of shareholder engagement through dialogues

### 6.1.1 The role of dialogue in shareholder engagement

The empirical findings support what previous literature has suggested, namely that dialogue is an integral part of shareholder engagement (Gifford, 2010; Ferrari and Beunza, 2018; Semenova and Hassel, 2018). However, in the Swedish context, it is suggested to be *the* tool for shareholder engagement. Previous research has suggested that the cultural context is an important factor when it comes to the role and form of shareholder engagement Gifford 2010; Ivanova 2017). As the Swedish context offers access to company management and is largely characterized by a non-confrontational corporate culture, the finding that dialogue is at the heart of the engagement efforts among Swedish funds is not unexpected (Gifford 2010; Ivanova 2017).

### 6.1.2 Shareholders as norm entrepreneurs?

From the empirical material, it is clear that funds view themselves in line with what Sjöström (2009) would classify as norm entrepreneurs. As a result, funds acknowledge unconditional ESG-related questions to target firm management as value-adding, as they, by conveying their expectations relating to ESG-issues, can help steer or nudge the direction of companies. The idea of funds as norm entrepreneurs was more pronounced in relation to larger target firms where the individual fund does not have much (formal) influence, and only in cases where the larger investor community was pushing in the same direction.

In fact, funds were found to act more consultative in dialogues with smaller companies, acknowledging the lack of a consultative approach with larger companies to limitations of access, knowledge and resources. For instance, funds could express that larger companies do not *need help* with ESG-issues due to their in-house competence. However, this must surely be dependent on the knowledge and expertise funds have to offer? Therefore, a more truthful explanatory model would perhaps be that funds do not want to use the resources needed to build the competence required (both in relation to general ESG-knowledge as well as company specific knowledge) to be able to 'help' larger companies in the realm of ESG. As a result, the question arises if funds simply rely on their role as norm entrepreneurs (Sjöström, 2009) as an excuse not to pursue more resource-intense engagement strategies?

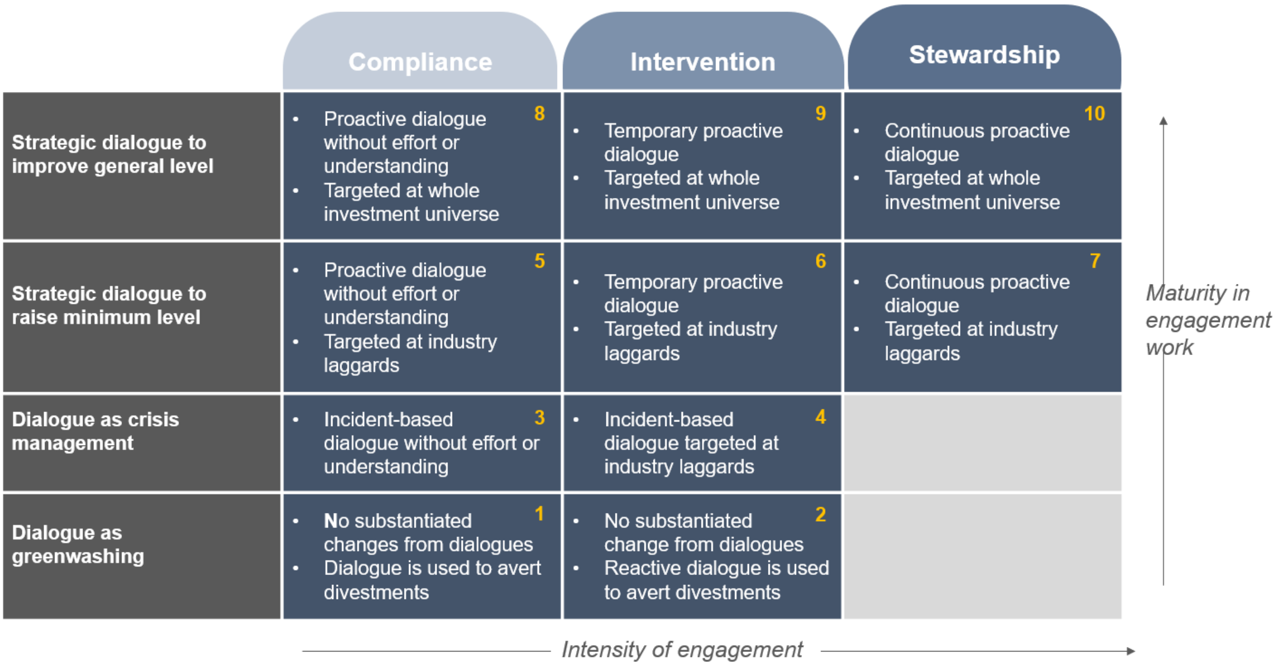
### 6.1.3 Different forms of dialogue: Classification through a maturity matrix

From the empirical material, differences between funds emerged regarding how and with what type of firms that engagement dialogue should be conducted, resulting in the development of a maturity ladder. Contrasting the maturity ladder, as a way to classify different levels of shareholder engagement, is Winter's (2012) model of shareholder engagement levels. As the maturity ladder illustrates a fund's utilization of opportunities of shareholder engagement, Winter's (2012) model differentiates between levels of intensity in the engagement (compliance, intervention and stewardship).

In the maturity ladder, opportunities to engage are lost if funds choose to exclude proactive engagement, or if they choose to target their proactive engagement merely at industry laggards. However, the maturity ladder does not classify the intensity of the engagement, meaning a fund can exercise all their opportunities to engage, but do so with a low level of intensity. At the same time, Winter's (2012) model only classifies engagement in terms of intensity and not in scope. This means that Winter's (2012) model does not classify the extent to which engagement opportunities are exercised. As a result, both models fall short in terms of classifying different types of engagement[6].

However, by combining the two models, a maturity matrix emerges, encasing both the intensity of the engagement, as well as the degree to which a fund company seizes their opportunities to engage. I argue that such a matrix better illustrates the different ways funds can address engagement dialogues, and consequently, what best practice looks like.

*Figure 5. The Maturity Matrix, derived by combining the Maturity Ladder with Winter's (2012) three distinguished levels of shareholder engagement intensity*



| | Compliance | Intervention | Stewardship |
|---|---|---|---|
| **Strategic dialogue to improve general level** | 8<br>• Proactive dialogue without effort or understanding<br>• Targeted at whole investment universe | 9<br>• Temporary proactive dialogue<br>• Targeted at whole investment universe | 10<br>• Continuous proactive dialogue<br>• Targeted at whole investment universe |
| **Strategic dialogue to raise minimum level** | 5<br>• Proactive dialogue without effort or understanding<br>• Targeted at industry laggards | 6<br>• Temporary proactive dialogue<br>• Targeted at industry laggards | 7<br>• Continuous proactive dialogue<br>• Targeted at industry laggards |
| **Dialogue as crisis management** | 3<br>• Incident-based dialogue without effort or understanding | 4<br>• Incident-based dialogue targeted at industry laggards | |
| **Dialogue as greenwashing** | 1<br>• No substantiated changes from dialogues<br>• Dialogue is used to avert divestments | 2<br>• No substantiated change from dialogues<br>• Reactive dialogue is used to avert divestments | |

As long as the engagement dialogue is done in a compliance-type of way (boxes 1, 3, 5, 8 in the matrix), the dialogue is not driven by an understanding of engagement as value-adding. Instead, dialogue is done as it is required or expected, which means funds will apply minimal efforts. When it comes to strategic dialogue done as compliance (boxes 5 and 8), this could mean that funds apply proactive dialogue by asking portfolio companies the same standardized questions through surveys. Such standardized proactive questions could also be asked in passing during regular meetings with target firm management, without expressing any expectations or discussing roadmaps to improve. An example of such a question could be target firm carbon dioxide emissions. As long as such a question is asked in a compliance-type of way, the fund's only purpose is to adhere to either regulations or

---

[6] For example, a fund company at the highest level of the maturity matrix does not necessarily apply their engagement with an intensity that Winter's (2012) model would classify at the highest level. Likewise, a fund at the stewardship level in Winter's (2012) models does not necessarily exercise stewardship-type engagement towards all of their holdings.

expectations from customers or industry-peers. Even though this would be classified as a low-intensity engagement strategy, and is hence far from best practice, this type of engagement could still have a normative effect in line with Sjöström's (2010) view of shareholders as norm entrepreneurs.

If the engagement dialogue is done in an intervention-type of way (boxes 2, 4, 6, 9 in the matrix), the dialogue is driven by an understanding of engagement as value-adding. However, the engagement dialogues are characterized as being temporary efforts to address specific issues or make a focused push for improvements. This is motivated by the idea of engagement dialogues as opportunities to mitigate risks or access untapped potential. When the specific risk has been mitigated or the opportunity capitalized, the engagement dialogue ceases. From the matrix, this type of temporary dialogue can be classified as greenwashing (meaning no substantiated change is recorded, box 2), incident-based (meaning it is only initiated as a reaction to an incident, box 4) or proactive (meaning it can be initiated without being triggered from a specific incident, box 6 and 9).

When it comes to engagement dialogues in a stewardship-type of way (boxes 7 and 10 in the matrix), fund companies recognize that dialogue is an ongoing commitment that does not cease if a specific target or goal is reached. Instead, the engagement dialogues are a continuous component of any ownership. In fact, engagement dialogues even define the value of the investment strategy. As a consequence, stewardship-type of dialogues cannot be conducted as crisis management or as greenwashing, as stewardship implies a commitment that is both true (violates dialogue as greenwashing) and continuous (violates dialogue as crisis management).

The distinction between box 7 and 10 in the matrix is based on a difference in scope, where the engagement dialogue is either targeted only at industry laggards, or at the entire portfolio. The empirical material indicates that there is a component of maturity present in the distinction between funds that target their strategic dialogue at all portfolio companies, and the ones that only target dialogue at industry laggards. This maturity component consists of acknowledging that a fund’s role as an owner, pushing for improved ESG-practices, should be equally pronounced for all portfolio firms as all firms need to improve their ESG-practices if we are to mitigate climate change or reach global commitments (such as the UN Sustainable Development Goals or the Paris Agreement). From the interviews, funds that did not target industry leaders often did so with the motivation that it was unnecessary, as such firms managed sustainability issues in a satisfactory way on their own. Hence, the component of maturity indicates that funds that conduct their dialogues according to box 10 in the matrix would have more pronounced engagement practices than funds conducting their dialogue according to box 7.

According to the maturity matrix, there are two general ways for funds to improve their engagement dialogues. First, funds can exercise a higher degree of their engagement opportunities by widening their scope in terms of dialogue-type as well as target firm-type. Second, funds can increase the intensity of their engagement, implying that firms move from a temporary view of their dialogues to see dialogue as a continuous effort. However, when it comes to the choice between a strategy according to box 7 and 10 in the matrix, previous research leaves room to argue that a strategy according to box 7 would allow better prioritization of resources. According to the literature, a dialogue strategy that is equally pronounced regardless of the starting point for the target firm in terms of ESG practices might be less likely to succeed compared to a strategy that targets industry laggards. This is due to the fact that industry leaders have less room to improve and therefore being less susceptible to shareholder engagement efforts compared to industry laggards. (Dimson et al. 2015). Furthermore, funds experience that they have more to contribute to the ESG work of industry laggards, as the industry leaders might have whole teams of dedicated ESG-experts in-house. As a result, interviewees expressed that it was easier to build credibility in engagement dialogues with industry laggards. Hence, *if* resources are scarce, previous research indicates that the prioritization of dialogue towards industry laggards (box 7 instead of 10) could be a correct one.

## 6.2 Internal structure to support engagement dialogue

The empirical research resulted in a distinction between four different ways in which fund companies can internally organize their engagement dialogue. To further map out the potential drawbacks of the different approaches, the approaches will be evaluated in the light of the challenges of engagement, outlined in the theoretical framework.

Drawing on the theoretical framework, the four main challenges to consider when designing the engagement architecture were identified as: Investment mandate and incentives to engage (1), Dispersed ownership (2), Resource limitations (3) and Internal conflicts of interest (4). In relation to these challenges, the different approaches give rise to different solutions and problems, discussed below.

### 6.2.1 Investment mandate and incentives to engage

Previous literature points to the fact that, under the current market structure, fund managers are incentivized to increase investment inflow rather than long-term fund performance. This implies that a fund manager’s focus might be diverted from engagement and redirected to marketing, sales-meetings and/or window-dressing (Winter 2012). Therefore, whenever fund managers are responsible for engagement dialogue, engagement-prohibiting market mechanisms, such as the ‘herd behavior’ described by Winter (2012), need to be taken into consideration. In contrast, by having a separate ESG-team in charge of engagement, funds could circumvent the problem of misaligned incentives, as the ESG-team will not be subjected to the same market mechanisms that Winter (2012) and Ivanova (2017) suggest would restrain fund managers from engaging with their holdings. Hence, having a separate ESG-team enables funds to direct resources towards engagement, despite unfavorable market structures, such as the misalignment of incentives for fund managers.

However, a separate ESG-team might not solve all issues related to the unfavorable market structure for engagement. Both Winter (2012) and Ivanova (2017) point to the general client inertia towards ESG issues which deters funds from engagement as sustainability is not included in the investment mandate. This issue is not solved by having a separate ESG-team, as the investment mandate might impact the internal mandate and resources given to such a team. Interestingly, the empirical material suggests that Swedish funds experience that their customers are demanding when it comes to responsible investments, indicating that this problem could be less pronounced in the Swedish context.

### 6.2.2 Dispersed ownership

As Ivanova (2017) and Winter (2012) suggest, portfolio diversification leaves funds with a small portion of the ownership in each company, limiting their influence. From a salience framework, this implies that funds will have low power, resulting in legitimacy and urgency becoming more important attributes in order to achieve salience (Gifford, 2010). This raises the question of how the four different ways to organize shareholder dialogues affect a fund's outlook to achieve legitimacy and urgency.

When it comes to urgency, there are several aspects to consider in the choice between having ESG-specialists or fund managers heading engagement dialogues. Overall, ESG-specialists and fund managers have the same opportunities to apply time-sensitivity (for instance by using deadlines) to increase urgency. When it comes to the criticality-part of urgency on the other hand, there are several aspects to consider. First, fund managers are responsible for the value of a fund's positions, implying that fund managers have privileges that ESG-specialists do not. For instance, when it comes to criticality enhancing actions such as AGM resolutions or use of public media, it is unlikely that these actions could be pursued without the involvement of fund managers, as these actions pose a threat to the value of a fund's position. In addition, ESG-specialists cannot access the tool of divestment (or investment) without convincing the fund management first. Hence, if fund managers have more immediate access to the criticality part of urgency, this implies that they should be more salient in the eyes of the corporate management.

Another aspect to consider is that criticality has a component of intensity, where assertiveness, persistence and use of resources enhance criticality according to Gifford (2010). As the empirical material suggests that time is a delimiting factor when fund managers head dialogues, fund managers might not have the same opportunities as ESG-specialists to achieve high intensity-engagements.

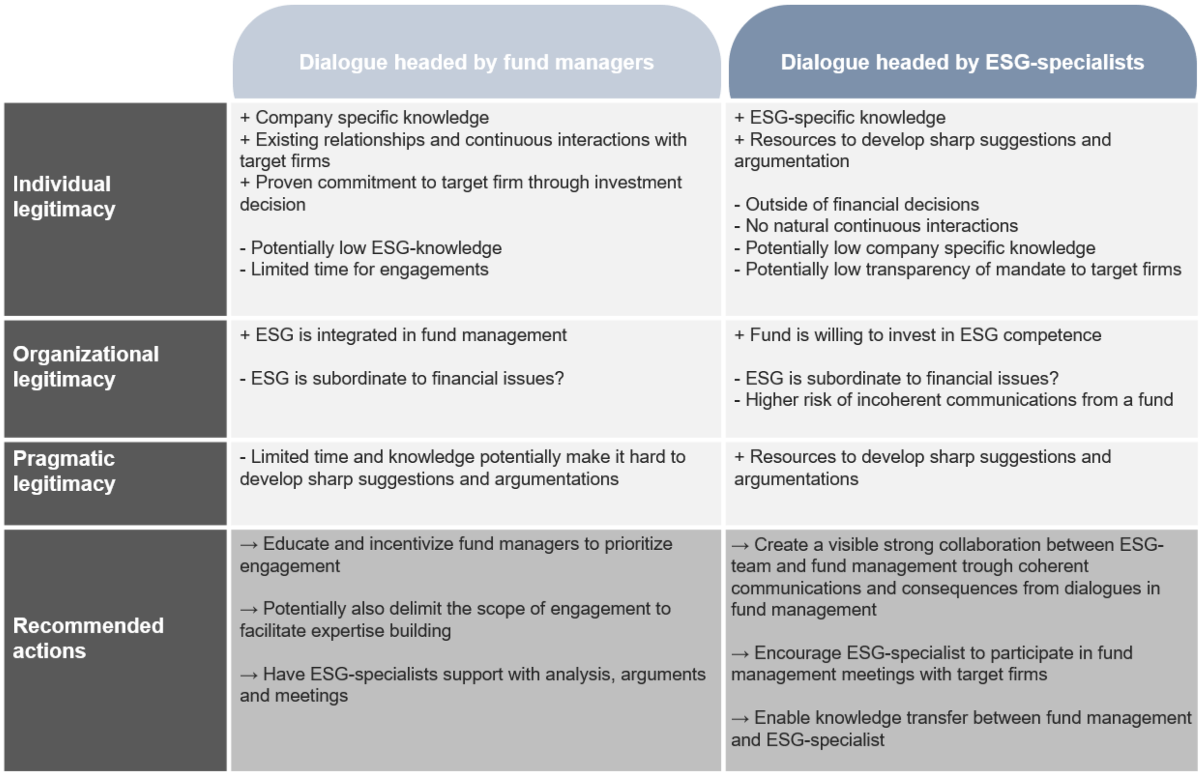
Concerning the legitimacy attribute, the restrained time of fund managers could also create legitimacy problems, as fund managers might not have sufficient time to develop a strong argumentation to allow for pragmatic legitimacy. In addition, the empirical findings established that fund managers today do not have sufficient ESG-knowledge to conduct ESG-dialogues in a credible and impactful way. Therefore, ESG-specialists will have access to more individual legitimacy, due to their credibility and expertise in ESG-related issues.

However, while ESG-specialists have more knowledge about ESG-specific challenges, they might lack the necessary understanding of the target firm culture, context and challenges that fund managers acquire from their continuous interactions with target firm management. In addition, fund managers have individual legitimacy through their proven commitment and belief in the target firm and its management, illustrated by the fund manager having the ultimate decision to invest or divest (provided the investment commitment is long-term). This proven commitment (through the decision to invest) would strengthen the perception of aligned interests between the fund and the target firm, increasing the individual legitimacy of fund managers. This type of individual legitimacy will be harder for ESG-specialists to acquire as they do not interact with company management on a regular basis nor has a proven commitment to the target firm.

When it comes to organizational legitimacy, having a separate ESG-team could either signal a strong commitment to responsible ownership or a subordination of ESG-issues compared to financial issues. A separate team could signal subordination of ESG-issues if a detachment between the engagement and fund management is obvious from a target firm perspective, for instance if they receive incoherent messages or if unsuccessful engagement dialogues are left without action in the fund management.

From the above analysis through the framework of Gifford (2010), ESG-specialists and fund managers most likely have different types of legitimacy in engagement dialogues, summarized in table 6. These differences in legitimacy implies differences in shareholder salience (Gifford, 2010), that are crucial to understand if funds want to optimize their efforts to achieve higher shareholder salience. As a result, the engagement approach needs to be evaluated in the light of a fund’s strengths and weaknesses. As an example, if the fund managers of a specific fund have very low ESG-competence, the required efforts to educate fund managers to achieve high individual legitimacy might be unreasonably high compared to hiring ESG-specialists to head engagement dialogues.

*Figure 6. Summary of considerations with fund managers vs. ESG-specialist heading the engagement dialogues, analyzed through the framework of Gifford (2010)*



| | Dialogue headed by fund managers | Dialogue headed by ESG-specialists |
|---|---|---|
| **Individual legitimacy** | + Company specific knowledge<br>+ Existing relationships and continuous interactions with target firms<br>+ Proven commitment to target firm through investment decision<br>- Potentially low ESG-knowledge<br>- Limited time for engagements | + ESG-specific knowledge<br>+ Resources to develop sharp suggestions and argumentation<br>- Outside of financial decisions<br>- No natural continuous interactions<br>- Potentially low company specific knowledge<br>- Potentially low transparency of mandate to target firms |
| **Organizational legitimacy** | + ESG is integrated in fund management<br>- ESG is subordinate to financial issues? | + Fund is willing to invest in ESG competence<br>- ESG is subordinate to financial issues?<br>- Higher risk of incoherent communications from a fund |
| **Pragmatic legitimacy** | - Limited time and knowledge potentially make it hard to develop sharp suggestions and argumentations | + Resources to develop sharp suggestions and argumentations |
| **Recommended actions** | → Educate and incentivize fund managers to prioritize engagement<br>→ Potentially also delimit the scope of engagement to facilitate expertise building<br>→ Have ESG-specialists support with analysis, arguments and meetings | → Create a visible strong collaboration between ESG-team and fund management trough coherent communications and consequences from dialogues in fund management<br>→ Encourage ESG-specialist to participate in fund management meetings with target firms<br>→ Enable knowledge transfer between fund management and ESG-specialist |

## 6.2.3 Resource limitations

Apart from leading to low shareholder power within a shareholder salience framework, portfolio diversification also creates issues relating to resources, where there is simply not enough capacity to monitor and engage with all holdings within a portfolio (Ivanova 2017). Hence, a clear strategy of resource prioritization is important. A thematic approach, rather than a case-by-case approach facilitates expertise building within certain focus areas, which helps when economizing resources. In contrast, a case-by-case approach is more demanding as it requires the fund to apply resources to understand a wide range of issues. As the empirical material shows, understanding the cause, effect, solution, and who to approach within a certain issue can be very intense in resources. Thus, a thematic approach might facilitate creation of individual legitimacy, as it allows fund representatives to become experts on specific ESG-issues (Gifford, 2010).

In line with previous research (Winter 2012; Ivanova 2017), the empirical material suggests that the resource limitations often result in a tendency for investors to rely on narrow streams of information, such as ESG-ratings or annual reports. As such narrow streams of information can often be insufficient when it comes to assessing a company's ESG performance (Revelli and Viviani 2015; Perks, Rawlinson, and Ingram 1992; Harte, Lewis, and Owens 1991), this introduces problems in relation to engagement dialogues.

As a result, a separate ESG-team could enable improved ESG-related research and analysis for funds, as ESG-specialists do not have the same constraints of time and knowledge as fund managers. However, it is not necessarily the case that the ESG-team must run the entire engagement in order for a fund to benefit from the improved capabilities of research and analysis. It could simply be enough to have ESG-specialists support fund managers with analysis.

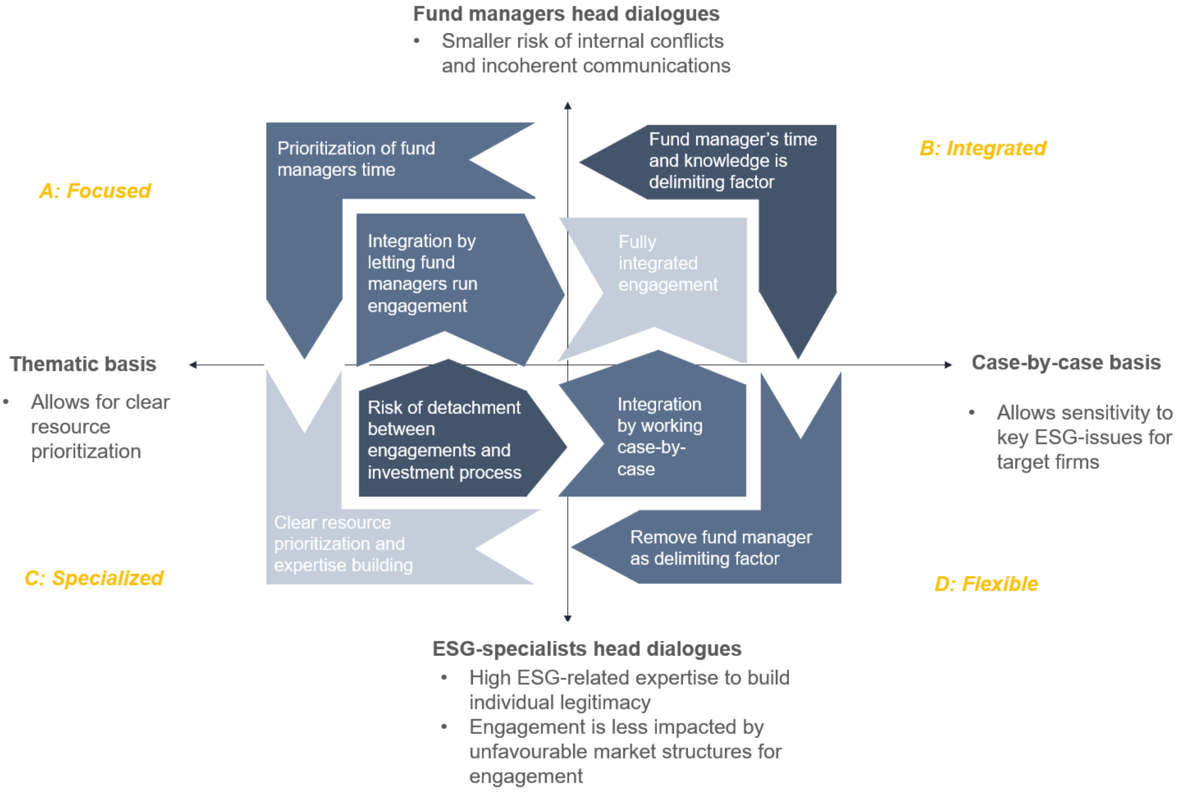
### 6.2.4 Internal conflicts of interest

Another challenge identified in previous literature relates to internal conflicts of interest, stemming from tensions between departments or groups within investors (Ivanova, 2017). In line with Ivanova (2017), there were indications in the empirical material that a separation between the ESG and equity teams increases the risk of communication problems and goal divergence. This implies that funds with a separate ESG-team in charge of dialogues must take precautions to avoid internal conflicts and goal misalignment that detaches engagement dialogues from the fund management. Such a detachment would not only hurt the organizational legitimacy, but could also imply value losses for the fund, as the engagement dialogues might not target the most material issues for the fund and underlying stocks (Gifford, 2010; Ivanova, 2017).

### 6.2.5 Framework for the organizational approach to engagement dialogues

Both the empirical findings, as well as the analysis from a theoretical perspective, suggest that there is no one-size-fits-all type of solution for the internal architecture for engagement dialogues. Instead, each fund company must evaluate what approach they believe to be the most efficient depending on their specific context and purpose of engagement dialogues. To facilitate such an evaluation, a framework is developed based on the empirical material and theoretical discussion above, outlining the major trade-offs between the four different ways to design internal processes. The framework is presented in figure 7.

*Figure 7. The trade-offs between the different strategies*



## *A. The integrated strategy – Fund manager run dialogues on case-by-case basis*

In the integrated strategy, the dialogue process is closely tied to the fund management. However, the time and ESG-expertise of the fund manager becomes the delimiting factor. In addition, the case-by-case approach does not facilitate expertise-building and resource prioritization for fund managers. From a shareholder salience point of view (Gifford, 2010), this implies that individual legitimacy might be hard to obtain, as the empirical material suggests that the individual legitimacy is largely dependent on the ESG-expertise of the fund representative.

## *B. The focused strategy – Fund manager run dialogues on thematic basis*

The focused strategy allows for a targeted approach, where the fund manager's time is economized to create the necessary expertise. The downside is that a thematic approach might make the dialogue stiffer in relation to the investment processes and the material ESG-issues of target firms, as the fund managers do not have the same flexibility in their engagement dialogues compared to a case-by-case approach. Although expertise in certain areas are created, a lack of general ESG-expertise among fund managers might still introduce problems, as fund managers will not be able to conduct dialogues on the most material issue for target firms. From a shareholder salience perspective (Gifford, 2010), this would inhibit organizational legitimacy, as the empirical material suggests that when funds are too focused on predetermined ESG-issues, target firms experience a divide between the interests of the target firm and the fund. Hence, whenever the thematic approach is applied, it is integral to make sure the chosen themes result in a meaningful dialogue to both the fund as well as target firms.

### *C. The specialized strategy – ESG-team run dialogues on thematic basis*

In the specialized strategy, the resources can be clearly prioritized, as a separate ESG-team can focus their resources on certain themes, allowing them to build necessary expertise to conduct dialogues in an effective way. A downside with the specialized strategy is the separation between engagement dialogues and fund management, as the dialogue is conducted by a separate team and according to predetermined themes. This creates risks of both internal conflicts as well as incoherent external communications. From a shareholder salience perspective, this creates risks of reduced organizational legitimacy (Gifford, 2010). The specialized strategy also implies difficulties regarding narrow-minded engagement processes, as dialogues are guided by predetermined issues rather than the material issues for each target firm. Even so, ESG-specialists will have greater general ESG-knowledge compared to most fund managers, allowing them to better maintain their individual legitimacy also in dialogues outside of the predetermined themes. In this way, funds are better equipped to allow dialogues to divert from their predetermined themes when target firms require it.

### *D. The flexible strategy – ESG-team lead dialogues on case-by-case basis*

In the flexible strategy, the time and knowledge of the fund manager is no longer the delimiting factor, but with a separate team, there is once again a risk of detaching the dialogue from the investment process. However, compared to the specialized strategy, the case-by-case approach allows the dialogue team more flexibility to cooperate and adhere to material ESG-issues of both the fund management and target firms. Despite this, whenever there are separate teams between the engagement dialogue and fund management, there is a risk of incoherent external communication and internal conflicts which might hurt the organizational legitimacy. On the positive side, by having a separate ESG-team, funds can mitigate unfavorable market structures that might create a ‘herd-behavior’ or imply misaligned incentives, resulting in engagement being down-prioritized by fund managers (Winter, 2012).

## 6.3 Mechanisms by which engagement dialogue successfully unfolds: how is shareholder salience created in the Swedish context?

The empirical research resulted in several mechanisms and critical factors identified to enhance adherence from target firms in engagement dialogues. From a theoretical point of view, shareholder salience has been a key concept in prior research when strategies for adherence in shareholder engagement have been evaluated. In order to understand how shareholder salience is created in the context of Swedish mutual funds, the key factors identified through the empirical research are analyzed below according to the shareholder salience framework developed by Gifford (2010). Through this, the mechanisms identified in the empirical research can be theorized, closing in on why these mechanisms would yield a fund influence.

### 6.3.1 Shareholder characteristics

From the empirical material, a fund representative's ability to conduct dialogues in an informed and credible way was described as a critical factor in order for engagement dialogues to unfold successfully. The credibility was in turn described to largely depend on the fund representative's knowledge and expertise in the matter being discussed. From a shareholder salience point of view, Gifford (2010) would classify this as *individual legitimacy* being an important attribute in order to achieve shareholder salience.

In relation to Gifford's (2010) framework, the empirical material suggests that the credibility and expertise of the individual fund representative would be more important than the experience and status of the individual engaging with the company. At the same time, target firms did not generally perceive fund managers to be sufficiently knowledgeable in ESG-issues to achieve efficient engagement dialogues. This would imply that funds should focus on the ESG-related expertise of their fund representatives, rather than trying to achieve individual legitimacy by focusing on the status or experience of the individual engaging with target firms.

The empirical material also pointed to three main problems of how funds conduct engagement dialogues, namely that target firms seek reassurance in dialogues rather than trying to understand the specific ESG-challenges at hand, that they rely on checklists, and that they are too focused on specific and predetermined ESG-issues. From a shareholder salience point of view (Gifford 2010), this way of conducting engagement dialogue would hurt both the organizational and individual legitimacy. The organizational legitimacy would be hurt due to the target firm experiencing a divide between the interests of the target firm (improving their practices) and the fund (checking a problem off a list). The individual legitimacy would be hurt as the individual fund representatives come off as arrogant, ignorant, and uninterested. In addition, funds will have difficulties achieving pragmatic legitimacy if they focus the dialogues on their predetermined ESG-issues, and not on the material issues for target firms.

*Table 8. Sources to fund influence analyzed by Gifford's* (2010) *shareholder salience framework*

| | **Power enhancing** | | | **Legitimacy enhancing** | | | | **Urgency enhancing** | |
|---|---|---|---|---|---|---|---|---|---|
| | Coercive | Utilitarian | Normative | Individual | Organizational | Pragmatic | Social | Time sensitivity | Criticality |
| ESG-expertise of engaging individual | | | | + | | + | | | |
| Reassurance-seeking dialogues | | | | - | - | | | | |
| Check-list based dialogues | | | | - | - | | | | |
| Focusing too much on predetermined ESG-issues | | | | - | | - | | | |

## 6.3.2 Target firm characteristics

Previous research suggests that the outcome of shareholder engagement is contingent on certain target firm characteristics (Logsdon, Rehbein, and Van Buren III, 2007; Dimson et al. 2015; Hoffman 1996; Adams, Licht, and Sagiv 2011). In line with Logsdon, Rehbein, and Van Buren III (2007), the size of the target firm was expressed by fund companies to impact their outlook to influence target firm actions through dialogues. In contrast to Logsdon, Rehbein, and Van Buren III (2007), neither board composition nor corporate visibility was mentioned by interviewees to impact target firm adherence in dialogues. In line with Dimson et al. (2015), funds also engaged less with ESG-industry leaders as funds found it harder to contribute to the ESG-work of such firms. Corroborating the findings of Gifford (2010), Hoffman (1996) and Adams, Licht, and Sagiv (2011), the personal values of the target firm management was found to be highly relevant for when funds chose to engage. In fact, the values of target firm management were addressed in a prerequisite-type of way among interviewed funds in the sense that funds would choose not to invest (or divest) in firms whose management did not display enough understanding of the added-value or importance of ESG.

Previous research has suggested that target firm traits impact shareholder engagements, raising the idea (for instance by Sjöström, 2020) that funds could choose purposefully what company to engage with in order to increase the success-rate of their engagements. Adding to this, the empirical research of this paper suggests that funds should not only choose what firms to engage with depending on firm traits, but also that funds should adapt their engagement strategy depending on firm traits. Gifford (2010) have previously suggested that shareholder salience has a temporal dimension, where attributes are applied sequentially as the engagement escalates. Adding to this, the findings of this study suggest that funds draw upon the attributes within shareholder salience differently depending on target firm characteristics (especially size).

Concerning smaller target firms, the empirical evidence suggests that funds can take a more direct approach in dialogues. In a shareholder salience framework (Gifford, 2010), this could be explained by funds having greater opportunities to use coercive or utilitarian forms of power with smaller target firms compared to larger firms. In line with the reasoning of Logsdon, Rehbein, and Van Buren III (2007), the evidence of this paper also suggests that the lesser ESG-knowledge and experience of ownership engagements among smaller target firms allow funds to access individual and organizational legitimacy with less effort.

When it comes to larger target firms, an analysis through Gifford’s (2010) salience framework reveals that legitimacy becomes more important, as attributes of power is harder to attain. Within the legitimacy attribute, the pragmatic legitimacy becomes more important as the empirical material would suggest that funds have a harder time achieving individual and organizational legitimacy with larger corporations for three reasons. First, larger target firms likely have more in-house ESG-competence, making it harder for funds to build legitimacy through superior expertise. Second, funds require more resources to attain a sufficiently large legitimate claim on a larger target firm (the associated risk is often lower with larger firms and more resources are required to achieve a significant stake (Gifford, 2010)). Third, larger firms tend to have more investors, reducing the outlook for funds of close personal access to company representatives. This would restrict funds from continuously demonstrating their expertise and professionalism in engagement dialogues (Gifford, 2010).

In addition, the right role for funds in dialogues was found to not only depend on characteristics of the target firm, but also on the characteristics of the ownership. Previous research has not found the ownership stake to be a critical attribute in order to achieve successful engagement dialogues, unless the stake is particularly large (Gifford 2010; Dimson et al. 2015). Although the empirical findings of this study suggest that a fund can gain attention and adherence of target firms regardless of their ownership stake, the findings point to the fact that the ownership stake impacts *how* funds achieve salience. Specifically, the empirical findings suggest that funds must alter their dialogue strategy depending on their ownership stake, both in terms of what issue to raise as well as how to raise it. From a theoretical point of view, a smaller stake would result in lower organizational legitimacy (Gifford, 2010), creating a need for other types of salience attributes to come into play. Furthermore, if the stake impacts the access to target firm management, individual as well as organizational legitimacy becomes even harder to achieve (Gifford, 2010), raising the need of other attributes additionally.

In addition, as the interviews strongly pointed to the fact that funds will have a difficult time impacting large strategic decisions without a large ownership stake, there seems to be a limit to the salience of a shareholder that does not have a large ownership position. This contradicts previous findings (Gifford 2010; Dimson et al. 2015), where the ownership stake has not been found to be a limiting factor in shareholder engagements. However, the findings of this paper also point to the fact that funds can compensate for a smaller ownership stake, mainly through pragmatic legitimacy, where the argumentation and business case behind a claim was suggested to grow in importance with a smaller ownership stake.

*Table 9. Sources to fund influence analyzed by Gifford's* (2010) *shareholder salience framework*

| | **Power enhancing** | | | **Legitimacy enhancing** | | | | **Urgency enhancing** | |
|---|---|---|---|---|---|---|---|---|---|
| | Coercive | Utilitarian | Normative | Individual | Organizational | Pragmatic | Social | Time sensitivity | Criticality |
| Small companies | + | + | | + | + | | | | |
| Large companies | | | | | | + | | | |
| Small ownership stake | | | | | | + | | | |
| Large ownership stake | + | | | | + | | | | |

## 6.3.3 Characteristics of the communications

In line with Ferraro and Beunza (2019), the empirical material does not support that a strict negotiating style of dialogues, where parties push to advance their distinct opinions, will yield constructive dialogues. Instead, interviewees pointed to the importance of a collaborative approach, where the aim is to build a common ground of how the issues and challenges are understood, which is what Ferraro and Beunza (2019) proposes in their model of communicative action. Regarding the three successive cycles that shareholders and target firms need to go through to achieve a collaborative dialogue (Ferraro and Beunza, 2019), the evidence of this paper especially points to the importance of establishing a common ground (second cycle).

Overall, the interviewees emphasized that engagement dialogues need to be based on friendliness, rather than aggressiveness or assertiveness. This would imply that urgency would not be regarded as an important attribute in engagement dialogues, as an assertive tone is connected to achieving criticality according to Gifford (2010). Instead, the evidence of this study points to the fact that shareholder salience is achieved through a collaborative approach (enhancing shareholder legitimacy) rather than an assertive approach (enhancing urgency). This is in line with findings by Gifford (2010) and Ferraro and Beunza (2019), suggesting that engagement dialogue benefits from funds taking the time to establish mutual understanding and a common ground.

Although an urgency-based engagement strategy (building on an assertive tone, hard demands, tight deadlines, and strong threats of divestments) was not suggested as an effective approach in the Swedish context, a dialogue completely without urgency was suggested to reduce a fund’s legitimacy. The empirical material suggested that engagement dialogues lose credibility if they are never followed up in the investment decisions. Hence, investors need to draw on attributes of urgency towards the end of, mainly unsuccessful, dialogues to retain their organizational legitimacy in subsequent dialogues. This was mainly suggested to be done by exercising, or threatening to exercise, utilitarian power (e.g. withdrawal of capital) or normative power (e.g. using public statements).

Apart from a discussion on the general tone of engagement dialogues, the empirical material points to two additional ways in which a fund's way of communicating impacts their shareholder salience. First, communicating a strong business case was found to be one of the most important factors to achieve successful engagement dialogues. This is in line with the propositions by Gifford (2010), who argues that pragmatic legitimacy is vital to achieve shareholder salience in engagement dialogues. Second, the empirical material points to the importance of communicating a common interest, in line with Gifford (2010) and Ferraro and Beunza (2019).

Concerning societal legitimacy (Gifford, 2010), the empirical material points to the fact that societal legitimacy has a role to play in engagement dialogues. However, the societal legitimacy seems to be more of a hygiene factor rather than something that is leveraged in the communication strategy to enhance shareholder salience. To exemplify this, several fund companies described that without a common problem definition, there is simply no point of engagement, as there is no outlook of mutual understanding. This is in line with previous research, where the societal legitimacy, through appeals to moral or ethical arguments, have not been found to be used by shareholders as a strategy to enhance their salience (Gifford 2010).

The last aspect to be discussed in relation to the characteristics of communication is the transparency of the communication in an engagement. From a shareholder salience perspective (Gifford 2010), the findings of this paper suggest that transparency regarding engagement dialogues enhance shareholder salience in three ways. First, it increases the organizational legitimacy of funds as funds communicate a coherent message regarding their stance on corporate responsibility. Second, transparency allows fund companies to draw upon the attribute of normative power due to the reputational threats to target firms and their management. Third, transparency raises the urgency, as the pressure increases when the claims on the target firm becomes public. However, this strategy could also have a counterproductive effect on organizational legitimacy, as it might hurt the trusting relationship between a fund and target firm. In line with research by Gifford (2010), the empirical material suggests that some funds experienced a very high level of organizational legitimacy, allowing them to access discussions on a confidential board-level. This access was attributed by the funds to a high degree of integrity in engagement dialogues. In other words, low transparency. However, there were only large and well-known funds that described this type of access, suggesting smaller funds might be better off pursuing organizational legitimacy through a transparency-based strategy. As transparency can both create and diminish organizational legitimacy, funds need to decide in what way they want to pursue shareholder salience and what type of relationship they seek with their portfolio companies.

*Table 10. Sources to fund influence analyzed by Gifford's* (2010) *shareholder salience framework*

| | **Power enhancing** | | | **Legitimacy enhancing** | | | | **Urgency enhancing** | |
|---|---|---|---|---|---|---|---|---|---|
| | Coercive | Utilitarian | Normative | Individual | Organizational | Pragmatic | Social | Time sensitivity | Criticality |
| Strong business case | | | | | | + | | | |
| Building on common interest | | | | | + | | | | |
| Contributing in dialogues | | | | + | | + | | | |
| Consensus of problem definition | | | | | | | + | | |
| Communicating to right individual | | | | | | + | | | |
| Ending dialogue when necessary | | + | + | | | | | + | + |
| Using transparency | | | + | | +/- | | | | + |

## 6.3.4 Leveraging other tools of engagement

The empirical research suggested three main ways in which the AGMs interplay with engagement dialogues, analyzed below according to the framework by Gifford (2010).

First, when the AGM functions as a catalyst for engagement dialogues, funds are enabled to draw upon the attribute of urgency as the AGM provides a solid deadline. It also enables funds to draw upon both normative and coercive power due to the implicit threat of funds taking the dialogue into the AGM (in the form of either resolutions or voting) if their claims are not met.

Second, the empirical research provided evidence that AGM-participation allows funds to build both organizational and individual legitimacy as target firms appreciate fund managers that participate in the AGMs, acknowledging them as interested and serious owners.

Third, when engagement dialogue takes a public form through AGMs, for instance by funds raising questions or using formal shareholder rights such as resolutions, a strong component of normative power is present, stemming from the reputation risk of the leadership and brand of the target firm. Such a public dialogue also increases the criticality by increasing the pressure of the target firm to respond to the claims.

Concerning coalitions, the empirical research provided strong evidence that dialogues through coalitions enhance the salience of shareholder claims. However, coalitions were not abundantly used in the Swedish context. Instead, funds identified the largest benefits of coalitions in an international context where the individual fund lacks organizational legitimacy and the cultural understanding that allow them to navigate engagement dialogues effectively.

Although coalitions enhance shareholder salience, there are limitations to coalitions that could explain why funds do not utilize coalitions more in the Swedish context. For instance, there are large overheads associated with coalitions, evident from both the empirical material as well as previous research (Gifford, 2010). Furthermore, coalitions imply that the credit for the engagement is shared, which is especially problematic if there are large free-rider problems associated with coalitions (Gifford, 2010). If engagement is treated as a marketing asset, coalitions therefore become especially problematic.

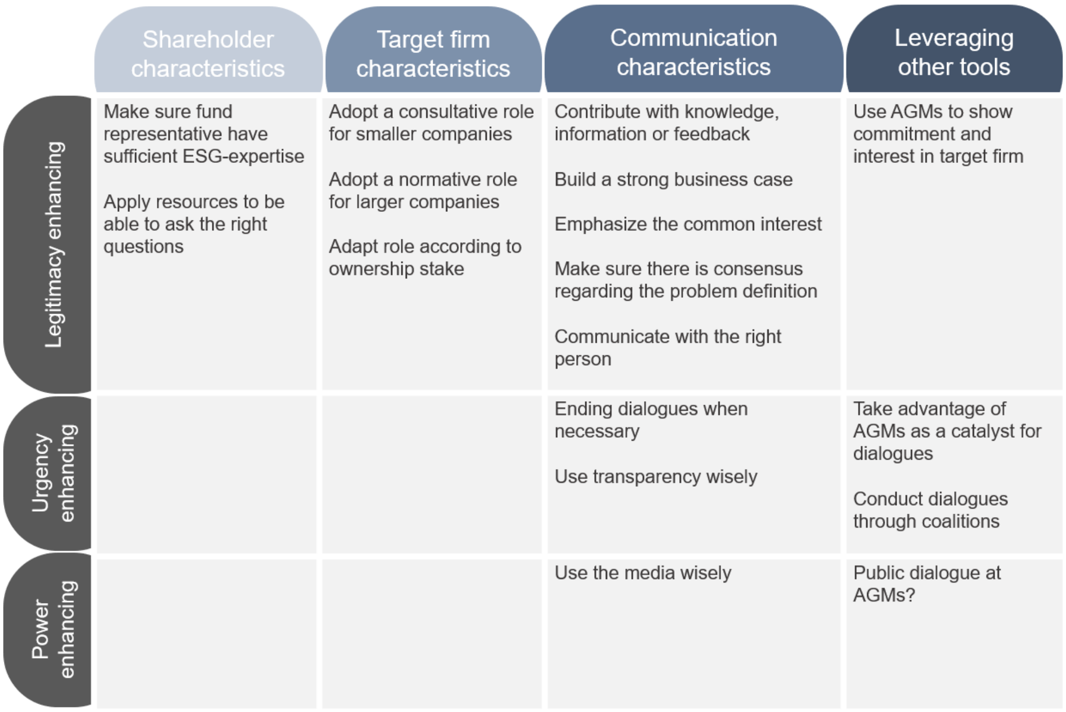
*Table 11. Sources to fund influence analyzed by Gifford's* (2010) *shareholder salience framework*

| | **Power enhancing** | | | **Legitimacy enhancing** | | | | **Urgency enhancing** | |
|---|---|---|---|---|---|---|---|---|---|
| | Coercive | Utilitarian | Normative | Individual | Organizational | Pragmatic | Social | Time sensitivity | Criticality |
| Dialogue before AGM | | | + | | | | | + | + |
| Participating in AGM | | | | + | + | | | | |
| Public dialogue at AGM | + | | + | | - | | | + | + |
| Dialogue through coalitions | | | + | | + | | | | + |

## 6.3.5 A framework of how shareholder salience is achieved in the Swedish context

In order to outline the mechanisms and critical factors used by funds to achieve shareholder salience in engagement dialogues, a framework is developed based on the empirical and theoretical discussion above. The framework aims to summarize the discussion above, explaining how the different factors identified in the empirical material contributes to shareholder salience by either enhancing the legitimacy, urgency, or power of funds. The framework is presented in figure 8.

*Figure* 8. *How is shareholder salience achieved among Swedish funds?*



| | Shareholder characteristics | Target firm characteristics | Communication characteristics | Leveraging other tools |
|---|---|---|---|---|
| Legitimacy enhancing | Make sure fund representative have sufficient ESG-expertise<br>Apply resources to be able to ask the right questions | Adopt a consultative role for smaller companies<br>Adopt a normative role for larger companies<br>Adapt role according to ownership stake | Contribute with knowledge, information or feedback<br>Build a strong business case<br>Emphasize the common interest<br>Make sure there is consensus regarding the problem definition<br>Communicate with the right person | Use AGMs to show commitment and interest in target firm |
| Urgency enhancing | | | Ending dialogues when necessary<br>Use transparency wisely | Take advantage of AGMs as a catalyst for dialogues<br>Conduct dialogues through coalitions |
| Power enhancing | | | Use the media wisely | Public dialogue at AGMs? |

The framework together with the analysis presented in the above chapter points to the fact that legitimacy would be the most important attribute to achieve shareholder salience for Swedish mutual funds. This is in line with the findings of Gifford (2010) and Santos, Sealey and Onuoha (2014). Furthermore, there is no strong evidence that time-sensitivity, utilitarian power, coercive power, and social legitimacy would attributes used by Swedish funds to achieve shareholder salience.

From the empirical material, there seems to be a difference between reactive and proactive dialogues, where funds seem to draw more upon attributes of power and urgency (e.g. hard deadlines, threats of divestments) in reactive dialogues compared to proactive dialogues. In addition, when it comes to leveraging other tools of engagement in dialogues, these seem to trigger attributes of power and urgency. This highlights an interesting interaction between dialogue and other engagement tools, suggesting that different tools might interplay or perhaps even counteract each other as they activate different attributes of shareholder salience. Gifford (2010) proposes similar ideas, discussing how aggressive urgency- or power-based approaches can be counteractive if they damage shareholder legitimacy.

# 7 Conclusion

This paper set out to address how Swedish equity funds could leverage their ownership through engagement dialogues to improve corporate sustainability. In order to do so, two research questions were formulated.

- How should the internal processes be designed to support the engagement process?
- What are the mechanisms by which ESG-related engagement dialogues successfully unfolds between Swedish equity funds and their portfolio companies?

In order to provide an answer to the research questions above, the theoretical framework, empirical findings and discussion was structured according to the following three themes:

1. The role and form of engagement dialogue in the Swedish context
2. Internal processes to support engagement dialogues
3. Mechanisms by which engagement dialogue successfully unfolds

The aim of the paper was to provide the theoretical and empirical findings separately, before combining these findings in the discussion. This resulted in three frameworks, one for each of the three themes, aiming to guide funds in how to better leverage their ownership through engagement dialogues.

The main conclusions for each theme are presented below:

1. The role and form of engagement dialogue in the Swedish context

   The empirical material suggests that Swedish funds allow dialogue to be at the heart of their engagement efforts, as they believe dialogue to be the most effective tool for shareholder engagement. Even though there was consensus in the empirical material that dialogue is the go-to-tool of shareholder engagement, there were several different views of the purpose and form of engagement dialogue. Therefore, a framework to categorize different ways of doing engagement dialogue was developed (the maturity matrix), classifying the quality of the dialogue in terms of both maturity and intensity. The aim is for the framework to facilitate any quality evaluation of engagement dialogues between different funds, as well as provide a roadmap to funds on how to improve their engagement practices.

   According to the maturity matrix, there are two general ways for funds to improve their engagement dialogues. First, funds can exercise a higher degree of their engagement opportunities by widening their scope in terms of dialogue-type (proactive vs. reactive) as well as target firm-type (industry laggards vs. industry leaders). Second, funds can increase the intensity of their engagement, implying that firms should move from a temporary view of their dialogues to see dialogue as a continuous effort.

2. Internal structures to support engagement dialogues

Engagement dialogues must be approached by funds internally in a way that creates efficient workstreams and maximizes responsiveness from target firms. This involves setting up an organizational structure and approach that fits a fund's current organizational structure, their in-house competence, their time horizon and relationship with portfolio companies. The empirical evidence therefore points to the fact that there is no one-size-fits-all type of internal approach that best supports engagement dialogues. Instead, the empirical materials suggest that there are four distinct ways of how fund companies can internally organize their engagement dialogues. The distinction between the four different approaches is made up by two choices funds make regarding their internal processes for engagement dialogue. First, a fund company can choose to have either sustainability experts or fund managers in charge of the engagements. Second, funds can choose to structure their approach to engagement dialogues on either a thematic or case-by-case basis.

Analysis from both an empirical and theoretical point of view suggest that there are several tradeoffs between the four different approaches, where a fund's current weaknesses or strengths can be amplified depending on how they choose to organize their processes for engagement dialogues. As a result, each fund company must evaluate what strategy they believe to be the most efficient depending on their prerequisites for, and purpose with, engagement dialogues. To help funds make such evaluations, this paper developed a framework based on the empirical material and theoretical discussion above, outlining the major trade-offs between the four different approaches to engagement dialogues that funds were found to have.

The other important internal process to support engagement was found to be the evaluation of engagements. The empirical material pointed to the fact that engagement needs to be evaluated in a way that enables learnings and continuous improvements. However, neither the theory nor the empirical research provided clear-cut answers of how the evaluation of engagement dialogues should be done. The empirical material pointed to the importance of a qualitative rather than a quantitative evaluation, but very few concrete ways to achieve proper qualitative evaluation was provided. Without proper methods to evaluate engagement, funds can neither learn from nor incentivize engagements in an effective way. Therefore, this topic should be further explored in future research.

3. Mechanisms by which engagement dialogue successfully unfolds

> From the interviews, several mechanisms and critical factors were identified by which engagement dialogues successfully unfolds between Swedish equity funds and their portfolio companies. Among important factors mentioned was the ESG-expertise of the fund representative and the business case of any suggestions put forward. Funds were also encouraged to build on the common interest between them and the target firm, adopt the right role depending on target firm characteristics and make sure to make an active contribute in engagement dialogues.
>
> The factors identified through the empirical research were analyzed according to a shareholder salience framework, resulting in evidence that legitimacy would be the most important attribute to achieve shareholder salience for Swedish equity funds.

Overall, target firms expressed that their owners are among the most important, if not the most important, stakeholder group when it comes to how firms address ESG-challenges. However, equity funds were not generally thought of as sufficiently knowledgeable or interested in sustainability in order for engagement dialogues to unfold successfully. An important conclusion is therefore that there are untapped opportunities for actively managed equity funds to better leverage their positions of ownership to increase corporate sustainability.

In fact, ESG-engagements could even be a way forward for actively managed equity funds to create added-value to their customers. As actively managed funds have fewer and more consciously chosen holdings in their portfolio compared to passively managed funds, they can dedicate more time to engage with each of their investee companies. Hence, actively managed funds have more incentives and are better positioned to engage compared to passively managed funds. As a result of the research pointing to actively managed funds seldom outperforming passively managed funds (e.g. French, 2008; Gruber, 1996), shareholder engagement could therefore become an increasingly important selling point to attract investments into actively managed funds.

# 8 References

Adams, Renée B., Amir N. Licht, and Lilach Sagiv. 2011. “Shareholders and Stakeholders: How Do Directors Decide?” *Strategic Management Journal* 32 (12): 1331–55. https://doi.org/10.1002/smj.940.

Agle, Bradley R, Ronald K Mitchell, and Jeffrey Sonnenfeld. 1999. “Who Matters to CEOs ? An Investigation of Stakeholder Attributes and Salience , Corporate Performance , and CEO Values Author ( s ): Bradley R . Agle , Ronald K . Mitchell and Jeffrey A . Sonnenfeld Source : The Academy of Management Journal , Vol . 42 ,.” *Academy of Management Journal* 42 (5): 507–25.

Aguinis, Herman, and Angelo M. Solarino. 2019. “Transparency and Replicability in Qualitative Research: The Case of Interviews with Elite Informants.” *Strategic Management Journal* 40 (8): smj.3015. https://doi.org/10.1002/smj.3015.

Alvesson, Mats, and Stanley Deetz. 2011. “Doing Critical Management Research.” 192–210. https://doi.org/10.4135/9781849208918.

Appel, Ian R., Todd A. Gormley, and Donald B. Keim. 2016. “Passive Investors, Not Passive Owners.” *Journal of Financial Economics* 121 (1): 111–41. https://doi.org/10.1016/j.jfineco.2016.03.003.

Baxter, Pamela, and Susan Jack. 2008. “Qualitative Case Study Methodology: Study Design and Implementation for Novice Researchers.” *The Qualitative Report Volume*. Vol. 13. https://doi.org/10.2174/1874434600802010058.

Bicksler, James L., Robert Monks, and Nells Minow. 1996. “Corporate Governance.” *The Journal of Finance* 51 (2): 774. https://doi.org/10.2307/2329384.

Blomkvist, Pär, and Anette Hallin. 2014. ’’Metod För Teknologer : Examensarbete Enligt 4-Fasmodellen’’. Studentlitteratur.

Callen, Jeffrey L., and Xiaohua Fang. 2013. “Institutional Investor Stability and Crash Risk: Monitoring versus Short-Termism?” *Journal of Banking and Finance* 37 (8): 3047–63. https://doi.org/10.1016/j.jbankfin.2013.02.018.

David, Parthiban, Matt Bloom, and Amy J. Hillman. 2007. “Investor Activism, Managerial Responsiveness, and Corporate Social Performance,” 91–100. https://doi.org/10.2307/20142423.

Delmas, M.A. and Burbano, V.C. (2011), “The drivers of greenwashing”, *California Management Review* , Vol. 54 No. 1, pp. 64-87.

Dimson, Elroy, O˘ Guzhan, Karaka¸s Karaka¸s, and Xi Li. 2015. “Active Ownership.” *Oxford University Press*. https://doi.org/10.1093/rfs/hhv044.

Durach, Christian F., Joakim Kembro, and Andreas Wieland. 2017. “A New Paradigm for Systematic Literature Reviews in Supply Chain Management.” *Journal of Supply Chain Management* 53 (4): 67–85. https://doi.org/10.1111/jscm.12145.

Dyck, Alexander, Karl V. Lins, Lukas Roth, and Hannes F. Wagner. 2019. “Do Institutional Investors Drive Corporate Social Responsibility? International Evidence.” *Journal of Financial Economics* 131 (3): 693–714. https://doi.org/10.1016/j.jfineco.2018.08.013.

Eisenhardt, Kathleen M. 1989. “Building Theories from Case Study Research.” *Source: The Academy of Management Review*. Vol. 14. https://www.jstor.org/stable/258557.

European Commission. 2019. “Green New Deal.” https://doi.org/10.2307/j.ctvd1c6zh.7.

Ferraro, Fabrizio, and Daniel Beunza. 2019. “Creating Common Ground: A Communicative Action Model of Dialogue in Shareholder Engagement.” *Organization Science* 29 (6): 1187–1207. https://doi.org/10.1287/orsc.2018.1226.

Finansinspektionen. 2016. “How Can the Financial Sector Contribute to Sustainable Development?”

French, Kenneth.R. (2008), Presidential Address: The Cost of Active Investing. The Journal of Finance, 63: 1537-1573. doi:10.1111/j.1540-6261.2008.01368.x

Gehman, Joel, Vern L. Glaser, Kathleen M. Eisenhardt, Denny Gioia, Ann Langley, and Kevin G. Corley. 2017. “Finding Theory–Method Fit: A Comparison of Three Qualitative Approaches to Theory Building.” *Journal of Management Inquiry* 27 (3): 284–300. https://doi.org/10.1177/1056492617706029.

Gifford, E. James M. 2010. “Effective Shareholder Engagement:The Factors That Contribute to Shareholder Salience.” *Journal of Business Ethics* 92 (SUPPL 1): 79–97. https://doi.org/10.1007/s10551-010-0635-6.

Gioia, Dennis A, , Kevin G. Corley, and Aimee L. Hamilton. 2012. “Seeking Qualitative Rigor in Inductive Research: Notes on the Gioia Methodology.”

Goodman, Jennifer, Céline Louche, and Katinka C van Cranenburgh. 2014. “Social Shareholder Engagement: The Dynamics of Voice and Exit.” *Journal of Business Ethics* 125 (2): 193–210. https://doi.org/10.1007/s10551-013-1890-0ï.

Gruber, Martin J. "Another Puzzle: The Growth in Actively Managed Mutual Funds." *The Journal of Finance* 51, no. 3 (1996): 783-810. Accessed June 15, 2020. doi:10.2307/2329222.

Hamilton, Ian, and Jessica Eriksson. 2011. “Influence Strategies in Shareholder Engagement: A Case Study of All Swedish National Pension Funds.” *Journal of Sustainable Finance and Investment* 1 (1): 44–61. https://doi.org/10.3763/jsfi.2010.0006.

Harte, George, Linda Lewis, and David Owens. 1991. “Ethical Investment and the Corporate Reporting Function.” *Critical Perspectives on Accounting*. Vol. 2.

Hebb, Tessa, Heather Hachigian, and Rupert Allen. 2012. “Measuring the Impact of Engagement in Canada.” In *The Next Generation of Responsible Investing*, 107–25. Springer Netherlands. https://doi.org/10.1007/978-94-007-2348-1_7.

Hoffman, Andrew. 1996. “A Strategic Response to Investor Activism.” *Sloan Management Review* 37 (2): 51–64.

Ivanova, Mila R. 2017. “Institutional Investors as Stewards of the Corporation: Exploring the Challenges to the Monitoring Hypothesis.” *Business Ethics* 26 (2): 175–88. https://doi.org/10.1111/beer.12142.

Karliner, J. (1997), *The Corporate Planet* , Sierra Club Books, San Francisco, CA.

Kosowski, Robert, Do Mutual Funds Perform When it Matters Most to Investors? US Mutual Fund Performance and Risk in Recessions and Expansions (August 1, 2006).

Kuna-marszalek, Anetta, and Agnieszka Klysik-uryszek. 2020. *CSR and Socially Responsible Investing Strategies in Transitioning and Emerging Economies*. Edited by Anetta Kuna-Marszałek and Agnieszka Kłysik-Uryszek. Advances in Business Strategy and Competitive Advantage. IGI Global. https://doi.org/10.4018/978-1-7998-2193-9.

Logsdon, Jeanne M., and Harry J. Van Buren. 2009. “Beyond the Proxy Vote: Dialogues between Shareholder Activists and Corporations.” In *Journal of Business Ethics*, 87:353–65. https://doi.org/10.1007/s10551-008-9807-z.

Logsdon, Jeanne M., Kathleen Rehbein, and Harry J. Van Buren III. 2007. “SEEKING SOCIAL CHANGE THROUGH SHAREHOLDER ACTIVISM: WHEN DO CORPORATIONS RESPOND POSITIVELY TO SHAREHOLDER RESOLUTIONS?” *Academy of Management Annual Meeting Proceedings*.

Lu, Lingyi, Viktoria Nacksten, and Kajsa Brundin. 2019. “Söderberg & Partners Hållbara Fonder 2019.” 2019. https://online.flippingbook.com/view/884525/.

McCahery, Joseph A., Zacharias Sautner, and Laura T. Starks. 2016. “Behind the Scenes: The Corporate Governance Preferences of Institutional Investors.” *Journal of Finance* 71 (6): 2905–32. https://doi.org/10.1111/jofi.12393.

Mitchell, Ronald K., Bradley R. Agle, and Donna J. Wood. 1997. “Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts.” *The Academy of Management Review* 22 (4): 853. https://doi.org/10.2307/259247.

Neubaum, Donald O., and Shaker A. Zahra. 2006. “Institutional Ownership and Corporate Social Performance: The Moderating Effects of Investment Horizon, Activism, and Coordination.” *Journal of Management* 32 (1): 108–31. https://doi.org/10.1177/0149206305277797.

Nordström, Fredrik. 2020. “The Contemporary Swedish Fund Market - Swedish Investment Fund Association.” 2020. https://www.fondbolagen.se/en/Facts_Indices/the-swedish-fund-market-today/.

O’Rourke, Anastasia. 2003. “A New Politics of Engagement: Shareholder Activism for Corporate Social Responsibility.” *Business Strategy and the Environment* 12 (4): 227–39. https://doi.org/10.1002/bse.364.

Parguel, B. , Benoit-Moreau, F. and Larceneux, F. (2011), “*How sustainability ratings might deter ‘greenwashing’: a closer look at ethical corporate communication*”, *Journal of Business Ethics* , Vol. 102 No. 1, pp. 15-28.

Perks, R. W., D. H. Rawlinson, and L. Ingram. 1992. “An Exploration of Ethical Investment in the UK.” *The British Accounting Review*. Vol. 24. https://doi.org/10.1016/S0890-8389(05)80066-6.

Peterson, Richard A., and Amitai Etzioni. 1965. “Modern Organizations.” *American Sociological Review* 30 (4): 632. https://doi.org/10.2307/2091393.

Polla, Thierry. 2012. *Norm-Based Exclusions; How Responsible Investors Handle Controversial Companies.* . Novethic Research. https://www.scribd.com/document/358522133/Norm-based-exclusions-how-responsible-investors-handle-controversial-companies-Thierry-Polla.

Proffitt, W. Trexler, and Andrew Spicer. 2006. “Shaping the Shareholder Activism Agenda: Institutional Investors and Global Social Issues.” *Strategic Organization* 4 (2): 165–90. https://doi.org/10.1177/1476127006064067.

Provan, K. G. 1982. *Power in Organizations. Academy of Management Review*. Vol. 7. https://doi.org/10.5465/amr.1982.4285388.

Revelli, Christophe, and Jean-Laurent Viviani. 2015. “Financial Performance of Socially Responsible Investing (SRI): What Have We Learned? A Meta-Analysis.” *Business Ethics: A European Review* 24 (2): 158–85. https://doi.org/10.1111/beer.12076.

Rivoli, Pietra. 2003. “Making a Difference or Making a Statement? Finance Research and Socially Responsible Investment,” 271–87. https://doi.org/10.2307/3857782.

Rubach, Michael J, and Terrrence C. Sebora. 2009. “Determinants of Institutional Investor Activism : A Test of the Ryan-Schneider Model Author ( s ): Michael J . Rubach and Terrence C . Sebora Published by : Pittsburg State University Stable URL : Https://Www.Jstor.Org/Stable/40604646 REFERENCES Linked Re” 21 (2): 245–61.

Ryan, Lori Verstegen, and Marguerite Schneider. 2003. *Institutional Investor Power and Heterogeneity: Implications for Agency and Stakeholder Theories*. *Business & Society*. Vol. 42. https://doi.org/10.1177/0007650303260450.

Santos, Nicholas J.C., John Sealey, and Austin G.C. Onuoha. 2014. “Shareholder Engagement and Chevron’s Policy 520 on Human Rights: The Role Played by the United States Jesuit Conference’s ‘National Jesuit Committee on Investment Responsibility.’” *Critical Studies on Corporate Responsibility, Governance and Sustainability* 7: 43–63. https://doi.org/10.1108/S2043-905920140000007002.

Scherer, Andreas Georg, and Guido Palazzo. 2007. “Toward a Political Conception of Corporate Responsibility: Business and Society Seen from a Habermasian Perspective.” *Academy of Management Review*. Vol. 32. https://doi.org/10.5465/AMR.2007.26585837.

Semenova, N. & Hassel, L.G. (2019) Private engagement by Nordic institutional investors on environmental, social, and governance risks in global companies. Corporate Governance: An International Review 27(2): 144–61.

Shleifer, Andrei, and Robert W. Vishny. 1997. "A Survey of Corporate Governance." *The Journal of Finance* 52 (2): 737. https://doi.org/10.2307/2329497.

Simpson, George, Max Weber, A. M. Henderson, and Talcott Parsons. 1948. *The Theory of Social and Economic Organization. The Philosophical Review*. [1st Ameri. Vol. 57. New York: Oxford University Press. https://doi.org/10.2307/2181723.

Sjöström, Emma. 2009. "Shareholder Influence on CSR: A Study of the Swedish Corporate Sector."

Sjöström, Emma. 2010. "Shareholders as Norm Entrepreneurs for Corporate Social Responsibility." *Journal of Business Ethics* 94 (2): 177–91. https://doi.org/10.1007/s10551-009-0255-1.

Sjöström, Emma. 2020. "Active Ownership on Environmental and Social Issues: What Works?" www.mistra.org.

Sparkes, Russell, and Christopher J. Cowton. 2004. "The Maturing of Socially Responsible Investment: A Review of the Developing Link with Corporate Social Responsibility." *Journal of Business Ethics*. https://doi.org/10.1023/B:BUSI.0000033106.43260.99.

Suchman, Mark C. 1995. "Managing Legitimacy: Strategic and Institutional Approaches." *The Academy of Management Review* 20 (3): 571. https://doi.org/10.2307/258788.

Tranfield, David, David Denyer, and Palminder Smart. 2003. "Towards a Methodology for Developing Evidence-Informed Management Knowledge by Means of Systematic Review." *British Journal of Management* 14 (3): 207–22. https://doi.org/10.1111/1467-8551.00375.

Uysal, Nur. 2014. "The Expanded Role of Investor Relations: Socially Responsible Investing, Shareholder Activism, and Organizational Legitimacy." *International Journal of Strategic Communication* 8 (3): 215–30. https://doi.org/10.1080/1553118X.2014.905478.

Vandekerckhove, Wim, Jos Leys, and Dirk Van Braeckel. 2007. "That's Not What Happened and It's Not My Fault Anyway! An Exploration of Management Attitudes towards SRI-Shareholder Engagement." *Business Ethics: A European Review* 16 (4): 403–18. https://doi.org/10.1111/j.1467-8608.2007.00512.x.

Wen, Shuangge. 2009. “Institutional Investor Activism on Socially Responsible Investment: Effects and Expectations.” *Business Ethics: A European Review* 18 (3): 308–33. https://doi.org/10.1111/j.1467-8608.2009.01565.x.

Wermers, Russ. "Mutual Fund Performance: An Empirical Decomposition into Stock-Picking Talent, Style, Transactions Costs, and Expenses." *The Journal of Finance* 55, no. 4 (2000): 1655-695. Accessed June 15, 2020. www.jstor.org/stable/222375.

Wilson, Virginia. 2012. “Research Methods: Interviews.” *Evidence Based Library and Information Practice*, no. 7: 96–98. https://doaj.org/article/038d446f67174d509eacbf99af6587b4.

Winter, Jaap W. 2012. “Shareholder Engagement and Stewardship: The Realities and Illusions of Institutional Share Ownership.” *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.1867564.

Wook Lee, Dong, and Kyung Suh Park. 2009. “Does Institutional Activism Increase Shareholder Wealth? Evidence from Spillovers on Non-Target Companies.” *Journal of Corporate Finance* , no. 15: 488–504.

Yin, Robert K. 2017. “Designing Case Studies.” In *Case Study Research and Applications: Design and Methods,* 414. SAGE Publications, Inc.

# Appendix I – The different approaches illustrated by four cases

In order to illustrate each of the four strategies, the case of four different fund companies are described below. Table 12 outlines key characteristics of the engagement approach between these different fund companies, described in more detail in the different cases. The cases aim to highlight the reasoning behind the chosen strategy for the four different fund companies to show that all four strategies can be effective, but that each fund company must evaluate what strategy they believe to be the most useful in their context. Furthermore, the cases aim to illustrate how the practical infrastructure and processes might look like for each strategy.

*Table 12. Overview of differences between the cases below*

| | **Sustainability team function** | **Approach to proactive dialogue** | **Dialogue initiation** | **Key aspects** |
|---|---|---|---|---|
| **Fund A: Focused strategy** | Supports fund managers with analysis and develops tools and processes | Thematic approach based on sectors to identify laggards | In-house analysis to compile questions to all concerned holdings. The answers are vetted, discussed and companies are ranked | Focus on developing infrastructure to make ESG-data and news as accessible for the fund managers as financial results |
| **Fund B: Integrated strategy** | No supporting sustainability team | Case-by-case approach based on the mutual benefits of improved sustainability | In-house analysis to identify questions to management of unclear or worrying aspects | Incentivize fund managers to help fund managers prioritize sustainability |
| **Fund C: Specialized strategy** | Perform ESG analysis and drive the engagement | Thematic approach based on chosen SDGs to identify laggards | Norm-based screenings and analysis through their own ESG-analysis framework | |
| **Fund D: Flexible strategy** | Perform ESG analysis and drive the engagement | Case-by-case approach based on level of exposure and magnitude of challenges | Norm-based screenings and analysis through their own ESG-analysis framework | An engagement strategy is drafted for each engagement. They also drive thematic engagements through a third-party service provider |

### i. A focused strategy: Company A

In Fund Company A, the fund managers are responsible for all engagement dialogues, but they are supported by a sustainability team with dual purposes. First, the sustainability team has a direct supportive function to the fund managers when it comes to ESG-analysis and dialogues. Second, the team has an indirect enabling role, where they develop new tools and processes to enhance the fund managers’ prerequisites for ESG analysis and engagement.

The model applied by Company A is a collaborative one, where one fund manager and one member of the sustainability team are involved in each ‘case’, meaning each engagement process. The division of labor between the two varies depending on the fund manager’s understanding of the ESG issue. In some cases, the fund manager can have a better understanding of the problem and context than the sustainability team. In such cases, it is natural that the fund manager takes the lead. For instance, if they are working with a case on deforestation, and one of the fund managers is an educated agronomist, the fund manager can conduct much of the analysis by themselves. In other cases, the ESG-team can support the fund manager with the problem identification. For instance, Company A uses carbon dioxide emissions as a proxy for climate risk in between norm-based screenings and stress-tests, but it is not always evident what the causality between a portfolio company’s carbon dioxide emissions and their climate risk is. In such cases, the sustainability team can provide their specialist knowledge to facilitate the analysis of the actual climate risks, which are only indicated by the proxy.

By receiving guidance and support from the sustainability team, the fund managers develop their own skills and knowledge when it comes to ESG and engagement. Hence, they become better equipped to lead the next case to a larger extent. For fund company A, the sustainability team has no value in itself. Rather, the goal is to make the sustainability team redundant as the fund managers develop the skills to manage the ESG-analysis and engagement processes on their own.

Today, the fund managers are flooded by information. As they receive loads of emails from their third party ESG service provider, important information can easily be missed. Hence, the sustainability team also focuses on building an infrastructure for the fund managers to have the relevant information available and understandable. The goal is for the necessary ESG-data, such as carbon dioxide emissions and relevant news flashes, to be as simple for the fund managers to access and navigate as the quarterly financial results.

If the sustainability team identifies an imbalance in the number of dialogues held between funds, they will approach the fund manager to identify why less dialogues are held in that fund. Are all portfolio companies perfect or do the fund manager require more support in the engagement processes? Furthermore, Company A has a dialogue-group with both fund managers and members from the sustainability team. The group discusses what dialogues to initiate and evaluates the ongoing dialogues. The evaluation often concerns the lack of, or insufficient, responses from companies. By seeking the advice from experienced fund managers, further action is evaluated in terms of their chances to get a better response and subsequently if they should divest or join forces in a coalition to get through to the company?

Although Company A can proactively engage in dialogues with portfolio companies after general norm-based screenings, their proactive dialogues are often done in a thematic way. The thematic approach is based on Company A’s exposure to a particular industry or sector in combination with the extent of the challenges in that industry. When a sector is chosen, an analysis is performed to compile fundamental questions to ask all concerned holdings. As the portfolio companies submit their answers, the information is vetted and compared against external sources of information.

The next step is to discuss all cases with the concerned fund managers and rank all companies. Who are the industry leaders and are they taking enough ESG action? Why do the other companies not perform on the same level? While the actual rating is not important in absolute terms, it provides a structured process to compare and benchmark the portfolio companies against each other.

When the rating is complete, the risk is evaluated per company. If the risk is too large, Company A will choose to divest as they are not willing to bear this extensive risk during an engagement process. If Company A assesses that they can bear the extra risk for a while as they engage to improve the ESG practices of the portfolio company, they initiate a dialogue with the company. Hence, the thematic process is a way to identify laggards, in relation to what Company A expects of their portfolio companies, and hence raise the level of best practice in the entire sector.

After the sector evaluation, Company A can initiate dialogues with one percent of their holdings in that sector, or with fifty percent, as they do not work with relative performance evaluation. Instead, they build their benchmark on what Company A themselves assess is the accepted level of the sustainability performance. For instance, when this thematic approach was performed in the online casino industry, no company lived up to the sustainability expectations of Company A, and hence they chose to divest in the entire sector. The current thematic process has been going on for six months and will probably result in demands of reduced drug use in a specific food sector.

By having a sustainability team supporting the fund managers, skills and knowledge about ESG is infused in the investment process. As the time of the fund managers is the limiting factor, a supporting sustainability team can help free up resources for proactive engagements. Working thematically is another way to prioritize the resources, as it allows Company A to improve the effectiveness of their engagement process. By targeting their research, they can ask better questions, raise the important issues and put forward the right demands.

Company A also emphasizes that the role of the fund manager is changing in terms of the ESG skills and knowledge that is required. One way to tackle this is to have specialists support the fund managers in this transition period, as well as facilitating the knowledge development of the fund managers. As ESG becomes increasingly important for the value development of their portfolio companies, Company A believes that ESG cannot be separated from the investment analysis and ongoing ownership. Hence, as ESG is related to the *investment alpha*, the engagement must be led by the fund managers. Although they have a separate ESG-team, they sit together and work closely with the fund managers in order to mitigate the issues that Company A have seen with other large funds, where the ESG team is almost completely detached from the fund management team.

### ii. An integrated strategy: Company B

For fund Company B, sustainability is an integrated part of the investment process, and not something that can be added as a topping. Therefore, their fund managers are not only responsible for integrating ESG analysis into the investment process, but they are also in charge of the engagement initiatives with their portfolio companies.

To support the fund managers, Company B has a committee for responsible investments. The committee members are no sustainability experts, but in their different roles they can help structure and manage different processes related to sustainability. The committee can also help in terms of having an ear to the ground to catch demands from customers, the public and the media. Overall, Company B feels a strong pressure from their clients to invest and own responsibility.

For Company B, investing in the right companies is an integral part of their sustainability practices. As they are long-term owners, they want the companies to have a long-term perspective, which means that their portfolio companies need to be prepared for the ESG-related megatrends. As they invest in ‘good’ companies, they have been spared from reactive dialogues in many cases. Instead, they believe that the proactive dialogue holds much more potential to influence the companies they invest in.

Company B educates their fund managers in responsible investments, but they also incentivize the fund managers to work with sustainability and engagement by including ESG related goals into the performance evaluation. So far, these goals are mainly about making sure all holdings have been analyzed according to their newly developed ESG-analysis framework, but they are also considering incentivizing engagement dialogues. Although the fund managers understand that ESG-issues are material to the investments, the incentives are in place to help the fund managers prioritize Company B’s commitment to sustainability.

The fund managers continuously engage in dialogues with the portfolio companies. The proactive dialogues are held with good intent and with a cooperative approach. Rather than pushing hard demands, company B centers the discussions around the mutual benefits of improving the portfolio company’s sustainability practices. ‘How could we help you improve?’ is therefore the central question. Hence, the fund manager will support and encourage the companies by providing their perspective and experience. One example of this is the transfer of best practices between companies when it comes to structuring and accounting for their ESG impact. For instance, the fund manager could say *‘Company XX is using Scope 3 in their accounting, maybe you should too’*.

Overall, the proactive dialogues are often centered around encouraging a more structured and integrated approach to sustainability as well as encouraging more sustainability investments. Being a long-term and loyal shareholder facilitates the proactive dialogues, as trust has been built up in the relationship. If the portfolio company experiences that company B have supported them in ups and downs, and that Company B has had valuable input in the past, it increases the likelihood of the portfolio company heeding to the opinions of Company B.

The relationship between the fund manager and the portfolio company is also important for a successful proactive dialogue. As the fund manager is the one that has made the decision to invest, and therefore believes in the portfolio company, the fund manager is respected by the portfolio company. Furthermore, Company B believes that the conversations outside ESG-issues help build their legitimacy as a trustworthy partner, which increases their opportunities for successful proactive dialogues when it comes to sustainability. This is another reason why Company B have chosen to let their fund managers run the engagement processes.

Company B performs a regular norm-based screening of the portfolio companies by a third party service provider. They receive external analysis of companies but emphasize the importance of their in-house analysis in order to evaluate the sustainability performance of their holdings. In fact, Company B has seen a shift in recent years of how sustainability issues are addressed. Before, the gut feeling was often the guiding light for the fund managers when it came to evaluate the portfolio companies' sustainability work. Today, a much more structured analysis is performed by the fund managers to evaluate the company performance and improvements in relation to sustainability.

In order to facilitate the in-house sustainability analysis for the fund managers, an ESG-analysis framework has been developed. The tool is meant to improve both the ESG integration in the investment analysis and the proactive dialogues with portfolio company management. At the end of the analysis, the fund manager can add 'Questions for company management' to be addressed at the next meeting if anything is unclear or worrying. The tool was implemented to help the fund managers work more structured with ESG integration and engagement dialogues, but the tool also enables Company B to be more transparent on their ESG work toward their clients.

To further facilitate a structured process, a log is used to keep track of ongoing dialogues. The log supports the fund managers to follow-up the engagement dialogues. As several fund managers will interact with the same company, the log also enables cooperation between the fund managers on sustainability issues. Company B emphasizes the importance of communicating a coherent message to the portfolio companies when it comes to proactive dialogues, which the log aids with. As all ESG-analysis and comments about the dialogues are transparent within the company, the log together with the new ESG-analysis framework also facilitates a knowledge dispersion among the fund managers.

Although other fund companies work thematically, Company B addresses proactive dialogues on a case-by-case basis. As the fund managers are responsible for the engagement process, the proactive dialogues need to be based on their analysis and knowledge of each company. The issues raised can be anything from improved sustainability accounting, hiring a sustainability manager or upgrading the production facilitates. However, there are also companies that ‘do everything right’, meaning they do not only invest to improve internal processes but also have a product that will benefit from increased ESG-focus in demands and legislation. In these cases, company B experiences that a portfolio company need little additional help as they can manage improvements on their own. However, a continuous dialogue is still performed, but with an aim to transfer knowledge rather than express demands and expectations, for instance regarding new legislation such as the EU Taxonomy.

### iii. A specialized strategy: Company C

Fund Company C organizes their ESG analysis and engagement processes through a dedicated sustainability team.  Although the fund managers engage in dialogues as a part of the investment processes, Company C wouldn’t call those dialogues impact-dialogues, i.e. targeted and strategic dialogues to achieve a specific change in a portfolio company. By having a separate team handling the engagement efforts, they can direct more resources to their sustainability work.

Company C has a strong thematic focus, where they target their proactive dialogues on a limited number of global challenges, for instance mitigating climate change or corruption. The dialogues are often initiated after a norm-based screening and analysis through their own ESG-analysis framework, where the sustainability team identifies the laggards in relation to the chosen themes in each sector. Even though a company can have an overall score that is more than acceptable, there can be certain aspects relating to any of the focus-areas that needs to improve. Through an engagement selection process, these weaknesses are identified, and a dialogue is initiated to encourage the company to improve in that specific area. In many cases, the initial dialogues are not directly targeted at presenting company C’s expectations on the portfolio company. Instead, initial dialogues and field visits can be used to gather information in order to formulate what expectations that they should emphasize in the subsequent dialogues.

According to Company C, they are not meant to solve the problems of their portfolio companies through engagement. Instead, the goal is that all proactive dialogues should be constructive and result in actions from the companies. For the dialogues to be constructive, company C believes that it is important to know what they are talking about in order to be legitimate in their claims and opinions. Hence, the dialogue drivers need to understand the company and the business sector whenever they engage in proactive dialogues. Personal experience of engagement dialogues is also key to achieving successful proactive dialogues, according to company C, which is another reason for them to focus their engagement efforts through a specialized team. If the holding is a large one in a particular fund, the fund managers can participate in the engagement meetings with the portfolio companies.

Another important factor in order to be successful with proactive dialogues is to target the right person at the portfolio company. For instance, by first approaching the operations division of the portfolio company, company C could get the opportunity to get the full picture of the situation, before they decide to escalate the process and approach the CEO or chairman. However, the escalation process is dynamic, and it is important to be responsive to the company with whom the dialogue is held. Hence, they have no static checklist for how a proactive engagement process is to be conducted. However, just because a process is dynamic does not mean that the process is ad-hoc. Instead, having a clear structure for each engagement process is important in order to evaluate, compare and relate dialogues with each other.

To bridge the gap between the fund managers and the sustainability team, Fund company C has a committee for responsible investments, where the engagement processes are discussed between the fund managers and the sustainability team. The committee meets regularly to discuss engagement processes, but the committee also has the mandate to decide to completely divest certain companies.

### iv. A flexible strategy: Company D

Company D has a small sustainability team in absolute numbers, but a large one considering their company size. The sustainability team is responsible for the sustainability commitments, which includes both ESG analysis and engagement processes.

As Company D wanted to make sure their engagement resulted in as much impact as possible, they chose to focus part of their proactive dialogues on a few limited themes and manage the engagement process through a specialized consultant. The consultant is responsible for the analysis and dialogue with the companies, but Company D makes sure to play an active role by listening in to meetings, conducting field visits and following the development closely. By working through a third party, Company D can leverage cooperation with other investors as well as the specialized knowledge of the consultant.

Although Company D works thematically with proactive dialogues through a consultant, the sustainability team also engage in proactive dialogues by themselves. These proactive dialogues are not done according to a particular structure or theme but are more ad-hoc depending on where Company D identifies the largest needs. Although Company D works thematically through an external consultant, they are classified to work case-by-case in this framework, as they target their internal resources to such dialogues. However, Company D is a great example of how different strategies can be combined to maximize the impact.

Internally at Company D, the choice to engage in a dialogue can either be driven by their level of exposure to a particular holding, the magnitude of the challenges in a particular industry or by questions from their customer concerning a particular company. Furthermore, reactive dialogues can also turn into proactive ones. When Danske Bank was the center of a money laundry scandal, Company D did not only engage in reactive dialogues with Danske, but also conducted an ESG-analysis of all the large Nordic banks in their portfolio. This analysis resulted in proactive dialogues with the other banks. The initial dialogue with the other banks focused on gathering information in order for Company D to formulate their expectations and desired actions from the banks. These were then communicated in the subsequent dialogues. Although they divested in Danske Bank as a result of the money laundry scandal, they still engage in dialogues with the bank to communicate their expectations and opinions.

In their in-house proactive dialogues, Company D focuses on Swedish companies, as they experience that they have greater opportunities to gain legitimacy as owners. This in turn makes the companies more likely to heed to Company D’s opinions and suggestions. The sustainability team are responsible for the dialogues, which allows much more focused and dedicated work. As other fund companies might emphasize that the regular meetings between the portfolio companies and the fund managers provide a forum to raise sustainability issues, Company D does not classify these types of conversations as impact-dialogues.

For a dialogue to be an impact-dialogue there must be a clear structure, purpose, goal and deadline. Company D believes that is not enough to simply meet in order to have an impact. Furthermore, the background and competence that the fund managers have might not be the right one to efficiently engage in impact-dialogues. Instead, the sustainability team can provide both specialized knowledge and experience that the fund managers might lack. When the fund managers meet their portfolio companies, the sustainability team can participate to advance their knowledge and relationship with the company. However, the fund managers meet the companies on a much more regular basis than the sustainability team does.

Whenever a proactive dialogue is initiated, the sustainability team drafts a strategy for the engagement process. The strategy contains an overview of the situation, an analysis of the consequences of the issue at the center of the discussions as well as a motivation to why this is a material engagement for Company D. When it comes to Swedish companies, an initial meeting is often set up with the fund managers or other investors. After each meeting or contact, the strategy is revisited, and the next step is planned. For instance, if a company refers to their coming sustainability report the sustainability team will reconnect with the company after the report has been launched to follow up the discussions.

A key part of the engagement process for the sustainability team is to keep a close discussion with the fund managers. The fund managers and the sustainability team can disagree about companies and how to proceed, and then internal discussions are vital to reach consensus. For these dialogues to be productive, the fund managers need to understand the developments in the engagement process, which is achieved by information sharing through monthly meetings, informal chats and a database. Furthermore, the sustainability team sends out regular updates by email to the concerned fund managers of the different engagement processes.

In the database, the fund managers can keep track of the ongoing engagements, for instance who the sustainability team met with and what was discussed. The database also contains a comment on whether the sustainability team has a positive, neutral or negative outlook of how the engagement process will proceed, which gives the fund managers a heads up before there is a potential decision of divesting in the committee for responsible investments.

As the ESG-analysis has become much more standardized and integrated, the sustainability team has been able to target their resources more on proactive dialogues. This development is expected to continue, where the fund managers will take over more of the ESG integration in the investment analysis. When Company D looks ahead of how their sustainability work will develop, they believe that the ESG team will grow rather than having the fund managers participate more actively in the engagement process.