

The Performance of Investor Engagement Dialogues to Manage Sustainability Risks

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Abstract

This empirical study investigates the performance of a collaborative dialogue process where active Nordic investors interact with target companies behind the scenes to manage sustainability risks. The question addressed is what are the financial and nonfinancial characteristics of targets that provide opportunities for a successful dialogue process. The social movement theory of interest-driven collective action and the dialogic theory of effective communication are used as the conceptual framework with which to examine a proprietary dataset covering 326 dialogues with MSCI World companies. The results indicate that the performance of an agent-led collaborative dialogue process depends on the target company's characteristics. The responsiveness of targets to the direct requests of the agent for comments, the willingness of targets to make an effort to implement changes raised by the agent throughout ongoing negotiations, and the success of the dialogue process are systematically related to the sustainability and financial attributes of targets.

Keywords:

Dialogue, sustainability, risk, performance, process, management, activism

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1. Introduction

Institutional investors pursue an active ownership role in pressuring MSCI World index companies to improve sustainability practices (Goranova and Ryan, 2014; Gifford, 2010; Rehbein et al., 2004). The sustainable and responsible investment (SRI) strategies of active ownership include private engagement dialogues, shareholder resolutions, and voting at annual general meetings (AGM) (Eurosif, 2016; PRI, 2016; Rehbein et al., 2004; David et al., 2007; Yamahaki and Frynas, 2016; Logsdon and van Buren, 2009; Bauer et al., 2014; McDonnell et al., 2015). Studies claim that many active SRI investors interact with companies in their portfolios behind the scenes and out of sight from media scrutiny (Barko et al., 2018; Logsdon and Buren, 2009; Rehbein et al., 2013). This literature defines a private dialogue as a process in which companies and active investors engage in ongoing negotiations to manage material sustainability risks (Logsdon and Buren, 2009). Most previous large-scale empirical studies have investigated dialogues aiming to withdraw shareholder resolutions on sustainability risks prior to an AGM. The existence of large US databases on shareholder resolutions and the well-established tradition of investor activism through resolutions may explain the large-scale empirical studies that examine the performance of dialogues as a withdrawal strategy, indicating the willingness of the target to implement the request in the resolution to satisfy the objectives set by the activists (David et al., 2007; Cundill et al., 2018; Rojas et al., 2009; Proffitt and Spicer, 2006; Tkac, 2006; Monks et al., 2004).

This study focuses on the performance of hidden activism in the form of direct dialogues between institutional investors and global companies in relation to sustainability risks prior to or independent of a shareholder resolution (Barko et al., 2018; Bauer et al., 2014; Dimson et al., 2015; Goodman et al., 2014; Hoepner et al., 2018; Rehbein et al., 2013). There are relatively few broad-scale studies

due to the lack of data and public transparency in the dialogue process. Prior studies employ proprietary databases on thematic private engagements by sole institutional investors who primarily target domestic, blacklisted companies with the objective of enhancing financial performance by demanding improvements in sustainability practices (Dimson et al., 2015; Bauer et al., 2014; Hoepner et al., 2018; Barko et al., 2018). In exploring the performance of this form of unobservable activism, researchers examine the effects on the external financial and sustainability outcomes of targets by assuming an economic perspective on active ownership. There is evidence that successful dialogues improve accounting performance and governance (Dimson et al., 2015), sales growth and portfolio returns (Barko et al., 2018), and reduce downside risks (Hoepner et al., 2018). The outcomes and success of the private engagement dialogue are, however, shaped by the performance of dialogues at the process level, including the actions of, the reactions to and interactions among, activists or their agents and target companies (Goranova and Ryan, 2014). The internal performance of the dialogue can reflect (1) the extent and frequency of private interactions in the form of letters, phone calls, and meetings, (2) the nature of an interaction, (3) the length of a dialogue sequence, (4) the responsiveness of targets to activist contacts, (5) and the willingness of targets to take action and make the changes required by activists. This paper shifts the focus of engagement dialogues from the impact of activism on company-level aggregated financial outcomes to examining the internal performance of the dialogue process and its determinants.

This paper advances previous empirical studies in the following ways. It explores the internal performance of the dialogue process related to environmental, social and corruption incidents when a company has violated social norms, such as UN Global Compact principles. The dialogue process is led by a

professional agent in collaboration with Nordic institutional investors who use this form of SRI activism to pursue changes in portfolio companies across countries in order to manage sustainability risks triggered by incidents. The study introduces internal performance measures for the dialogue process, such as responsiveness, progress, and success, in order to assess the efficacy of the dialogue in interactions between targets and the engagement agent. The responsiveness and progress measures relate to the responses and actions of targets, and the success measure captures the end result of the dialogue process. Social movement theory is adopted as a starting point to explain whether the state of targets can facilitate the performance of the dialogue process when the primary objective is sustainability changes in targets and not short term financial performance. A dialogic theory then explicitly provides insights into interactive communications that can bring about meaningful and sustainable transformation of target companies through dialogic processes. This study also extends current sustainability accounting research into company-stakeholders interactions and economics-based motivational factors to improve sustainability operations in companies by focusing on the performance of collaborative dialogues between companies and active investors in order to influence the management of sustainability risks (Lisi, 2015; Afreen and Kumar, 2016; Murray et al., 2010).

The study describes in detail the collaborative dialogue process led by the agent who acts on behalf of Nordic institutional investors. This part of the paper provides the key stages of the dialogue process used by Nordic activist investors, said to be oriented more to long-term value rather than short-term profit (Poulsen et al., 2010; Thomsen and Conyon, 2012; Lekvall, 2018). Interacting with global MSCI World companies across borders brings complexities to the dialogue process carried out by the agent on behalf of their Nordic

clients. Social movement theory is applied when stakeholder influence on company sustainability performance is likely to form as the collective, interest-driven action of active owners to encourage companies take action for social change. The study empirically investigates the specific financial and nonfinancial characteristics of the targets, presenting their opportunities for a successful dialogue. Company-specific characteristics can guide the investors when selecting target companies for a dialogue process.

The remainder of this study is organized as follows. Sections 2 and 3 present the features of the dialogue process model, summarize the theoretical framework of the paper, review the prior research on private engagement and active ownership, and develop hypotheses. Sections 4 and 5 describe the data and sample, and provide empirical evidence of the company-specific determinants of the internal performance of dialogues. Section 6 concludes the paper.

2. The dialogue process

The term “dialogue” is used to describe the process of interactions between investors and companies that are conducted in private to deal with risks related to sustainability incidents. The objective of the process is, in collaboration with management, to improve the sustainability performance and transparency of the target company. This terminology is in line with that used by Logsdon et al. (2009), Rehbein et al. (2013), Goranova and Ryan (2014) and Cundill et al. (2018). Dialogue can be a standalone process when large institutional investors seek to exercise influence via their voice and gain access to a company’s management (Gifford, 2010; Cundill et al., 2018). Alternatively, dialogue can be part of a broader engagement process, and be a precursor to a shareholder proposal (Bauer et al., 2015; Cundill et al., 2018). To provoke activists into commencing dialogue there must be a serious environmental or social issue, such

as an alleged violation of social norms (e.g., the UN Global Compact principles) in the form of a sustainability incident (Logsdon and Buren, 2009). A recent and material sustainability incident triggers investors to enter into dialogue with a portfolio company to provide urgent support for the management of sustainability risks (Hoepner et al., 2017; Dimson et al., 2015). The underlying rationale of the engagement is that a dialogue not only affects the target's current sustainability performance, but also serves as a mechanism to avoid similar risk-inducing incidents in the future (Hoepner et al., 2017). The expectation is that a dialogue can provide support in achieving the changes pursued by activist investors, and provide opportunities to negotiate solutions to address sustainability risks (Goranova and Ryan, 2014; Logsdon and Buren, 2009; Rehbein et al., 2013).

In this study, an established professional agent specializing in SRI services without managing the underlying financial assets of clients conducts private, direct, constructive and continuous dialogues with the target company on behalf of Nordic institutional investors, and with the continuous involvement of the owners in the process. An engagement platform is used to share information on the dialogue process. Investors make individual and collaborative engagement decisions on the platform, and the agent acts as coordinator of the active owners. The preliminary step in initiating a dialogue is to identify a sustainability incident and alert the investor to a concern, bring the incident to the attention of active owners, and select the incident and target company on behalf of the investors. Examples of sustainability incidents can include the use of child labor in the value chain, corruption-related bribery in different countries, water pollution, and violations of labor rights. On behalf of the investors, and in continuous collaboration with the investors on the engagement platform, the agent then enters into a direct and continuous dialogue

with the target company.

In the first stage of the dialogue process, the target company is alerted to the investor concerns about the incident. More details about the incident are then collected from the target company and the pre-engagement status of the target is established. In the second stage of the dialogue process, the agent summarizes the results of the initial dialogue to determine the responsiveness of the target and the verifiable actions taken on the reported violation. If the incident is not addressed sufficiently, or at all, by the target company, the dialogue will continue. In the third stage, an invitation is extended to the target management to attend a meeting for further consultation. In the fourth stage, the agent formulates the goal of the dialogue, the action plan for the investors, and a recommendation for further actions. The changes that investors demand are made explicit in the dialogue, in order to improve transparency and the sustainability performance of the target. When the goal of a dialogue is achieved, the dialogue process is considered successful and closes, however, if dialogue fails to provide satisfactory results and is unsuccessful from the owner's perspective, the process can move into visible (public) activism, such as a shareholder proposal to the AGM. Another option is to exclude the target from the portfolio of the activists. The overall objective of the dialogues is to improve the sustainability policy and transparency to enhance the sustainability performance of the target.

3. Hypothesis development

To explore the performance of the dialogue process, this study will adopt social movement theory and dialogic theory as a theoretical lens. The social movement theory suggests that social activism aims to change the social practices of target companies by challenging the legitimacy of existing social responsibilities with new suggestions based on moral principles or pragmatic business concerns

(Judge et al, 2010; Lee and Lounsbury, 2011). Activists can support companies in managing sustainability risks and finding new business opportunities to improve financial performance and governance. In effect, the attributes of companies are likely to reflect opportunities in a social movement process, and facilitate company responsiveness to the challenges in the movement. Social movement is likely to arise when the actions of owners are collective, and there is some degree of coordination, shared identity and continuity (Cundill et al., 2018; Lee and Lounsbury, 2011). In this study, the collaborative actions of Nordic institutional investors are coordinated and managed by the agent who uses the Engagement Forum online platform, which aggregates opinions, efforts and experience to impose pressure for a social change.

The dialogic theory is a new theoretical perspective on accounting that strengthens the arguments of the social movement theory in relation to dialogue process being a meaningful and effective communication tool for serving social change. The dialogic theory explicitly argues that “organizations should engage with stakeholders and publics to make things happen, to help make better decisions, to keep citizens informed, and to strengthen organizations and society” (Taylor and Kent, 2014, p.388). Dialogic engagement is defined as a negotiated exchange of ideas and opinions between companies and investors to facilitate value sharing, healthy conversation, mutual understanding, and relationship maintenance in order to make decisions that can create social capital (Taylor and Kent, 2014; Uysal, 2018). A relational orientation of dialogic engagement emphasizes that active and engaged interactions involve a meaning-making process to articulate the social demands of stakeholders to companies and facilitate progressive social change (Bebington et al., 2007; Taylor and Kent, 2014). In line with the social movement theory, the dialogic theory states that communications

require a specific environment in which the dialogue process can take place to maintain the alignment between social norms and a company’s practices, and enhance the long-term survival capacity of the company (Taylor and Kent, 2014; Uysal, 2018). Company-level configuration can also facilitate dialogic communication.

The social movement theory has been supported in prior studies of a target’s responsiveness to the outcomes of formal and visible forms of investor activism on shareholder resolutions. Lee and Lounsbury (2011) empirically confirmed that the specific features of target companies make them superior in responding to social challenges, such as pressures to enhance their environmental performance. Reid and Toffel (2009) found that US companies that have been targeted by shareholder resolutions on environmental issues are more likely to increase transparency and publicly disclose information to the Carbon Disclosure Project. Clark, Bryant, and Griffin (2017) focused on social issue resolutions and found that companies are likely to respond to engagements. Focusing on the link between company sustainability performance and dialogic theory, Uysal (2018) provides evidence that companies are likely to develop and facilitate dialogic website communication with investors in order to improve their sustainability practices. This study will be extended from public shareholder resolutions and dialogic engagement in web-based stakeholder relations, to hidden private dialogues led by the agent as a social movement.

Drawing on past empirical research (Barko et al., 2018; Dimson et al., 2015; Rehbein, et al., 2004; Uysal, 2018), this study examines the company characteristics that can determine the internal performance of the dialogue process to improve the sustainability practices of the target company when a sustainability incident prompts an agent to collectively act on behalf of the institutional investors. Prior research finds support that a company’s financial

and sustainability performance and size influence the outcomes of social activism and facilitate dialogic communication (Goranova and Ryan, 2014; Goranova et al., 2016; Rehbein et al., 2004; Uysal, 2018). Large companies can benefit from their economies of scale and resource capacity in social movement change and relationship-building efforts (Rehbein et al., 2004; Dimson et al., 2015; Goranova and Ryan, 2014; Lee and Loundsbury, 2011; Uysal, 2018). Their actions and responsiveness to dialogues are driven by high visibility, social exposure, and reputational concerns. Rehbein et al. (2013) report that larger companies are more likely to invite shareholders to dialogue that follows the submission of a shareholder resolution. Dimson et al. (2015) find that an asset manager engages on environmental, social and governance concerns with larger companies, and they are likely to make the changes demanded by the asset manager. Therefore, the following hypothesis is proposed.

Hypothesis 1. The size of the target company is positively related to the performance of the dialogue process.

Another factor that can affect the performance of the dialogue process is the sustainability performance of the target company (Goranova et al., 2016; Goranova and Ryan, 2014; Rehbein et al., 2013). Starks et al. (2017) suggest that long-term investors prefer high sustainability profile companies, suggesting that their interest in long-term value affects sustainability. Rehbein et al. (2013) argue that companies with good sustainability performance tend to be more interested in implementing the sustainability changes raised by social activists. Companies with strong sustainability practices operate from a more powerful position that is based on already developed productive interactions with stakeholders to influence external social movement change. Heath (2006) and Eesley and Lennox (2006) found that companies with good

sustainable practices are more likely to communicate and engage with their stakeholders. Similarly, McDonnell et al. (2015) argued that more socially responsible companies are likely to adopt social movement practices and become more receptive to activist challenges over time. Thus, the following hypothesis is proposed.

Hypothesis 2. The sustainability performance of a target company is positively related to the performance of the dialogue process.

Based on prior large-scale empirical research into engagement effects, the financial performance of the target company has been found to drive the company response and incentive for making social movement changes (Bauer et al., 2015; Dimson et al., 2015; Goranova and Ryan, 2014). In this tradition, companies with high market performance are likely to have the financial capacity to respond to activism and adopt social movement demands, as they prefer to hold higher levels of stock prices (Dimson et al., 2015; Bauer et al., 2014; Brav et al., 2008; Poulsen et al., 2010). Companies that have the resources to address sustainability concerns are also more likely to prioritize social movement. Judge et al. (2010) found that the profitability of target companies positively facilitates the adoption of changes demanded by social activists. Dimson et al. (2015) showed that target companies experience improved profitability after successful engagements in relation to sustainability improvements with the potential for financial benefits. Uysal (2018) found that profitable companies facilitate more dialogic communication with stakeholders. Thus, we posit the following hypothesis.

Hypothesis 3. The accounting and market performance of the target company are positively related to the performance of the dialogue process.

TABLE 1 Summary of Dialogues

DISTRIBUTION OF DIALOGUES			
Sustainability Risk	Num. of cases	% Sample	% Successful
Environment	68	20.86%	38.24%
Human rights	131	40.18%	19.08%
Labor rights	103	31.60%	35.92%
Corruption	24	7.36%	37.50%
Total	326	100.00%	29.75%

4. Method

4.1 Sample and data collection

The sample is based on 326 dialogues with 267 companies between 2005 and 2013. The data was obtained from the agent database of dialogue records, and aggregated with Thomson Reuters’s data on company characteristics using ISIN code and company name. Table 1 shows the distribution of dialogues across sustainability risks. 71.78% of dialogues are associated with the social risks of human and labor rights. Dialogues on environmental risk represent 20.86%, and dialogues on corruption risk constitute 7.36%. In Table 1, the dialogue processes are categorized as successful or unsuccessful. A dialogue is classified as successful if the dialogue goal is achieved and the dialogue process is ended. The other dialogues are classified as unsuccessful. Success is, on average, achieved in 29.75% of dialogues. Dialogues on the environment, labor rights and corruption risks have success rates of 38.24%, 35.92%, and 37.50%, respectively.

4.2 Dependent variables

The performance measures of the dialogue process are the dependent variables. The set of performance measures relates to response and progress ratings and an indicator of success. The response rating indicates how well the target company responds to a request from the agent for comments throughout the dialogue process. The progress rating indicates how well the dialogue is progressing; how the target company makes an effort to

implement the changes demanded by the agent on behalf of active owners. Response and progress performance measures are rated by the agent and based on a numerical scale ranging from one (low performance) to five (high performance). Response and progress ratings for each dialogue process are obtained from the agent’s records. The success rate is a dummy variable that indicates whether the dialogue process is successful or unsuccessful.

4.3 Independent variables

The independent variables operationalize the distinct, main characteristics of companies: company size, sustainability performance, accounting performance and market performance. Following Dimson et al. (2015), company size is measured by a company’s market value. Accounting and market performance are operationalized by return on assets (ROA) and Tobin’s *Q*. A company’s ROA evaluates operating performance and gives an estimate of its profitability and efficiency (Guenster et al., 2006). Tobin’s *Q* is a market-derived measure that reflects expected future gains and captures the tangible and intangible values of a company.

Sustainability performance is operationalized by annual third-party assessments—including ESG performance, and ESG transparency ratings — that come from the Thomson Reuters ASSET4 database. Ratings are based on a numerical scale ranging from 100 (good performance) to 0 (poor performance). The total sustainability performance rating is based on the environmental, social and

corporate governance (ESG) sub-ratings. Examples of sustainability categories included in the sustainability performance rating are emission reduction, resource reduction, product innovation, employment quality, health and safety, and diversity. The sustainability transparency rating is based on the integration/vision and strategy category, which reflects a company’s capacity to convincingly show and communicate the integration of sustainability dimensions in decision-making processes. The sustainability transparency rating includes the publication of sustainability information in specific reports, disclosure of an annual Global Reporting Initiative report, provision of assurance on sustainability disclosure, a policy for communicating transparently on sustainability issues, and the integration of sustainability factors in the annual report to name the material dimensions of the transparency rating.

4.4 Control variables

Control variables are also included in the analysis. The study draws on the groups of company characteristics (i.e., maturity, discretionary spending and capital structure) used in the model of Dimson et al. (2015) to examine the characteristics of the target companies in the year before the engagement. The control variables include company age, sales growth, leverage, and capital expenditure. The study also controls for the number of dialogues for each target company, and the length of dialogue.

4.5 Analytical procedure

When testing the performance measures of response and the progress of dialogue process, the study runs a multivariate regression of the following type:

$$DIAL_PERF_{it} = b_0 + b_1SIZE_{it} + b_2TARG_PERF_{it} + b_3AGE_{it} + b_4GROWTH_{it} + b_5LEVERAGE_{it} + b_6CAPEX_{it} + b_7INTENS_{it} + b_8LENGTH_{it} + e_{it} \quad (1)$$

The dependent variable is the performance measure of dialogue process (i.e., response or progress) for a dialogue *i*, and *t* indicates time periods for each dialogue. Following Bauer et al. (2015), the study treats each dialogue as a single observation in the empirical analysis. All of the independent and control variables are defined in the appendix. The parameters of the Model (1) are computed using robust, clustered standard errors adjusted for misspecification of the model and intra-cluster correlation with clustering along a dialogue dimension (Cameron and Trivedi, 2005). The method is applied to account for the potential non-independent and non-identical distribution of errors because we have pooled time periods of data for each dialogue over the dialogue period.

We estimate a logistic regression to test the performance measure of the success of the dialogue process. The logistic regression model to estimate the likelihood of success of dialogue process is specified as follows:

$$Prob(SUCCESS_{it}=1) = b_0 + b_1SIZE_{it} + b_2TARG_PERF_{it} + b_3AGE_{it} + b_4GROWTH_{it} + b_5LEVERAGE_{it} + b_6CAPEX_{it} + b_7INTENS_{it} + b_8LENGTH_{it} + e_{it} \quad (2)$$

The dependent variable is an indicator variable that equals one if dialogue *i* is successful and zero if unsuccessful, and *t* indicates time period for each dialogue. All of the independent and control variables are defined in the appendix.

Logistic regression uses maximum likelihood estimation and accounts for the non-normal distribution of errors associated with the binary dependent variable of performance of dialogue (Pacheco and Dean, 2015; Hair et al., 2014). The results of the logistic regression include odds ratios and marginal effects (Reid and Toffel, 2009). The marginal effects are estimated at the mean of all other variables (Reid and Toffel, 2009). The parameters of the Model (2) are estimated using robust standard errors that are corrected for some misspecification of the model with clustering along a dialogue dimension in order to account for the potential

TABLE 2 Descriptive Statistics, Correlations, and Univariate Tests

Panel A: Descriptive Statistics

	Mean	SD
RESPONSE	3.21	1.06
PROGRESS	2.98	1.09
SIZE	8.68	1.20
SUST_PERF	56.84	24.06
SUST_TRANSP	55.86	32.07
ROA	0.12	0.08
TOBINQ	0.40	0.24

Panel B: Correlations

Variables	1	2	3	4	5	6	7	8
RESPONSE	1.00							
PROGRESS	0.63 (0.00)	1.00						
SUCCESS	0.13 (0.00)	0.45 (0.00)	1.00					
SIZE	0.11 (0.02)	0.28 (0.00)	0.16 (0.00)	1.00				
SUST_PERF	0.33 (0.00)	0.26 (0.00)	0.19 (0.00)	0.53 (0.00)	1.00			
SUST_TRANSP	0.32 (0.00)	0.29 (0.00)	0.14 (0.00)	0.49 (0.00)	0.79 (0.00)	1.00		
ROA	0.08 (0.02)	0.30 (0.00)	0.18 (0.00)	0.39 (0.00)	0.16 (0.00)	0.15 (0.00)	1.00	
TOBINQ	-0.15 (0.00)	-0.30 (0.00)	-0.06 (0.03)	-0.11 (0.00)	-0.04 (0.15)	-0.09 (0.00)	-0.41 (0.00)	1.00

Panel C: Univariate Tests

Variable	RESPONSE		PROGRESS		SUCCESS	
	Mean diff	p-value	Mean diff	p-value	Mean diff	p-value
SIZE	0.70	0.00	0.87	0.00	0.48	0.00
SUST_PERF	21.21	0.00	12.33	0.00	7.70	0.00
SUST_TRANSP	25.72	0.00	19.16	0.00	7.79	0.00
ROA	0.03	0.00	0.05	0.00	0.03	0.00
TOBINQ	-0.09	0.00	-0.15	0.00	-0.03	0.03

Notes: Panel A displays the descriptive statistics for 326 dialogues; Panel B displays Pearson correlation coefficients among dependent and independent variables in the model. Panel C displays the univariate tests for 326 dialogues based on two samples with high and low progress and response performance and two samples with successful and unsuccessful dialogues. The t-test for differences in mean is reported in p-value. All financial variables are winsorized (p=0.1)

non-independent and non-identical distribution of errors when we have pooled time periods of data for each dialogue over the dialogue period (Cameron and Trivedi, 2005).

5. Results

5.1 Primary tests

Table 2, Panel A, shows the descriptive sta-

tistics and univariate tests for the dialogues on sustainability risks and company-specific characteristics.

Table 2, Panel B, reports the Pearson correlation coefficients between the dependent and independent variables of Models (1) and (2). The measures of performance of the dialogue process are significantly positively related to company size, sustainability performance and

transparency, and profitability, and there are significantly negative correlations with market performance. The significant correlation coefficients provide preliminary support for the hypotheses of the relationships between company characteristics and the internal performance of dialogues. The results of Spearman correlation coefficients are not materially different from those reported above (not reported).

Table 2, Panel C, displays the results of univariate t-tests for the differences in company characteristics at high and low performance of dialogues. High performance is defined at the highest values, four and five. Low performance is defined at the lowest values, two and one. The t-tests reveal that companies with high values for response and progress are significantly larger and have significantly higher sustainability performance, sustainability transparency, and ROA and lower Tobin's Q, relative to low values for response and pro-

gress. Successful dialogues also are significantly larger and have significantly higher sustainability performance, sustainability transparency, and ROA and lower Tobin's Q, relative to unsuccessful dialogues. Thus, the high performance of dialogue process is associated with larger companies, companies with good sustainability performance and transparency, more profitable companies and companies with low market performance.

Table 3 presents the results of the analysis of the company characteristics leading to good company response, progress of the dialogue process and the success of dialogues over the period of interaction. In Table 3, Panel A, the results show that company sustainability performance and transparency are positively and significantly associated with response and the progress performance of the dialogue process. Company size, sustainability performance, sustainability

TABLE 3 Drivers of the Performance of the Dialogue Process
Panel A: Response and Progress Performance

	RESPONSE					PROGRESS				
SIZE	0.089 (0.227)	-0.090 (0.312)	-0.063 (0.486)	0.085 (0.276)	0.072 (0.318)	0.224 (0.001)	-0.095 (0.363)	0.096 (0.357)	0.162 (0.015)	0.176 (0.004)
SUST_PERF		0.026 (0.000)					0.015 (0.004)			
SUST_TRANSP			0.016 (0.000)					0.011 (0.001)		
ROA				0.177 (0.849)					2.674 (0.014)	
TOBINQ					-0.935 (0.184)					-2.877 (0.000)
AGE	0.001 (0.891)	-0.009 (0.159)	-0.005 (0.440)	0.001 (0.911)	0.001 (0.901)	0.004 (0.543)	0.001 (0.889)	0.003 (0.666)	0.003 (0.643)	0.004 (0.563)
GROWTH	0.048 (0.862)	0.149 (0.594)	0.081 (0.777)	0.031 (0.912)	0.058 (0.835)	-0.108 (0.601)	-0.030 (0.889)	-0.049 (0.816)	-0.372 (0.102)	-0.075 (0.728)
LEVERAGE	-0.605 (0.283)	-0.229 (0.693)	-0.034 (0.956)	-0.595 (0.315)	0.530 (0.619)	-0.641 (0.259)	-0.230 (0.709)	-0.106 (0.864)	-0.320 (0.593)	2.853 (0.002)
CAPEX	-0.047 (0.265)	0.029 (0.544)	-0.041 (0.342)	-0.047 (0.271)	-0.054 (0.212)	0.007 (0.853)	0.051 (0.210)	0.011 (0.770)	0.012 (0.767)	-0.016 (0.697)
INTENS	-0.095 (0.592)	-0.182 (0.253)	-0.176 (0.276)	-0.097 (0.587)	-0.091 (0.612)	-0.223 (0.044)	-0.278 (0.007)	-0.282 (0.005)	-0.227 (0.038)	-0.212 (0.063)
LENGTH	0.000 (0.602)	0.000 (0.732)	0.000 (0.784)	0.000 (0.587)	0.000 (0.572)	0.000 (0.013)	0.000 (0.023)	0.000 (0.020)	0.000 (0.009)	0.000 (0.005)
Intercept	2.574 (0.000)	2.784 (0.001)	3.041 (0.001)	2.582 (0.000)	2.806 (0.000)	0.827 (0.192)	1.081 (0.252)	1.287 (0.186)	0.982 (0.102)	1.541 (0.005)
Num. of obs.	787	686	686	785	787	788	687	687	786	788
Adj. R ²	0.036	0.166	0.144	0.036	0.046	0.173	0.178	0.185	0.204	0.267

Notes: p-values are presented in the parentheses. All reported p-values are two-tailed. A coefficient of a variable in bold indicates that the variable is statistically significant at least at the 10 percent level.

TABLE 3 (Continued)
Panel B: Success Performance

	SUCCESS				
SIZE	0.162 (0.145) [0.038]	0.213 (0.145) [0.050]	0.209 (0.136) [0.050]	0.092 (0.425) [0.021]	0.150 (0.171) [0.035]
SUST_PERF		0.004 (0.667) [0.001]			
SUST_TRANSP			0.003 (0.610) [0.001]		
ROA				3.569 (0.018) [0.832]	
TOBINQ					-1.794 (0.101) [-0.418]
AGE	0.034 (0.007) [0.008]	0.032 (0.018) [0.008]	0.033 (0.015) [0.008]	0.033 (0.010) [0.008]	0.033 (0.008) [0.008]
GROWTH	0.020 (0.965) [0.005]	0.225 (0.657) [0.053]	0.220 (0.669) [0.052]	-0.446 (0.379) [-0.104]	-0.041 (0.932) [-0.010]
LEVERAGE	0.332 (0.721) [0.078]	0.360 (0.733) [0.085]	0.395 (0.708) [0.093]	0.717 (0.463) [0.167]	2.633 (0.106) [0.614]
CAPEX	-0.258 (0.039) [-0.060]	-0.272 (0.036) [-0.064]	-0.283 (0.026) [-0.066]	-0.256 (0.041) [-0.060]	-0.274 (0.040) [-0.064]
INTENS	-0.082 (0.654) [-0.019]	-0.060 (0.748) [-0.014]	-0.062 (0.735) [-0.015]	-0.080 (0.664) [-0.019]	-0.064 (0.728) [-0.015]
LENGTH	0.000 (0.109) [0.000]	0.000 (0.365) [0.000]	0.000 (0.361) [0.000]	0.000 (0.098) [0.000]	0.000 (0.109) [0.000]
Intercept	-3.067 (0.002)	-3.731 (0.005)	-3.671 (0.005)	-2.963 (0.004)	-2.796 (0.005)
Num. of obs.	1293	1108	1108	1286	1293
Pseudo R ²	0.076	0.079	0.079	0.089	0.083

Notes: p-values are presented in the parentheses. All reported p-values are two-tailed. Parameter estimates are reported with odds ratios. Marginal effects are presented in brackets. A coefficient of a variable in bold indicates that the variable is statistically significant at least at the 10 percent level.

TABLE 3 (Continued)
Panel C: Response Performance

	RESPONSE				
SIZE	0.428 (0.050) [0.096]	0.109 (0.800) [0.022]	0.244 (0.509) [0.050]	0.417 (0.069) [0.093]	0.406 (0.055) [0.090]
SUST_PERF		0.090 (0.000) [0.018]			
SUST_TRANSP			0.059 (0.000) [0.012]		
ROA				0.520 (0.853) [0.116]	
TOBINQ					-3.102 (0.096) [-0.689]
AGE	-0.004 (0.871) [-0.001]	-0.052 (0.076) [-0.010]	-0.054 (0.041) [-0.011]	-0.004 (0.861) [-0.001]	-0.011 (0.637) [-0.003]
GROWTH	-0.743 (0.337) [-0.166]	-1.148 (0.351) [-0.228]	-1.458 (0.248) [-0.298]	-0.790 (0.298) [-0.177]	-0.876 (0.273) [-0.194]
LEVERAGE	-1.123 (0.460) [-0.251]	-1.390 (0.588) [-0.277]	-1.114 (0.681) [-0.227]	-1.065 (0.493) [-0.238]	2.381 (0.374) [0.529]
CAPEX	-0.198 (0.180) [-0.044]	0.013 (0.954) [0.003]	-0.189 (0.252) [-0.283]	-0.198 (0.185) [-0.044]	-0.259 (0.127) [-0.058]
INTENS	-0.200 (0.564) [-0.044]	-0.650 (0.051) [-0.129]	-0.601 (0.082) [-0.123]	-0.201 (0.563) [-0.045]	-0.192 (0.598) [-0.043]
LENGTH	-0.000 (0.884) [-0.000]	-0.000 (0.462) [-0.000]	-0.000 (0.875) [-0.000]	-0.000 (0.893) [-0.000]	0.000 (0.912) [0.000]
Intercept	-2.382 (0.180)	-3.125 (0.347)	-3.017 (0.343)	-2.356 (0.184)	-1.558 (0.378)
Num. of obs.	463	391	391	463	463
Pseudo R ²	0.078	0.285	0.079	0.078	0.097

Notes: p-values are presented in the parentheses. All reported p-values are two-tailed. Parameter estimates are reported with odds ratios. Marginal effects are presented in brackets. A coefficient of a variable in bold indicates that the variable is statistically significant at least at the 10 percent level.

TABLE 3 (Continued)
Panel D: Progress Performance

	PROGRESS				
SIZE	0.593 (0.009) [0.148]	0.238 (0.482) [0.059]	0.165 (0.601) [0.041]	0.464 (0.048) [0.116]	0.515 (0.021) [0.129]
SUST_PERF		0.032 (0.039) [0.008]			
SUST_TRANSP			0.034 (0.004) [0.008]		
ROA				4.294 (0.106) [1.074]	
TOBINQ					-5.968 (0.003) [-1.491]
AGE	0.015 (0.463) [0.004]	0.013 (0.555) [0.003]	0.013 (0.568) [0.003]	0.015 (0.471) [0.004]	0.014 (0.514) [0.004]
GROWTH	-0.640 (0.329) [-0.160]	-0.647 (0.396) [-0.160]	-0.272 (0.725) [-0.067]	-1.067 (0.141) [-0.267]	-0.613 (0.421) [-0.153]
LEVERAGE	-2.304 (0.156) [-0.576]	-1.741 (0.362) [-0.431]	-1.154 (0.549) [-0.286]	-2.096 (0.200) [-0.524]	4.436 (0.072) [1.108]
CAPEX	0.025 (0.839) [0.006]	0.121 (0.354) [0.030]	0.032 (0.809) [0.008]	0.022 (0.883) [0.005]	-0.077 (0.567) [-0.019]
INTENS	-0.795 (0.031) [-0.199]	-0.875 (0.012) [-0.217]	-0.919 (0.005) [-0.228]	-0.795 (0.032) [-0.199]	-0.815 (0.036) [-0.204]
LENGTH	0.000 (0.268) [0.000]	0.000 (0.313) [0.000]	0.000 (0.235) [0.000]	0.000 (0.264) [0.000]	0.000 (0.324) [0.000]
Intercept	-4.765 (0.008)	-3.532 (0.165)	-3.142 (0.214)	-4.195 (0.020)	-3.099 (0.074)
Num. of obs.	480	429	429	480	480
Pseudo R ²	0.179	0.183	0.214	0.194	0.244

Notes: p-values are presented in the parentheses. All reported p-values are two-tailed. Parameter estimates are reported with odds ratios. Marginal effects are presented in brackets. A coefficient of a variable in bold indicates that the variable is statistically significant at least at the 10 percent level.

transparency, and ROA are positively and significantly related to the progress performance of the dialogue process, while Tobin's Q has negative and significant relationships with the progress of the dialogue process. The progress of the dialogue process is also significantly associated a longer duration of dialogues and low intensity of dialogues per target company. Finally, Table 3, Panel B, reports the association between company-specific factors and the success of dialogues. The results show that higher operating performance and lower market performance tend to drive successful dialogues relative to unsuccessful dialogues.

The findings of the study provide support for Hypothesis 1, stating that company size is positively related to the internal performance of the dialogue process. Large companies are more likely to show better progress in the dialogue process. Hypothesis 2 is also supported. The sustainability characteristics of target companies drive the internal performance

of dialogues as assessed by the response and progress performance. The results support Hypothesis 3, that accounting and market performance are associated with the performance of the dialogue process. Companies with high profitability and low market value are especially more likely to show good progress and success in the dialogue process.

5.2 Robustness tests

We performed a subgroup analyses of dialogues with high/low response and progress ratings in the robust analysis. To identify the difference in the characteristics of companies, the dependent variables of target company response and the progress made by the target company are categorized into the group of high level response/progress that consists of ratings of five and four, and the group of low level response/progress that includes the ratings of zero and one. A dummy variable is coded with a value of one for the high level of response/progress and with value of zero

for the low level of response/progress. Table 3, Panels C and D, reports the impact of company attributes on the high value of response and the progress performance of the dialogue process in relation to the low value. Company size, sustainability performance, sustainability transparency and operating performance have a positive and significant association with the performance of dialogues, while the relationships between market value and the performance of dialogues are negative and significant. The results, thus, support the arguments of primary analysis.

As an additional robustness check, we also used alternative measures for the control variables. Discretionary spending is operationalized by dividend yield, and capital structure is measured by cash holdings. The results (not reported) are consistent with our main analysis.

6. Discussion and conclusions

This study investigated the company-specific financial and nonfinancial attributes that contribute to the internal performance of a private, behind-the-scenes dialogue process when mitigating incident-related sustainability risks in investee companies. The data comes from the proprietary records of a professional engagement agent who leads private and collaborative dialogues with MSCI World companies on behalf of, and with, the active involvement of Nordic institutional investors. The study demonstrates that Nordic institutional investors who work with the agent target companies in response to sustainability incidents that are triggered by the violation of sustainability norms (e.g., UN Global Compact). The main objective of Nordic institutional investors is to manage the downside risk inherent in sustainability incidents.

The theoretical foundation of the study is based on the social movement theory and the dialogic theory, where active owners pursue a social movement against target companies by means of dialogic communication. The social movement hypotheses of the study define the

relationships between company characteristics (size, sustainability and financial performance) and the internal performance of the dialogue process. The dialogic theory provides a conceptual underpinning of the dialogue process itself to engagement induced change, and transformations in the sustainability activities of target companies. To assess the efficacy of engagement dialogue, this study introduces internal performance measures of how target companies respond to the contacts and requests of the agent and how targets make an effort to implement sustainability changes and improvements that are negotiated by the agent. This study also evaluates the final performance of the dialogue process by measuring when the dialogue process is considered to be successfully completed by the agent.

The results of the study provide support for the social movement theory, and suggest that company size affects the progress of the dialogue process, which suggests that interactions with larger companies more often tend to lead to progress in taking action to manage sustainability risks. Large companies have more at stake in their investor relations than small companies. The nonfinancial indicators, sustainability performance and transparency drive both the response and progress performance of the dialogue process. Leading companies want to maintain their comparative advantage when compromised by an incident by responding positively to the dialogue process. The outcomes of the financial characteristics of target companies on the different internal performance measures of dialogues are mixed, indicating the importance of measuring performance in several dimensions. In this respect, profitable companies are more likely to respond to the direct requests of an agent and make an effort to implement changes raised by the agent for a successful dialogue process. Unlike previous research on active ownership, this study finds that companies with low market performance are more likely to respond to the dialogue process. The results may be driven

by a recent sustainability incident that triggers investors to enter into dialogue with the company in order to improve market value.

This paper seeks to advance research in the accounting and governance literature by introducing the different internal performance measures used by the agent in the engagement process to influence the sustainability practices of target companies. Past studies have mainly provided evidence of post-dialogue changes in the financial and sustainability performance of successful, completed negotiations at company level (Dimson et al., 2015; Bauer et al., 2014; Hoepner et al., 2018; Barko et al., 2018). The paper unfolds what a successful dialogue process means, and demonstrates that the internal performance of the dialogue process varies because target companies have different financial and nonfinancial potentials to meet the demands of active owners. The paper also contributes to our knowledge of the internal efficacy of the agent-driven dialogue process in relation to unexpected sustainability incidents. Finally, this paper shows that the performance of the dialogue process related to sustainability risks can be understood and addressed via social movement theory and dialogic theory. It extends the primary economic perspective deployed by scholars with respect to the motivational factors of improved sustainability performance of companies, such as financial benefits in the form of reduced

costs, increased efficiency and better reputation (Lisi, 2015; Dimson et al., 2015; Bauer et al., 2014; Hoepner et al., 2018; Barko et al., 2018). By translating dialogic theory into the potential of a two-way hidden dialogue for managing sustainability risks, this empirical paper complements research by Grafton and Mundy (2017), Cagliolo and Ditillo (2012), Afreen and Kumar (2016) and Murray et al. (2010), which provides a view of the benefits and risks of inter-company informal interactions (relational contracts) and an interactive, collaborative process involving companies and stakeholders. The study also has practical implications for investors when targeting global companies, by demonstrating the role the financial and nonfinancial profiles of the companies have on a successful engagement process.

The conclusions of the study are relevant for Nordic institutional investors who use the Engagement Forum in a collaboration led by the agent to engage with companies regarding sustainability incidents. The relevance of the specific Nordic engagement approach can, however, be extended to other commercial parties and asset managers that provide engagement services, particularly in Europe. The present study is limited to a relatively small number of dialogues from a proprietary dataset that have been evaluated by the agent in relation to their response and progress measures.

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APPENDIX

Variable Definitions

Variable	Definition
DIAL_PERF	Response or progress performance rating of dialogue process
SIZE	Market value of equity
TARG_PERF	Company-specific performance
TOBINQ	Tobin's Q, (market value of equity + book value of debt)/(book value of equity + book value of debt)
ROA	Return on assets, earnings before interest, taxes, depreciation and amortization (EBITDA) / total assets
AGE	Company age relative to the start date of the company in Thomson Reuters Datastream
GROWTH	Annual sales growth rate
LEVERAGE	Leverage, book value of debt / (book value of debt + book value of equity)
CAPEX	Capital expenditures / total assets
RESPONSE	Response rating
PROGRESS	Progress rating
INTENS	Engagement intensity
LENGTH	Duration of dialogue
SUCCESS	Indicator variable that equals one if dialogue is successful
SUST_PERF	Aggregate environmental, social and governance rating of Thomson Reuters ASSET4
SUST_TRANSP	ESG transparency rating of Thomson Reuters ASSET4