# Nordic Private Shareholder Engagement as an ESG Risk Management Strategy – From Agents to Stewards

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## Abstract
This study aims for advancing the understanding of shareholder impact on corporate risk management processes in the context of alleged misconduct. The study analyses 47 engagement dialogue case reports depicting how environmental, social and governance (ESG) risk management has been externalized to active institutional owners on a collaborative engagement platform. Based on qualitative content analysis a conceptual model for ESG risk management is proposed. The model comprises of three empirically grounded concepts: *aligning situational context, impacting internal context* and *managing the external context*. The concepts are explored through the lens of agency and stewardship theory and propose a more nuanced view of management as self-centered agents. Responsiveness to shareholder demands on stewardship is the key to successful private engagements. The paper contributes by clarifying that ESG risk management is about stewarding shared resources and embracing the management of risks external to the corporation in contrast to purely managing reputational risk.

## Keywords:
Corporate governance, Shareholder engagement, ESG risk management, Agency and Stewardship theory, Qualitative content analysis

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## 1. Introduction

During the last years, we have seen an increased scrutiny and criticism of how Nordic companies conduct themselves in terms of environmental, social and governance (ESG) responsibilities. The justifiable criticism has related to investments in environmentally harmful business such as brown coal, prioritization of financial profits at the expense of dignified care in privately managed caring homes, and widespread bribery schemes while conquering new telecommunication markets. In addition, several Nordic banks are investigated for being instrumental in laundering dirty money on a global scale. The scrutiny has revealed contradictions between stakeholder expectations how ESG risks are managed in practice (Mason and Simmons, 2014).

In this study, it is argued that corporate ESG risk management has been externalized to stakeholders including social interest groups and active owners, mainly institutional shareholders. The study focuses on how active owners, as a response to alleged ESG risk incidents leading to bad news, assess and influence the corporate conduct through a private engagement dialogue on a collaborative engagement platform of invited shareholders led by the professional engagement firm (Cowton and Sparkes, 2004; Vandekerckhove et al., 2007). Qualitative data compiled in incident driven engagement dialogue case reports are analyzed to explore '*how active owners, through the private engagement dialogue, aspire to impact on corporate ESG risk management practice*'. The objective is to advance the understanding of what happens behind-the-scenes in the private engagement dialogue to support improved corporate ESG risk management.

Although shareholder engagement has become an increasingly popular tool in practice to develop relationships and negotiate solutions to ESG issues (Eurosif, 2018), there is a call for more field-based empirical research relating to shareholder and company interactions (Rehbein et al., 2013; Dimson et al., 2015; McNulty and Nordberg, 2016) and for how companies are affected by the private engagement process (Sjöström, 2008; Semenova and Hassel, 2019). This paper presents an exploratory view on the interaction between shareholders and the company on matters related to downside ESG risks. At the outset, management is acting as agents, but as the process evolves in successful engagements, management is transferred into stewards. This study proposes a more nuanced view of management as self-centered actors and presents a conceptual model for stewarding ESG risks. Based on qualitative content analysis the engagement dialogue is depicted based on three empirically grounded concepts: *aligning situational context, impacting internal context* and *managing the external context* which lays the foundation for the conceptual ESG risk management model presented in this paper.

The remainder of this paper is structured as follows; the following section outlines previous research and theory relating to agency and stewardship theory as well as shareholder engagement; the next section describes the engagement process, the role of the engagement platform, and the empirical data followed by a section describing the research process, including the methodological approach. Finally, the results and conclusions are presented as well as limitations and areas for future research.

## 2. Previous research and theory

This section presents an overview of shareholder engagement related research as well as the fundamental concepts of the agency and stewardship theories.

### 2.1. Shareholder activism and engagement

The rise of Socially Responsible Investments (SRI), or nowadays also referred to as Sustainable and Responsible Investments, has increased investor awareness of the economic value of extra-financial information relating to ESG risks and opportunities (Brammer et al., 2006; Renneboog et al., 2008). A key driver for SRI is the belief that higher company standards for ESG risk management pay off in the long-run through both potential equity premium and by reducing downside risk and operational uncertainties (Hebb et al., 2012). A responsible investor is one who has a specific focus on the impact the business has on the environmental and social context where business operations are seen as a means for advancing sustainability while generating financial returns (Lydenberg, 2007). The attempt by investors to influence companies is often associated with the term shareholder activism. A shareholder group can engage in coordinated action to utilize their unique rights to facilitate change through various means, such as filing a shareholder resolution at the Annual General Meeting with supported media exposure, or a private engagement dialogue with a company over the ESG issue. According to Rehbein et al. (2013), corporations have four options for responding to shareholder activists. They can seek for the omission of the resolution, let the resolution go to a vote by all shareholders, seek consent or action, or engage in a private dialogue with the shareholder activist group. Informal and private dialogues between shareholders and management are considered a cost-efficient strategy with an opportunity for a collaborative approach. Shareholder resolutions are public with potentially negative consequences for firm value (Gillan and Starks, 2000). Through the engagement dialogue, active owners aspire for bringing about ethical, social, and environmental change (e.g. Parker, 2014; Adams and Larrinaga-González, 2007) and improved corporate conduct and corporate governance (Lydenberg, 2007).

It is debated whether shareholder engagement is a successful way for changing corporate behavior (David et al., 2007; Haigh and Hazelton, 2004; O'Rourke, 2003) and previous research has challenged the notion that engagement would be a responsible ownership practice. Shareholders are not necessarily granted sufficient access to the company (Spitzeck and Hansen, 2010), and the process may not facilitate real change in actual business practices and decisions (Greenwood, 2007; Spitzeck and Hansen, 2010; Sjöström, 2008). Dimson et al. (2015) have in a larger scale empirical study analyzed corporate social responsibility engagements with U.S public companies from 1999-2009. They conclude that engagements, where the company is subject to reputational concerns, have a greater possibility to succeed and implement desired improvements. No market reaction is noted for unsuccessful engagements, but a positive market reaction is noted during the first year after a successful engagement. Two years after a successful engagement Dimson et al. (2015) noted improvements in the corporate governance structure of the companies. Semenova and Hassel (2019) have empirically examined private corporate ESG dialogues by Nordic institutional investors with global firms and their subsequent implications. They document that engagements are driven primarily by ESG risks and not current financial underperformance. Their study concludes that ESG policy, performance, and reporting quality improve after activism, which indicates that the objective of activism is met in successful engagements.

Past research asserts that an honest and transparent dialogue between stakeholders and the target company is fundamental for the implementation of corporate strategy and for ethical decision making and firm behavior (Noland and Philips, 2010). Through the dialogue, the firms will be in a better position to predict and understand changes in the demands of the external context and even to respond to these changes, which in turn reduce uncertainties and provide an opportunity for timely and relevant disclosures (Rehbein et al., 2013). The term dialogic engagement is proposed by Bebbington et al. (2007) for describing how the change in relation to corporate accountability and environmental, ethical, and social responsibility can be facilitated through stakeholder intervention. The term dialogic engagement entails that it is no longer sufficient for corporations to interact with their shareholders, but to acknowledge the need for mutual recognition, respect, and collaboration (Noland and Phillips, 2010). Target company responsiveness to active investor demands is seen as the key to successful private engagements.

## 2.2. Agency and stewardship theory

A scandal may be fuelled by that perceived company practice is not corresponding to what in fact is being implemented. Separating between what is said and what is done in practice. A decoupling of walk and talk (Meyer and Rowan, 1977) may be used as a response strategy to external pressures and allegations of misconduct depending on how well the expectations of various stakeholders are aligned (Crilly et al., 2012). In the context of engagement, this relates to how well shareholders are aware of the actual practices within the firm. The agency theory presumes that there is a gap between managers and shareholder risk preferences and presents managers as self-centered and selective agents with regards to how risks are assessed, managed, and communicated. This results in an agency conflict between shareholders and management when e.g. management may prioritize financial returns while shareholders expect both financial returns and taking responsibility for longer-term ESG matters. The agency conflict may be furthered by information asymmetry due to that management have more information about the company, its risks, and actual performance, than the shareholders (Jensen and Meckling, 1976).

Involuntary disclosures, where information about the company and its operations surfaces in the public domain against the will of its managers, may have detrimental effects on the company (Dumay and Guthrie, 2017). In these circumstances, companies tend initially to deny the allegations (Vandekerckhove et al., 2007) and spend more resources on resisting the external pressures than remediating the actual root causes (David et al., 2007). An et al (2011) propose voluntary disclosures as one strategy to address the information asymmetry and subsequently reduce the agency cost. Voluntary disclosure of negative ESG related incidents are not necessarily perceived as a negative signal by shareholders, but may instead be perceived as a risk mitigation tool to display risk awareness and proactivity (Reimsbach and Hahn, 2013). A company reporting the bad news itself, as opposed to being unveiled by a third party, can reduce the negative impact of the incident and increase shareholder trust (Fennis and Stroebe, 2014). In contrast to the agency theory, the stewardship theory (Donaldson and Davis, 1991) is built on the assumption that management and employees intrinsically desire to perform well and in a less self-interested way than agents. The desire of management is to be a good steward of the corporate assets and assume that management is aligned with the interests of the principals (Donaldson, 2008). The managerial action is built upon an assumption of a social contract representing a commitment between the owners and the organization represented by its employees and managers, and the wider stakeholder context in which the company operates. Stewardship is thus defined as the actions taken to respect this contract, or covenant when personal interests are subsided in preference of more long-term and sustainable goals (Hernandez, 2012).

Through the lens of stewardship theory, a corporate scandal does not originate from the agency conflict and information asymmetry but from how management is navigating a certain cultural context and from the applied management philosophies at large (Davis et al., 1997). Stewardship is to be separated from altruism in the sense that stewardship behaviors promote the interests of multiple stakeholders and beneficiaries to promote collective and long-term good (Hernandez, 2012). Donaldson and Davis (1991) argue that the agency and stewardship theories are not antagonistic but the application of these theories is dependent on the phenomena and the situational contingencies. The agency conflict is commonly managed through intensified monitoring, external verification and audit (Chow, 1982), financial incentives for management, and subject matter board expertise (Jensen and Meckling, 1976; May, 1995) while stewardship theory promotes the creation of enabling and empowering structures for top performance. Corporate governance becomes a tool for installing the right structures to support coordination between the managers and shareholders (Donaldson, 1990). Organizational and employee behaviors can be transformed through a shift from agency i.e. control of distrust, to stewardship i.e. facilitating right behavior through collaborative structures (Hernandez, 2012; van der Kolk et al., 2015). These structures relate to e.g. leadership and behavior as well as management systems emphasizing control through interaction and relationships (Hernandez, 2012).

Stewardship presumes being aware of and taking responsibility for externalities, such as the environment and society, in which the firm operates. The social contract, between the firm and its wider stakeholder context, depends on transparency and collaboration. As such, target firms might be more responsive to shareholder engagements as stewards than agents.

## 3. Research method and process

An overview of the empirical data, the method as well as the coding process, is outlined in this section.

### 3.1. The engagement platform and case reports

The study analyses 47 engagement dialogue case reports, documented by an engagement consultant over eight years. As a response to ESG related allegations some shareholders, such as institutional investors, may outsource the engagement dialogue and fact-finding to an engagement consultant[1]. The engagement consultant possesses subject matter expertise and experience in how to facilitate dialogues with companies in a professional manner. Outsourcing the dialogue may, however, result in that the shareholders distance themselves from the actual misconduct and consequences. In addition, there is evidence that the engagement consultant may possess home bias i.e. favoring engagements in a particular setting such as a regulatory context well known to them. (Bauer et al., 2013). The engagement consultant, facilitating the dialogues on a platform for institutional investors is subject to analysis in this study. The engagement professional is a privately held, investor independent company founded in 1992 in the Nordic. The consultant is a leading provider of global engagement services and had over 50 employees at the time of analysis. Since then the number of employees has expanded globally of which a vast majority are dedicated entirely towards corporate engagement dialogues. The engagement philosophy is based on the premise that changes in business conduct drive changes in corporate value and enables effective risk management. (GES, 2014).

The engagement process is incident driven as the consultant commonly initiates a dialogue with the targeted company after alleged violations have come to the attention of the

[1] According to the Independent Research on Responsible Investment (IRRI) Survey results presented in December 2015 44 % of asset owners engage directly, 28 % outsource the engagement to a specialist firm, 23 % expect the contracted asset managers to engage on their behalf and 5 % do not engage at all on stewardship issues. The survey was completed by 1,287 analysts, portfolio managers and companies from 681 firms globally and they voted for 836 different firms and 538 individual analysts. The survey is presented at https://vimeo.com/149177753.

consultant. The violations are assessed against global norms, such as UN Global Compact and OECD Guidelines for Multinational Enterprises. When an engagement case has been opened the engagement consultant performs initial risk analysis and initiates the dialogue with the target company. The engagement dialogue is managed via letters, emails, telephone conversations, and direct dialogue and meetings with senior management in the target company. The dialogue is documented in an engagement case report describing the dialogue, including process goals, response, and progress status from a performance perspective. The case reports also include information about the location for the incident, root causes, and sources of information for the violation. (GES, 2014). The engagement data is made available to the clients with a stake in the target company providing an opportunity for an exchange of information on the engagement case between the professional consultant and participating investors. A proprietary database of ESG incidents in MSCI (Morgan Stanley Capital International) world companies and related engagement case data, were used as empirical data in this qualitative study. The complete database consisted of 858 engagement case reports relating mainly to dialogues on behalf of Nordic institutional investors with a stake in MSCI world target companies. The case reports were documented during 2005-2012. The case reports provide a rich description of the individual engagements suited for qualitative analysis.

This study uses secondary data. However, it should be mentioned that the researcher during 2013 - 2016 had a professional responsibility for the ethics and compliance work, as well as remediation program, at one large Nordic company subject to an engagement dialogue facilitated by the engagement consultant. The dialogue with this company was not part of the data provided by the engagement consultant as the dialogue was launched after 2012. During this process, the researcher, in the capacity of an employee for a target company, had several meetings with the engagement consultant who were gathering information about the alleged misconduct and more specifically providing recommendations and asking for evidence of improvements from the target company. This provided the researcher with a first-hand experience of the type of questions and level of documentation requested including formal sign-off of meeting minutes and verification of company statements.

### 3.2. Method and coding process

This study adopts an inductive approach whereby concepts are derived from the empirical data (Schreier, 2012) through qualitative content analysis (QCA). According to Schreier (2012) QCA can be used to describe qualitative material in a systematic way. In addition, QCA reduces the data to answer the particular research question. Elo and Kyngäs (2007) propose that QCA is suitable for systematic data analysis and coding of large amounts of texts. The data for the coding can be derived from various sources, such as interviews, observations, visual materials, and documents. In this study, the data consisted of engagement dialogue case reports documented by the engagement consultant on a platform. The platform provided real-time information on the engagements to investor clients and an opportunity to collaborate on ongoing engagements in target companies. As the purpose was to describe the data, the coding frame was built inductively based on a data-driven strategy conceptualizing the main themes addressed in the private engagement dialogues on the platform.

The research process was divided into three phases. Preparation of the material, organizing the material, and structuring the material for reporting purposes with the input, main activities and output summarised in table 1. Throughout the process, three meetings were arranged with the engagement consultant to discuss the documentation process as well as test the emerging concepts.

**Table 1**. Research process overview

| PHASE | INPUT | ACTIVITIES | OUTPUT |
|---|---|---|---|
| Preparation of material | Raw data from the engagement consultant | Reading through cases, sorting cases per issue type in spread-sheet | 858 case reports sorted in four issue types |
| Organising | Text field data for 858 case reports | Organising case reports in a spread-sheet based on richness of data in text fields. Cases selected to ensure a representative sample per issue type. | Coding frame based on 23 cases and eight inductive categories |
| Structuring | Coding frame with eight categories | Selective coding of 24 additional cases. Cases selected to ensure a representative sample per issue type. | Three core concepts |

The initial phase, preparation of the material, included the process of getting familiar with the material and structuring it to fit into a spread-sheet to allow for further sorting and analysis. During this iterative reading process, the researcher read through the cases and field descriptions with the purpose of getting a view of the richness and coherence of the data. During this phase, it became clear that the empirical evidence consisted of heterogeneous descriptions of the dialogue between the engagement consultant and the target company. The main contents were an explanation of the incident, a reference to the allegedly violated ESG requirement or norm, the improvement requirements from the engagement consultant, and a description of the actions employed by the company.

During the preparation phase, it was noted that the level of detail varied to some extent, with a natural variety of older cases containing more information than the newer cases and some company responses being more detailed while others had not been able to respond in an early stage of the engagement process. It was also noted that, although the database had several fields/ headlines, not all fields were filled into the same level of detail. One explanation being that some fields had been added to the database over time, resulting in that older cases lacked some information or had been documented in another field. Some of the cases were completed or closed while others were still ongoing.

The engagement consultant had structured the cases into a type of misconduct. The categories were Human Rights and Labour Rights violations, Environmental and Corruption incidents, Inhumane Weapons, and regional concerns in Burma. The categories Inhumane Weapons and Burma were omitted from the analysis as they relate mainly to another SRI strategy, negative screening, and exclusion of target, which means refraining from doing business within this industry or country. The latter types were not considered relevant from the perspective of improving ESG risk management within one company.

During the organizing phase of data mining, the fields with the richest qualitative data related to the origin of incident or allegation, company response as well as continued dialogue and recommendations were selected for further coding. The coding process started with a review of the cases with the richest data within each issue type (i.e. corruption, environment, human rights, and labor rights. The initial coding resulted in several hundred substantive codes, which were further sorted in excel and saturated through constant comparison, selective coding, and writing memos. After a detailed review of 23 case reports, eight data-driven categories had emerged, refining the QCA coding frame. The eight categories were named externalized management, refuting responsibility, systemic non-compliance, dedicated competence, policies and procedures, third-party verification, transparency, and external collaboration. As the purpose of the study was to develop empirically derived concepts, cases were selected for analysis until the inductive categories saturated within the coding frame. The data-driven categories were further structured into three empirical concepts named aligning situational context, impacting external context, and managing external context.

During the process, a representative distribution of cases, per issue type, guided the selection of additional cases for coding. At the end of the process, a total of 47 case reports had been included in the process as outlined in Table 2.

**Table 2**. Case reports and coding sample per issue type

| ALLEGATION | TOTAL POPULATION | | CODING SAMPLE | |
|---|---|---|---|---|
| | # of cases | *% of total* | # of cases analysed | *% of total analysed* |
| Corruption | 102 | *12 %* | 7 | *15 %* |
| Environment | 233 | *27 %* | 12 | *26 %* |
| Human Rights | 242 | *28 %* | 16 | *35 %* |
| Labour Rights | 281 | *33 %* | 12 | *26 %* |
| | 858 | | 47 | |

## 4. A Model for ESG risk management

this section presents the conceptual model for ESG risk management.

### 4.1. An interplay between agency and stewardship

The objective of the study has been to explore how the shareholders, through the private engagement dialogue, aspire to impact corporate ESG risk management practice. A conceptual model for *ESG risk management* is presented based on eight inductive categories and three empirical concepts *alignment of situational context, impacting the internal context,* and *managing the external environment* as presented in figure 1. More detailed examples from the engagement case reports are included in appendix 1.

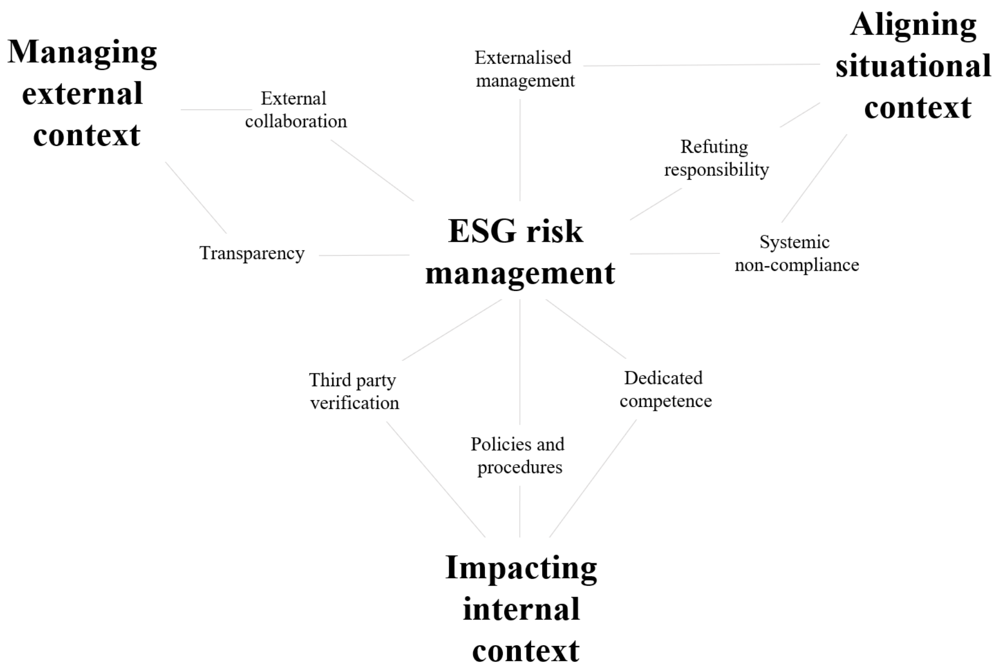


**Figure 1**. A conceptual model for ESG risk management

## 4.2. Aligning situational context

The incident driven engagement case reports analyzed reveal a need for alignment. The concept of *aligning situational context* has been derived from the categories *externalized management, refuting responsibility,* and *systemic non-compliance.* Management may not perceive the situation in the same way as the shareholders and are thus not able to act as stewards (Donaldson, 2008), the misalignment may also feed decoupling because of agency conflicts of the self-interest of management (Crilly et al 2012). Companies may also initially respond by refuting the responsibility and denying the non-compliance (Vandekerckhove et al., 2007).

The stewardship theory assumes the alignment of goals and objectives, between owners and managers, which will enable managers to act in the best interest of shareholders. (Donaldson and Davis, 1991). The inductive category *externalized management* portrays how the company management has externalized the stewardship of ESG matters. Prompted by the incident (e.g. public concerns raised in the media or through an NGO or industry association), the shareholders are initiating an inquiry regarding the actual company practice. The inquiry, facilitated through the engagement platform, is in this study seen as an external ESG risk management process where external parties bring ESG related non-compliance or concerns to the attention of the target company.

The case reports confirm the notions in previous research and anecdotal evidence that target companies tend to initially deny the allegations of misconduct (Vandekerckhove et al., 2007 and David et al., 2007). In several cases, the dialogue is initially revolving around establishing the company's responsibility for the alleged misconduct. The category *refuting respon-*

*sibility* demonstrates an initial denial or hesitation to embrace the allegations. Management is acting as a self-centered, defensive agent, reluctant to take in the alleged information.

The incident driven ESG engagement case reports also show that the alleged misconduct perhaps is not an isolated phenomenon, but part of systemic mismanagement of ESG risks. The companies, that now are accused of an ESG related violation, have signed up to e.g. the UN Global Compact principles, stating formal compliance to responsibility principles. The incident reveals gaps in actual compliance. The category *systemic non-compliance* reveals a gap between policy and practice (Meyer and Rowan, 1977) either as an evasive or emergent strategy to manage the shareholder demands (Crilly et al 2012).

## 4.3. Impacting internal context

The case reports depict how the shareholders, during the iterative engagement process, are viewing management both as agents and stewards and aspire to facilitate improvement in both formal policy and leadership practices. The shareholders are aspiring for *impacting the internal context* to monitor agency and support stewardship through improved structures and processes and ensure more effective coordination between the managers and owners (Hernandez, 2012; Donaldson, 1990). The concept of *impacting internal context* has been derived from the inductive categories *building competence, policies and procedures,* and *third-party verification.*

The agency theory presumes implementation of systems and control in a more constraining and directive manner e.g. management control and monitoring as well as recommending new competence to the board and dedicated board committees (e.g. Jensen and Meckling, 1976; May, 1995) whilst the stewardship theory facilitate improvement through collaboration, relationships and employee development (Hernandez, 2012; Davis et al.,1997).

There is a contradiction between the increased societal demands on corporations and a lack of trust and skepticisms towards the corporate capability to act as stewards (Mason and Simmons, 2014). Traditional means of third-party involvement and auditing are recommended to reduce the agency conflict (Chow, 1982).

## 4.4. Managing external context

The actual consequences from poor ESG risk management and lack of stewardship is not always direct harm to the company but constitutes a threat to external parties directly exposed to the harmful consequences of incidents related to corporate activity (Schneider and Scherer, 2013). As such, it is not sufficient to manage the internal context through e.g. building capacity, implementing policies and procedures, and auditing these activities. ESG risk management needs to be alert on potential incidents in both the internal and external context of the company (Bebbington et al., 2007). The concept of *managing external context* is derived from the categories of *voluntary disclosure* and *external collaboration*.

A key aspect of ESG risk management is to manage the elements of distrust (Mason and Simmons, 2014; Dimson et al., 2015). The distrust is evident both in the call for third party verification as well as transparent and *voluntary disclosures*. An et al., (2011) propose voluntary disclosure as a means for mitigating the information asymmetry and subsequently reducing agency costs. A company is expected to disclose both ESG risks and actual risk management and compliance. Voluntary disclosure of negative ESG related incidents can be perceived as a risk mitigation tool (Reimsbach and Hahn, 2013) to show risk awareness (Dumay and Guthrie, 2017) and increase trust between shareholders and the target company (Fennis and Stroebe, 2014).

Throughout the dialogue, the company is expected to engage in transparent disclosures and *external collaboration* with stakeholders to advance the corporate ability to predict and understand the changes in the external context. Private engagement can entangle the increased and revised demands on corporate responsibility (Rehbein et al., 2013). External collaboration is visualized by engaging in industry dialogues, developing common industry standards and monitoring and control mechanisms as well as implementing a broader stakeholder representation in boards. The purpose of external collaboration is to remediate and manage common and structural challenges in the external context. By engaging in mutual interaction with shareholders, the company will facilitate respect and an understanding of the impacts and effects from failures related to externalities of the firm (Noland and Phillips, 2010) and demonstrating to build capabilities to act as stewards.

## 5. Conclusions

Contrary to financial risk management, where the consequence for failure can be measured as a direct financial impact on the corporation, the consequences from ESG risk management failures are to a large extent external to the corporation with potential indirect financial consequences. The corporation may encounter direct financial consequences due to fines, costs for remediation, and lost sales, but the real damage is on the environment, society, and individuals. In this respect, a company is liable for managing risks and potential harm caused to others - to the environment and society in which the organization operates. ESG risk management is at its core stewarding shared resources and embracing the management of risks external to the corporation. Stewardship implies a responsibility for shared assets and moving beyond the immediate individual financial interests of the agency (Donaldson, 2008).

The conceptual model for ESG risk management process presented in this paper proposes an iterative process between viewing management as both stewards and agents. At an outset, management is viewed as stewards, but as the process evolves both agency and stewardship strategies are advocated for improved corporate ESG risk management. The paper proposes a more nuanced view of management as self-centered actors and portrays how investors assume that management can and should act as stewards. Contrary to traditional agency conflict-driven studies, such as Van der Kolk et al (2015), where management act as a rational agent with short-term economic interests, this study proposes that shareholders should consider management as stewards to assume responsiveness for the alleged ESG incidents with more long-term consequences for firm value (Davis et al.,1997; Hernandez, 2012; Mason and Simmons, 2014)).

The paper also acknowledges that in a private engagement process an alignment with the situational context is needed. A common understanding of the ESG incident, the root causes of related risks, and their relation to the target company need to be established. A misalignment of the situational context leads to the de-coupling of responsibility and action. Target company non-responsiveness to an investor dialogue results in an inefficient engagement dialogue where no actual change to management behavior is achieved. The risk to exclude the target company from investor portfolios increase with an unsuccessful engagement. Responsiveness to investor demands on ESG risk management includes real and tangible changes in the internal context. Public commitment to ESG risk management needs to be supported by dedicated competence, policies, and procedures and to be robust enough to pass third party verification and audit.

Finally, ESG risk management, presume efficient management of the external context. Shareholders expect companies to transparently disclose actual remediation and risks (Dumay and Guthrie, 2017; Fennis and Stroebe, 2014; Reimsbach and Hahn, 2013). In, addition it is expected that the company not only works in isolation and with internal processes but engage with the external context through shareholder collaborations and community engagement. A fundamental change in ESG risk management processes requires more than formal policy statements and disclosures in sustainability reports. Responsiveness to shareholder demands on stewardship is the key to successful private engagements in a situation when ESG risk management is externalized to active owners and their professional consultants.

### 5.1. Limitations

The empirical data established a particular frame for the analysis as the origin of an engagement case is a call for action from investors on companies due to an incident or scandal. As such, there have already been some public indications of misconduct or potential violations of human rights, labor rights, or environmental or corruption concerns. This study is limited to the data documented on the platform for the engagement dialogue and is not the direct voice of the investor or the company. After a meeting with the company, as part of the dialogue, the engagement consultant sends meeting minutes to the company to confirm that the documentation reflects what has been discussed in the dialogue. The data reflects the perceptions of the engagement consultant on both the dialogue process and target company responsiveness.

### 5.2. Areas for future research

When severe criticism is raised towards a company, the pressures are multifaceted and the effects and changes made within a company cannot be isolated to consequences from the engagement dialogue. To understand the actual impact on the micro-processes within the company the data analysis would need to be complemented with interviews and review of target company internal material. In addition, the investor dialogue with the engagement service consultant on the platform is not directly visible in the material. This study analyzed the dialogue from the perspective of the service provider, the engagement service firm. A future study could analyze the engagement from an owner’s perspective, both the dialogue between the owner and the service provider and direct engagement between the owner and the company. The case reports came from a single service provider. A potential extension is to multiple engagement professionals in order to identify whether the engagement firms emphasize specific traits in the process.

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## Appendix 1 - Case report examples

| CORE CATEGORY | ENGAGEMENT CASE REPORT SAMPLE TEXT |
|---|---|
| **Externalised management** | "The case regarding the alleged anti-union behaviour stems from three main sources, namely the ILO, an on-going court suit against the company, as well as a fact-finding mission made by the city council. The ILO Committee of Freedom of Association (The Committee) has reported on complaints submitted by various trade unions. The said complaints concern a summary of cases which the local government is criticized for not having addressed, in particular the murder of two union representatives.<br>A law suit has been filed against the company, the company has denied the allegations and claimed it could not influence the situation due to contractual limitations. The city council went on an independent fact-finding mission to and the delegation reports to be shocked by both disturbing employee testimonies as well as the company's lack of investigation of the matter. Further the delegation highlights the potential that the company is, either through intention or negligence, prioritising the company's interests as opposed to the lives and safety of its workers." |
| **Refuting responsibility** | "There have been several external reports stating that the forestry company is performing illegal logging activities in at least three countries. The main concern regards the logging of natural forests in areas with a highly sensitive biodiversity, including national parks.<br>There have been negotiations between non-governmental organisation and the company to come up with a sustainability plan. Regretfully there was no agreement and the company is reported to continue its aggressive logging activities. The company has responded to inquiries from the engagement consultant via press releases where the allegations are denied." |
| **Systemic non-compliance** | "The company stands accused of systematically dumping billions of gallons of highly toxic waste into pits dug into the earth. The seriousness of the environmental situation has been confirmed by scientific reports and following a fact-finding trip to the area."<br>"In light of the alleged wrongdoing covering three countries and the fact that the company has a history of having been accused of corruption, there is a risk that the misconduct is not limited to a couple of individuals. Rather there could be gaps in the company's proactive risk management and safeguards against bribery in particular may be insufficient. Emerging economies are the fastest growing markets for the company and it will hence be doing more and more business in countries that have an elevated corruption risk. This lead [the investment consultant] to conclude that the company should accordingly enhance its policies, proactive risk assessment and control over business partners in those locations, and the company global anti-corruption preparedness will therefore be subject to further analysis." |
| **Building competence, policies and third-party verification** | "The company described in a letter to [the engagement consultant] that they are undertaking several measures in order to investigate and analyse the reported incidents, as well as to improve management systems. In the Annual Report, the Board stated that it accepts ultimate responsibility for the actions of management and the culture at the company and is committed to making significant changes in order to avoid similar incidents to recur.<br>External auditors were appointed to review internal controls and corporate governance practices. A report with findings and recommendations was received by the company. As a result, the board endorsed an action plan in relation to the recommendations in the report.<br>The measures include changes in top management as well as the establishment of two new committees in order to immediately strengthen specific parts of the company's corporate governance structure."<br>"The company has stated its commitment to complete an environmental assessment, meanwhile receiving criticism for failing to uphold its commitments. It is therefore of utmost importance that the activities are subject to independent third-party verification. A proactive and precautionary approach entails the adoption of the necessary policies and guidelines. Education and compliance programs should be targeted in the area of forestry conservation. Furthermore, internal monitoring system must be in place." |

| CORE CATEGORY | ENGAGEMENT CASE REPORT SAMPLE TEXT |
|---|---|
| **Third-party verification** | "The company has taken a responsible course of action by adopting and implementing a global policy for human rights. In its latest sustainability report, the company informs about significant progress in promoting awareness and compliance through training, assessment tools and alliances. The company is a signatory to the Voluntary Principles on Security and Human Rights and promotes the Universal Declaration on Human Rights, which is included in the company's training program. The program applies to all employees, managers, security employees and contractors in international operations, requiring them to report on alleged violations of the policy to managers, the Compliance Committee or the Compliance hot-line.<br>The robustness of the policy and program has been confirmed by external stakeholders involved in a shareholder process with the company. In the operations in Country X the company collaborates with a local think-tank to measure possible risk and impacts of its operation. The foundation also monitors the assessment process of new operation areas."<br>"The company is recommended to include a section on how the work with corruption prevention is progressing in the annual governance report. The implementation of these measures should be verified by an organisation with relevant experience." |
| **Transparency and External Collaboration** | "The company has already taken steps to address the problem: it has set up structures, procedures and regulations, it also has a Code of Ethics and an Ethics Committee to communicate and implement the company's core values through the organisation. It joined the Global Compact in 2003. Meanwhile [the engagement consultant] does not believe that the company has addressed the issue of corruption adequately and would like to see the following: Firstly, the company should report on how the company uses agents and intermediaries and how the company is working in order to minimise risks related to corrupt business practices.<br>By way of example the company could join 'TRACE', a non-profit membership association specialising in anti-bribery due diligence reviews and compliance training for commercial intermediaries. Secondly, the company should report more transparently on issues related to corruption, e.g. on-going investigations, company training, accountability mechanisms and financial reporting. The results should be verifiable. Finally, [the engagement consultant] encourages the company to participate in 'integrity activities' in its work against corruption. "<br>"The company has adopted a responsible course of action in promoting and implementing increased safety measures at its plants. And while the company has policies guaranteeing the freedom of association, the company - in dialogue with investors and important NGOs in the area of human rights - is reviewing its human rights policy to better ensure their protection and to prevent violations of said principles. In order to verify the results of its work the company assigned the industry association to perform an audit of the conditions at its Colombian bottlers, with a particular focus on freedom of association and security. The association has ensured that workers testimonies confirmed their right to exercise freedom of association. [The engagement consultant] further believes that these measures together with investments in its organisation to better address labor relations evidence the company's commitment to human rights. The company has taken several important steps in increasing its transparency and openness to stakeholders." |