The Rise of Considerate Capitalism

Fund managers are increasingly being asked to play a role in ensuring good corporate behaviour, but strong ESG analysis is a crucial part of delivering shareholder returns, says Rupert Krefting, head of corporate finance and stewardship at M&G.

Editor of Hub News Cherry Reynard interviews Rupert Krefting on M&G's approach to responsible investment. Interview taken from Hub News, Spring 2018.

Companies are coming under increasing scrutiny from governments and regulators not just for the returns they deliver to shareholders, but for the way those returns are generated. Increasingly, investors see both the risks in poor governance and also the opportunities presented from solving long-term structural problems around the globe, such as climate change. Rupert Krefting, head of corporate finance and stewardship, leads this charge at M&G, holding companies to account, and helping the group's fund managers make better investment decisions.

For Krefting, responsible investment is more than just voting, it is part and parcel of being an active investor. He says: "It means investing for the long term, being active, engaging with companies and their management team, using our shareholdings to vote at AGMs. The most important part is engaging with companies, a lot of the other things can be done by passive investors. We want to be asking the intelligent questions that hold companies to account and influence management's behavior."

Responsible investing comes with many names and acronyms. Krefting defines it as all the 'non-financial' aspects of a company's operations; those elements that can't be seen on the balance sheet or profit and loss statement. These considerations are having an increasingly profound effect on shareholder returns. He points to recent cyber-crime, to show the impact of poor governance on share prices, such as the example with Equifax, when their cyber disclosure caused the share price to fall 30%.

The group's engagement criteria are wide-reaching and they will vary their focus according to the nature of the company involved. "With a technology company, for example, emissions aren't as relevant," Krefting says. "But it's crucial for oil and gas companies. For a technology company, we want to talk more about governance and social issues, regulation or cyber security. The key thing is to draw out the relevant issues on a stock by stock basis."

The analysis is a collaborative effort with the fund managers. Krefting sees his role as there to help the fund managers make better decisions, to understand the risks they are taking in individual investments, and also where the opportunities lie. He says: "Prior to a meeting with company management, we will plan what we're going to talk to them about with our central analysts. We think about the most relevant ESG factors and draw out the key issues – whether that is health and safety, or the supply chain or how they treat their employees."

> "We are here to add value to the investment teams. It is not just about looking at the investment risks but also the opportunities. For example, with the transition to a lower carbon economy, there is such a huge investment required that there are opportunities in new investments as well as risks from stranded assets."

At each stage, Krefting and his team are trying to have a wide-reaching conversation with corporate management teams. While some will simply want to trawl through the results presentation, he believes it is important to get beyond that and understand the real issues confronting the company.

Companies are becoming increasingly receptive to being asked these questions. Partly, he says, this is because at M&G, they take a non-confrontational, collaborative approach. He adds: "If you show that you are a long term shareholder, and are generally supportive of the company, management will take on board what you are saying. The more shareholders start asking non-financial questions, the more corporate management teams will get used to it and ultimately, it will influence their behavior. If no-one asks the questions, management may not take action."

He says certain topics are more sensitive than others. For example, cyber security can be an uncomfortable topic for many companies because it has such commercial impact. He says: "We have learned that we need to open up with 'what do you have in place' rather than 'when were you last hacked'."

Ideally, the team will always have time to meet management and do in-depth research. However, this is not always possible, and the group will also do shorter reviews that the fund management teams can use quickly. This will take in elements such as the past history of its management team, its board structure, tax and accounting and give an overall review. This can help the fund managers frame their analysis ahead of a broader review.

The biggest topic on his agenda at the moment remains climate change, where there is lots of regulatory activity. The Financial Stability Board has created a task force for climate change disclosure, for example. This looks at the physical risks to assets from climate change, and the risks in transitioning from a high carbon to a low carbon economy.

Two other areas likely to be important for companies in the shorter-term are cyber security and diversity. Krefting says: "Cyber security is coming up the list of important topics pretty fast. It can be very price sensitive and is costing companies an increasing amount of money. They not only have to contend with the expense, but also of their loss of reputation and brand. Companies will have to be more open about this in future with the new data protection regulations coming in next year. Diversity speaks for itself, but M&G is a strong supporter of the 30% Club aiming to get greater representation of women in senior management positions."

In addition to the financials, Krefting believes strong analysis of environmental, social, and governance criteria is likely to be crucial in delivering returns for active shareholders in the future.

The value of investments will fluctuate, which will cause fund prices to fall as well as rise and you may not get back the original amount you invested.

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