Bloomberg Environmental Social Goverance - Module 6

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Corporate Governance and Shareholder Activism

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As a shareholder, Worthing Capital Management uses its shareholder power to influence corporate behavior. It is concerned about the financial risks of companies lagging on ESG material matters. Firms use various tactics when seeking changes in companies, including pushing for divestments or demanding that companies explore a sale. Usually, activist shareholders' demands start as private conversations with management. When activists feel their demands are not being heard, they will often go public, engaging in activities like media campaigns that challenge management or board members. If activist shareholders don't get their way, they will often submit shareholder resolutions or, as a last resort, push to replace the chief executive officer. Worthing Capital Management sees the value in holding companies. By engaging deeply with them, Worthing can do more to create change that aligns with investor values rather than fully divesting from them. They've often used proxy voting as a tactic, pledging to vote against the boards of companies that fall short on ESG issues. Worthing Capital Management wants to focus on promoting diversity as well as encouraging companies to reduce their carbon footprint in alignment with the Paris Agreement's target of limiting global warming to 1.5 degrees Celsius. Worthing Capital Management is one of many asset managers that has used shareholder activism as a strategy to create the change investors want to see. In 2021, shareholder activists teamed up with environmental and socially-minded investors in record numbers. The most successful campaign was arguably hedge fund Engine No. 1's successful proxy battle where they pushed to add three climate-conscious directors to the board of fossil-fuel behemoth Exxon Mobil Corp. They won. Like Worthing Capital Management, Engine No. 1 has publicly stated that they prefer to engage with companies rather than divesting from them. They also launched an ESG ETF that seeks to provide funding to companies that can help transform their models. Other notable initiatives include investor Dan Loeb's attempt to break up Royal Dutch Shell and Bluebell Capital Partners' push for a management shakeup at GlaxoSmithKline. Activist investors' appetite for corporate change is showing no signs of slowing. In fact, efforts are getting more aggressive. Investors are pressing big companies to do everything from reallocate capital and shrink their carbon footprint to overhaul management teams. The ESG investment team members at Worthing Capital Management see themselves as responsible shareholders and collectively agree that they can help companies increase value for all shareholders. Joy, an equity-focused portfolio manager on the team, noted, "It would be irresponsible not to engage with companies. The board and management of companies have a fiduciary duty to deliver satisfying returns to their investors and act in their best interest."

B.I. Act Go shows activist data, including all global activism campaigns dating back to the beginning of 2017. Top activists will have data back to 2010. Campaigns included are those where shareholders are publicly seeking to make a change at a company without company cooperation. A known activist may get a board seat or take a large stake in a company without disclosing public activist intentions. A credible news report on one of those situations, a hedge fund or investor with a history of activism filing a 13D after purchasing shares on the open market, or hostile bids by shareholders unaffiliated with management—where the bidder has stated activist goals—are also included. This data does not include proposals by small ESG investors, stakes disclosed in a 13F or 13G filing without accompanying activist intentions, campaigns where the investor owns debt but not equity, or short selling campaigns. All data is sourced from public regulatory filings, news, and press releases. To search for data, type criteria in the amber box at the top or select filters below. Let's look at Icahn Enterprises, a diversified holding company, and focus on consumer discretionary companies with a billion-dollar-plus market cap. Type "Icahn Enterprises" in the amber box, then click the "Any Sector" dropdown and select "Consumer Discretionary." Click the "Any Market Cap" dropdown and select "One Billion Plus." The search results show the start date, the exit date if applicable, and the objectives of the campaign for each company returned. The return calculation is based on stock performance from the start date through either the end date or the current date if the campaign is still ongoing. You can also see the market cap of the target, as well as the stake held by the activist, if known.

Assessing Companies' ESG Performance

Joy starts assessing some energy companies she is currently holding in the portfolio she manages. She wants to see if and how their practices align with the Paris Agreement's 1.5 degree Celsius temperature goal. She also wants to identify any other ESG issues where they may be falling short. To look at energy giant Shell, she loads the ticker `Shel LN Equity` in the Terminal's command line. Joy likes to start her assessment on the `DES ESG` page, which shows a high-level breakdown of the company's ESG-related data. Since she is interested in Shell's contribution to temperature rise, she takes a look at the Temperature Rise section first. The GHG Protocol Corporate Standard classifies companies' GHG emissions into three 'scopes.' Scope 1 refers to the emission of greenhouse gases that are controlled or owned by Shell—such as direct emissions from fuel combustion on site (e.g., gas boilers, fleet vehicles, air-conditioning leaks). Scope 2 references the emissions that come from energy sources Shell purchases to do business—such as indirect GHG emissions from electricity, steam, heat, or cooling. Scope 3 refers to all other indirect emissions resulting from Shell's activities, including upstream and downstream transportation and distribution, business travel, remote working, and employee commuting. Joy sees that Scopes 1+2+3 contribute to a 1.78 degree Celsius increase over the next five to fifteen years, falling short of the 1.5 degree Celsius goal urged by the Paris Agreement.

Analyzing ESG Scores

Next, Joy looks at the company's Bloomberg ESG scores. She clicks on `ESG SCORE` to take a closer look. Bloomberg scores are industry-specific, so Joy can quickly see the most important environmental, social, and governance issues for the company, which is classified as Integrated Oils. The weighting column indicates the level of importance of a particular issue relative to others for an industry. In this case, climate exposure and GHG emissions management are important environmental issues for Shell. Joy sees that the company is mostly leading peers on environmental and governance issues. However, when she looks at the social issues section, she sees there is more room for improvement, particularly on labor and employment practices. To gain some insight, she clicks the Document icon next to the lagging social indicator to read the notes from the most recent shareholder meeting. It seems that the company committed to creating a common framework for monitoring labor rights in their supply chain in response to demands; however, the plan excludes trade union participation. One participant at the meeting asked the company to justify this decision: "If Shell really wants to improve labor rights in its global supply chain, why do they refuse to work together with IndustriALL Global Union to address these issues?" The participant went on to say Shell is only working with local unions when there should be global dialogue to ensure global solutions. Shell's CEO responded by explaining that while they recognize the role unions play in representing legitimate rights, on many occasions unions bring up concerns that are very local and very specific. As Joy continues to read through the transcript, she can see that there are also other concerns related to social issues, including the health and safety of surrounding communities where they operate. At the time this screen was captured, the company's score on health and safety policies was 5 out of 10.

Analyzing Raw ESG Data

Alongside looking at ESG scores, Joy dives deeper since she is always very rigorous in her assessment of companies. She goes to `FA ESG`, Bloomberg's ESG Financial Analysis screen, to take a closer look at all of the raw ESG data Bloomberg uses for analysis and building ESG scores. She clicks on the Environmental tab and sees that Shell's total GHG emissions for Scope 1 and Scope 2 went down in 2021 while Scope 3 has steadily increased. To interrogate the data or see its source for such purposes as investigating anomalies or confirming relationships between source entities, Joy clicks on total GHG emissions for 2021. She sees the data is derived from the company's Sustainability Report for 2021. Shell's Sustainability Report contains quantitative disclosures as well as qualitative data around what the company is doing to improve safety, reduce their greenhouse gas emissions, and increase the representation of women in the workforce. It also contains commentary around the data. As Joy scrolls through the report, she sees that eight contractors in Pakistan, Indonesia, and Nigeria lost their lives during the course of their work on Shell-operated venture activities in 2021. The report explains that Shell will measure the number of serious injuries and fatalities per 100 million working hours to improve their safety efforts going forward. Shell states that this will allow them to focus their efforts on the most serious injuries and fatalities on the most critical events. In addition to safety issues, Joy is interested in reviewing data on Shell's approach to climate change since a top priority for her is reducing the carbon footprint in her portfolio. She sees that in addition to short-term, medium-term, and long-term targets, the company announced a new absolute emissions target as of October 2021 to achieve their net-zero ambition. Shell is planning to reduce its absolute emissions from operations (Scope 1 and Scope 2) by 50% by 2030, compared with 2016 levels on a net basis. This new target is part of Shell's efforts to make energy transition a top priority. The company explains that to achieve its target, it will have to reduce emissions both from operations and fuels and from other energy products, such as electricity, that they sell to customers. It also means capturing and storing any remaining emissions using technology, protecting natural carbon sinks, and providing high-quality nature-based solutions to customers to offset unavoidable emissions. Now, Joy wants to look at Shell's gender diversity. She clicks the back buttons to return to `FA ESG`, then clicks on the Social tab. Here, Joy looks at the percentage of women in the workforce to see how it's changed over time. While there is still room for improvement, it looks like the percentage is increasing. She clicks on the metric for 2021 so she can interrogate the data. The gender diversity numbers in the Sustainability Report show that the percentage of women on the board has increased more than any other role, and now women make up 50% of the board's members.

Examining ESG News Headlines

Next, Joy decides to look at some news headlines. ESG news headlines, positive and negative, are important as they can have a major impact on companies. For example, in the past, the ESG investment team at Worthing Capital Management examined 24 major ESG controversies of S&P 500 companies over a five-year period and they found that the total market cap loss amounted to $534 billion. Joy wants to examine whether and how stock prices might react to different types of ESG-related news. She pays attention to correlations between news headlines, positive and negative, and significant price movements up or down to identify material matters that may not be apparent but that she might want to explore further. She types `CN` into the Terminal command line to look at company news for Shell. Then she types `ESG` into the filter to look at ESG-related news. Next, Joy types `controversy` in the filter and selects ESG Controversy Screening to look at controversies since she is particularly concerned with how companies address controversies. To examine price reactions to ESG news information, Joy opens the `GP` function. Joy sees the price has been steadily increasing since December 2021. She clicks on News and then clicks on the chart to see news. She types `ESG` in the filter and then selects Environmental, Social, and Governance under Topics. She sees the following headlines: *Shell Loses Climate Case That May Set Precedent for Big Oil.* The Dutch court criticized Shell's carbon target ruling that is not aggressive enough and that they needed to slash their emissions harder and faster than planned. She thinks back to the data she saw in the company's 2021 sustainability report which stated that they announced a new absolute emissions target as of October 2021 to achieve their net-zero ambition. She needs to do more research to understand how they are doing on the new target.

Analyzing ESG Research

To read more about Shell's current carbon target, Joy decides to examine `BI Carbon`, the Bloomberg Intelligence dashboard showing current carbon research on industries and companies. She sets the Industry dropdown to Oil & Gas and then clicks the Qualitative tab. Here she sees that Shell's Scope 1, 2, and 3 targets are not science-based targets, and they are planning to use carbon offsets to remove carbon dioxide from the atmosphere. Companies that are heavy emitters and that rely on fossil fuels may purchase carbon offsets.

Carbon offsets aim to balance carbon emissions by finding other ways to reduce carbon in the atmosphere by an equivalent amount. It's a way for companies to take near-term action to reach carbon reduction goals while they work to transition to more sustainable business practices. For example, companies may invest in wind farms to store carbon or they may invest in planting trees to help reduce the amount of fossil fuels used in energy networks. Joy has been reading about the growing debate around carbon offsetting. She wonders whether it is a viable option for companies like Shell, which may have a difficult time reaching their net-zero goals solely via emission-reduction initiatives. She sees the business risk that climate change poses to her portfolio, and she is pushing for holdings to become decarbonized; however she also sees potential upside (even beyond benefits to the planet). Companies making net-zero promises are innovating new products and creating investment opportunities to reach their emission goals. For example, the technology sector is currently creating software, hardware, and other products to help customers decarbonize. While groups such as the Science-Based Target Initiative (SBTI) are developing frameworks for setting and evaluating effective net-zero goals, there's currently no required standard for what a net-zero commitment means. For instance, some organizations may include Scope 1, 2, and 3 emissions, including direct emissions generated by the company and indirect emissions generated by upstream suppliers and the company's products. Meanwhile, other organizations may only include emissions they produce in their net-zero commitment. Joy clicks on the Scenarios tab to look at scenario analysis, which compares companies' set carbon reduction targets to industry benchmarks. It shows what the International Energy Agency (IEA) says is an appropriate level of carbon reduction and how that stacks up to the company's own carbon targets. Comparisons are based on absolute emissions and greenhouse gas intensity targets. GHG intensity targets are policies that specify emissions reductions relative to productivity or economic output, for instance, tons CO_2 per million dollars GDP. Absolute emissions targets specify reductions measured in metric tons, relative only to a historical baseline. Shell's targets are showing below the industry benchmark.

Analyzing Shareholder Proposals

Now that Joy has done some thorough analysis, she is ready to engage with the company about benchmarking themselves against peers. She reads into strategies for addressing issues like safety, climate change, and diversity. Before she reaches out, she looks at Bloomberg's Proxy Tracker to see how other investors are engaging with companies on these issues. Here, she can see how all of the shareholder proposals filed in recent years are performing. Joy decides to look at proposals addressing climate change risk first. She clicks the All Proposal Category dropdown and selects Environmental. Then she clicks the All Proposal Type dropdown and selects Climate Change Risk. Joy wants to look specifically at oil and gas companies, so she selects Oil and Gas Producers from the Industry dropdown. In the far-right column labeled %For, Joy can see the percentage of shareholders that have voted in favor of specific proposals. To get a better understanding of trends over time, Joy clicks on the Proposal Type by Year tab. In 2021, 3 proposals on climate change risk were filed. How many shareholders were in favor? Joy clicks the 'View' dropdown on the top left, and selects % For Excl Abstain. She sees that 53.2% of shareholders were in favor. Now Joy is ready to engage with the company. She calls management to ask how they plan on tracking and monitoring their progress internally to ensure they meet their goal of achieving net zero by 2050.