

[WHY EVERYONE'S TALKING ABOUT...]

Divestment

Marketing communication



Is divesting assets helpful for sustainable investing goals, or is it more fruitful to engage companies and try to steer them towards a more sustainable future?

For fund managers under pressure to decarbonize their holdings, 'divestment' – which imposes a blanket policy to eliminate any investment in companies engaged in specific controversial activities – offers a quick and easy way to lower one's portfolio's carbon intensity.

By divesting, you are also sending a signal – you are removing your financial stake on the grounds that the company is falling short on its climate commitments, for instance, or is heading irrevocably in the wrong direction in the transition to green energy.

Yet such actions merely shift the carbon from one balance sheet to another – you might simply be handing over your position to a less scrupulous investor. What's more, by divesting, you could also be removing the finance that the company needs to make the transition to a greener future – making divestment a lose-lose in the fight against climate change.

If you remain at the table, on the other hand, and continue to engage the board and use your voice, you'll retain your power to influence and can demand that the

company does better. Asset managers call this 'active ownership'. Indeed, research published by Harvard in 2020¹ concluded that "exit is less effective than voice in pushing firms to act in a socially responsible manner".

The 'divest or engage' debate gained a lot of traction in 2021. In the US, for instance, ExxonMobil – the world's biggest non-state oil company – was hit by a remarkable shareholder intervention, when the little-known hedge fund Engine No. 1 succeeded in gaining three seats on its board to drive faster climate action².

Was ExxonMobil a wake-up call for climate laggards?

Of all the recent high-profile engagement efforts, ExxonMobil might yet prove to be the most pivotal. The company had performed poorly for a decade³, its critics claim, because it had consistently ignored shareholder concerns about the energy transition.

Through their appointments, the Engine No. 1 directors imposed vital green energy experience on the board. And the move sent shockwaves throughout corporate America, extending far beyond the oil and gas industry. If an activist investor could do this to America's largest oil company, surely any carbon intensive company was vulnerable?

Similarly, the climate ruling against oil giant Shell in 2021 was seen by some as a crucial signal that would change the dialogue on a companies' responsibilities for climate change. Shell lost a landmark ruling in the Netherlands, in which a Dutch court ordered the company to reduce its emissions. It promptly moved its headquarters back to London⁴.

Is divestment ever the right decision?

For some investors, there comes a point when engagement runs its course – particularly on fossil fuels. Europe's largest public pension fund, ABP, announced in October 2021 that it will divest from all fossil fuel producers⁵.

Certainly, a tougher approach might be needed for those companies not transitioning fast enough – particularly in light of the landmark report by the UN's Intergovernmental Panel on Climate Change last year⁶.

Yes, investors need to give companies time to adjust as they transition their business onto a more sustainable path, but perhaps the threat of divestment should remain in the back pocket. A carrot and a stick – to be used as a last resort.

Written in April 2022

References

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- 6 Source: IPCC, 2021. <https://www.ipcc.ch/2021/08/09/ar6-wg1-20210809-pr/>

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