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#TimesUp for Australian listed companies

Boards and businesses that ignore ESG concerns do so at their peril.

The #TimesUp campaign has demonstrated how quickly things can change. What today appears impregnable and immutable can, in a heartbeat, be left exposed, discredited and abandoned. There are lessons in this for Australian listed companies.

Some are now learning these lessons the hard way. The royal commission into the banking industry has not only vaporised any semblance of trust held by corporate Australia, it has shocked regulators and consumers out of their complacency. It will take a generation to rebuild corporate reputations.

When investors are being increasingly clear, expansive and assertive in pressing their requirements, it is obvious that many corporates are having trouble keeping up or have lost interest. Investors are screaming out for more and better disclosure around measurable targets that give them confidence around long-term sustainability. But it appears many listed companies may be on a collision course with the sophisticated investors' expectations.

Recent research by corporate governance consulting firm Morrow Sodali confirms investors are demanding a clear articulation of business strategy, confidence directors are qualified and competent to fulfill their roles and proof decisions are aligned with corporate strategy and investor interests.

This is coupled with the fact that there is no longer a distinction between environmental, social and governance matters, and investment decisions.

A growing number of investors are employing their own environmental, social and governance (ESG) teams. These voices now sit around the table at one-on-one results and strategy briefings. A stroke of their pen can have a material impact on a company's share register or an annual general meeting (AGM) outcome. Their presence is not cosmetic.

We can see this dynamic at work in the Australian Council of Superannuation Investors (ACSI's) gender diversity voting policy, which recommends against the election of directors on companies whose boards have less than 30 per cent of women as members. AustralianSuper also announced in December 2017 it is divesting all tobacco holdings by 2019, joining a long list of funds that have already done so.

Despite the trend, many companies continue to disclose this information begrudgingly, viewing ESG enquiries as a distraction. This significantly under-appreciates the engagement culture that prevails among Australian investors and represents a missed opportunity for many listed companies.

The empirical link between good governance, environmental and social practices, and good financial returns is well established. More diverse boards – by gender, ethnicity, geography and social background – make better decisions. Open and inclusive corporate cultures produce better operational outcomes. Understanding long-term environmental patterns and risks results in better business planning. Engaging employees promotes productivity, guards against potential scandal and creates valuable ambassadors for the business.

An exclusive focus on maximising financial returns in the short term is likely to be rewarded with a regulatory response.

It is no longer enough to stand next to someone with a good story to tell. Now it is necessary to have one of your own. It is also insufficient to maintain sound policies and processes, without assessing suppliers, partners and employees. It is inherent to the prevailing social media 'fame and shame culture', that both positive and negative associations are contagious.

Sophisticated investors understand this and are increasingly dogged in their interrogation of senior management. Their field of vision now extends along every part of the supply chain and their modelling goes decades into the future.

This matters to investors because it leads to measurable financial outperformance and because their own clients demand it. Research by Responsible Investment Association Australasia indicates that nine out of 10 Australians expect their money to be invested ethically. Four out of five investors would be prepared to switch funds if their current fund engaged in activities that were inconsistent with their values.

Ethically-screened investments are generally outperforming the market. An interesting example of a quantitative approach to valuing reputation is provided by the Pittsburgh-based Intangible Assets Finance Society (IAFS). It maintains a set of indices which track the performance of selected portfolios against the S&P 500 Index of New York Stock Exchange and NASDAQ-listed companies. The IAFS portfolios have consistently outperformed the broader market since they started measuring in 2001.

My career advice to any talented and idealistic teenagers seeking to make the world a better place, would be to study finance and work in funds management. It is investors who are changing the world.

The growth of index and quantitative funds as a proportion of total funds under management magnifies the issue for corporates.

Many companies are being filtered out of investment contention without knowing why, usually falling at the first hurdle of disclosure. Others are in the crosshairs of passive investors who cannot divest holdings in the indices they follow and have few alternatives other than voting against AGM resolutions.

Some sectors are experiencing unprecedented regulatory intrusion, with the royal commission into the banking industry and the political micro-management of the energy sector cases in point. Expect more of this.

At the same time, the erosion of journalistic depth caused by repeated headcount reductions, and the rise of 'weaponised' social media as a key driver in the media cycle, mean it is very easy for even large and well-resourced companies to lose control of their message. Smaller companies may find it nearly impossible to get a message out in the first place.

Usually, negative impacts are seen in a falling share price, an eroded customer base, reduced ability to access capital or the loss of valuable employees. Increasingly, we will also see more investors boycotting companies who have failed to reputation proof their businesses.

Sound disclosure that inspires investor confidence is only the beginning. Good disclosure is only one pillar of sound reputation management. Earning a good reputation involves making promises and then keeping them, consistently. Reputations are not merely crafted through good communication, they are founded on robust strategy and ethical business practices.

The reason investors want to understand their companies is so they can assess risks before they grow. The swift implosion of Blue Sky shows that transparency is not negotiable. Red flags cannot be ignored. Where there is smoke, there is fire. Investors cannot afford to be caught standing behind the corporate equivalent of Harvey Weinstein, with the financial and reputational grief that entails..

Importantly, they are also seeking to more easily influence change. A good example of this is the growing movement for the introduction of non-binding company resolutions that create dialogue on specific matters, without compelling a course of action.

Best practice disclosure invites a dialogue with investors. Once you commit to listening, then it follows naturally that at least sometimes you will need to act on what you hear.

To be truly effective, engagement with investors must influence corporate strategy, rather than merely defend it. This is something Australian companies must be prepared to embrace.