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Institutional Determinants of Private Shareholder Engagement in Brazil and South Africa: The Role of Regulation

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ABSTRACT

Manuscript type: Empirical
Research Question/Issue: This study investigates to what extent regulation encourages private shareholder engagement attitudes and behavior (including behind-the-scenes consultations, letters, meetings, and ongoing dialogues) of pension funds and asset managers with listed investee companies on environmental, social, and corporate governance (ESG) issues in Brazil and South Africa.
Research Findings/Insights: Drawing on 44 in-depth semi-structured interviews with pension fund representatives, asset managers, and other investment players, the findings suggest that legislation provides limited direct encouragement to private engagement behavior. However, legislation encourages attitudes toward Responsible Investment by enhancing investor understanding of Responsible Investment, increasing the interest of pension funds and asset consultants in the Responsible Investment practices of asset managers, and reducing the fear of pension funds to violate their fiduciary duties, thereby promoting an enabling environment for ESG engagement.
Theoretical/Academic Implications: This article adds to the literature on comparative corporate governance and shareholder engagement. To the best of our knowledge, this is first study that specifically analyzes how regulation affects private shareholder engagement behavior in emerging markets, providing empirical support for the institutional perspective. The findings also suggest that the sophistication of the legislation on ESG issues in Brazil and South Africa is more typical of developed countries, indicating the need for a more fine-grained analysis of emerging markets in corporate governance studies.
Practitioner/Policy Implications: This study draws investors' attention to the importance of understanding the national legal environment of the companies with which they engage and offers insights to governments interested in fostering ESG engagement practices.

Keywords: Corporate Governance, Emerging Markets, Institutional Theory, Responsible Investment, Shareholder Engagement

INTRODUCTION

There has been a significant growth of Responsible Investment in emerging markets as institutional investors increasingly take into consideration environmental, social, and corporate governance (ESG) issues in their investment decision making. In Asian emerging markets, assets adopting Responsible Investment strategies amounted to around US $45 billion in 2013 (ASrIA, 2014). In Sub-Saharan Africa, an estimated US$125 billion were invested using Responsible Investment principles in 2010 (IFC, Sinco, & Riscura, 2011) and, in Brazil, an estimated US$40 billion employed a Responsible Investment approach in 2009 (IFC & TERI, 2009). The practice of shareholder engagement, a strategy for Responsible Investment (Goodman, Louche, van Cranenburgh, & Arenas, 2014), has also gained prominence in these markets, as shown by the advances promoted by the Emerging Markets Disclosure Project, championing engagement with over 100 companies in Brazil, Indonesia, South Africa, and South Korea for greater corporate transparency with the support of 55 local and foreign investors (USSIF, 2012).

Shareholder engagement (or shareholder activism) is one of the strategies available to investors seeking to adopt a Responsible Investment approach (for a recent review of the shareholder engagement literature, see Goranova & Ryan, 2014). Shareholder engagement is defined as "actions taken by shareholders with the explicit intention of influencing corporations' policies and practices" (Goranova & Ryan, 2014: 1232). Shareholder engagement may be classified into routine and

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extraordinary engagement. While routine engagement includes regular one-to-one meetings with corporate management and the exercise of voting rights, extraordinary engagement may include letter writing to senior management, the submission of shareholder resolutions, the request for extraordinary general meetings (EGMs), and joint institutional investor engagement (Martin, Casson, & Nisar, 2007). Shareholder engagement has also recently been categorized according to pathways of owner behavior (McNulty & Nordberg, 2016). Whilst path (a) relates to shareholder engagement that is primarily self-interested, may be financially or ideologically motivated, has short-term objectives, and involves engagement forms that reach public attention (e.g. voting or shareholder resolutions), path (b) involves the accommodation of plural actors and active engagement between shareholders and managers through private dialogue often over a considerable period of time. Most pertinent to this paper, shareholder engagement has typically been categorized according to the level of engagement privacy, as investors can engage with companies using public forms of engagement, such as the filing of shareholder resolutions, the exercise of voting rights and media campaigns, or adopting more private engagement strategies, including private negotiations, behind-the-scenes consultations, letters, phone calls, meetings, and ongoing dialogues (Clark & Hebb, 2004; Goranova & Ryan, 2014; Rehbein, Logsdon, & Van Buren, 2013). Following this classification, private engagements will be the focus of our investigation in this paper.

Our study specifically examines the influence of formal institutions on private shareholder engagement in emerging markets. Following North (1990), formal institutions include constitutions, laws, policies, and formal agreements – as opposed to informal rules like norms of behavior, conventions, and self-imposed codes of conduct. A study of this topic is important because formal institutional changes can reportedly stimulate shareholder engagement (Anabtawi & Stout, 2008) and foster different engagement strategies (Mallin, 2001). Conversely, questioning from shareholders can encourage the regulator to change legislation related to shareholder engagement (Dhir, 2006; Proffitt & Spicer, 2006). Nonetheless, while there is some empirical and anecdotal evidence that legislation influences shareholder engagement, the relationship between formal institutions and private engagement remains largely under-researched (anotable exception includes Chow, 2010); in particular, there are no studies that specifically analyze the impact of regulations on private shareholder engagement performed by institutional investors with listed companies in emerging markets. On the one hand, some scholars have pointed to the difficulty in obtaining data that measures private engagement, as dialogue between investors and companies takes place "behind-the-scenes" and without public knowledge (e.g. Amalric, 2004; Gillan & Starks, 2003; Rehbein et al., 2013). On the other hand, scholars have largely portrayed formal institutions in emerging and developing markets as underdeveloped in terms of the level of sophistication of relevant social and environmental regulation and in terms of the lack of legal enforcement (Dentchev, van Balen, & Haezendonck, 2015; Estrin & Prevezer, 2011; Tan, 2009), suggesting that formal institutions do not play an important role as drivers of private shareholder engagement in these markets (Sjöström & Welford, 2009). In sum, there is a literature gap with regard to the influence of formal institutions on private shareholder engagement in emerging markets.

Hoping to fill this literature gap, this study investigates whether and how regulations affect the attitudes and behavior of institutional investors with regard to private shareholder engagement. Brazil and South Africa were chosen for our enquiry given the growing interest in Responsible Investment and shareholder engagement by institutional investors in these countries. Brazil and South Africa feature the largest number of emerging market signatories to the United Nations-supported Principles for Responsible Investment (PRI) (PRI, 2016) and they reported to have conducted the largest number of extensive engagements among emerging markets (PRI, 2010). While institutional investors may include pension funds, insurance companies, unit trusts, open-ended investment companies, investment trusts in the UK and mutual funds in the US, hedge funds, and private equity funds (as defined by Martin et al., 2007), our paper focuses specifically on pension funds and asset managers, as we concentrate on investigating the main types of institutional investors engaging with listed companies in these two markets (as the characteristics of the institutional investors involved in the Emerging Markets Disclosure Project demonstrate). Therefore, the question arises as to what drives shareholder engagement behavior in countries such as South Africa and Brazil.

This study's findings suggest that legislation provides limited direct encouragement to private engagement behavior performed by pension funds and asset managers with listed companies in these two countries. However, there is evidence that legislation positively encourages Responsible Investment by enhancing investor understanding of Responsible Investment, increasing the interest of pension funds and asset consultants with regard to the Responsible Investment practices of asset managers, and reducing the fear of pension funds to violate fiduciary duties, thus promoting an enabling environment for ESG engagement.

This article adds to the stream of literature on comparative corporate governance and, particularly, to the literature on shareholder engagement which is focused on Anglo-Saxon countries and lacks a more international perspective (Bauer, Clark, & Viehs, 2013; Gifford, 2008; Sjöström, 2008). To our knowledge, this is the first study to specifically analyze how formal institutions affect the attitudes and behavior of pension funds and asset managers with respect to private engagement with investee companies on ESG issues in the context of emerging markets, providing empirical support for the institutional perspective. The findings also suggest that the sophistication of the legislation on ESG issues in Brazil and South Africa is more typical of developed countries, indicating the need for a more fine-grained analysis of emerging markets in corporate governance studies.

The structure of this paper is as follows. The first section reviews the existing literature relating to private shareholder engagement on ESG issues. We then discuss the role of formal institutions with reference to encouraging responsible behavior. Next, we briefly discuss the institutional contexts in Brazil and South Africa. Following a discussion of the research design and methods, we present and discuss the results drawing on 44 in-depth semi-structured interviews with pension fund representatives, asset managers, and other investment players. Finally, we conclude by considering the theoretical and practical contributions of this study and we highlight avenues for future research.

LITERATURE REVIEW

Private Shareholder Engagement

Previous research on private shareholder engagement has been hindered by a lack of data given the very nature of engagement in which dialogues between corporate managers and shareholders occur behind the scenes and out of sight from media scrutiny (Logsdon & Van Buren, 2009; Rehbein et al., 2013). Despite difficulties in data collection, there has been an increase in scholarship on this topic. An important stream of research focuses on the influence of shareholder engagement on financial performance. Smith (1996), Strickland, Wiles, and Zenner (1996), and Wahal (1996) report positive financial announcement returns in the samples involving private negotiations. Smith (1996) analyzed the engagement efforts of the California Public Employees' Retirement System (CalPERS) in changing the governance structure of target companies, noting that, when successful, engagement resulted in a statistically significant increase in shareholder wealth. Likewise, Becht, Franks, Mayer, and Rossi (2009) and Nesbitt (1994) observe that engaging with focus lists of underperforming companies leads to enhanced financial returns. For instance, Becht et al. (2009) found that Hermes' UK Focus Fund outperformed benchmarks and that the abnormal returns generated by the Fund are largely associated with its engagement practices rather than stock picking.

Another stream of research on private engagement is concerned with the factors that contribute to the effectiveness of shareholder engagement towards improving ESG performance of target companies. Gifford (2008, 2010) adopted Mitchell, Agle, and Wood's (1997) model of stakeholder salience to analyze the factors that enhance shareholder salience in improving corporate performance, concluding that the legitimacy of the investor and urgency-related factors, measured by the degree of assertiveness and persistence of the investor, contribute to effective engagement. Other researchers (e.g. Gond & Piani, 2013; Hebb, Hachigian, & Allen, 2015) also applied Gifford's (2008, 2010) framework to investigate engagement success. Examining collaborative engagements, Gond and Piani (2013) observe that company managers perceive that collaboration increases the degree of power, legitimacy and urgency of the investor group, and that investors manage these attributes to reshape the legitimacy and urgency of their claims in the eyes of managers. Investigating the perspective of the investee companies, Hebb et al. (2015) found that target companies consider the persistence of the engager and his knowledge of the investee companies to be important elements for a successful engagement, while the attributes of power and the time sensitivity factor of urgency were not raised as drivers of engagement saliency. Bauer et al. (2013) found that geography is another important determinant of engagement success. Studying the engagement activities of one particular UK asset manager, they noted that the institutional investor is more likely to achieve engagement success with firms from the US and Continental Europe than with UK firms, which they attribute to the fact that the investor selects more carefully firms abroad for which the expected success likelihood is highest.

A third stream of research on private engagement deals with the factors that encourage or limit institutional investors to engage with companies on ESG issues (e.g. Clark & Hebb, 2004; Kolstad, 2016; Tilba & McNulty, 2013). Tilba and McNulty (2013), for example, argue that higher pension fund engagement is explained by a number of investor-level factors, such as the presence of pension fund internal resources underpinning in-house investment management, large ownership stakes in corporations and a pension fund ethos of responsible ownership. Clark and Hebb (2004) note that the increasing awareness of pension funds regarding the positive impact of ESG issues on long-term value also encourages investor engagement. On the other hand, Tilba and McNulty (2013) claim that the lack of investment expertise of pension fund trustees and their reliance on external service providers act as barriers to engagement. As most trustees lack investment skills (see Kakabadse, Kakabadse, & Kouzmin, 2003; Myners, 2001), they rely on the advice of investment consultants who then incentivize pension funds to focus on short-term financial performance. As a result, pension funds encourage their asset managers to pursue short-term returns (e.g. by evaluating fund managers on a quarterly basis and by offering them short-term rewards) rather than incentivizing responsible ownership behavior.

Despite the above advances in our knowledge of shareholder engagement, Goranova and Ryan (2014) suggest that the shareholder engagement field has largely neglected the institutional perspective, paying little attention to the distinct institutional environments in which firms operate, and that research could benefit from a more contextualized approach that considers environmental factors. A small number of studies from an institutional theory perspective have outlined how both pressures from social movements (Rao & Sivakumar, 1999; Reid & Toffel, 2009) and enabling institutional frameworks such as the PRI and the Interfaith Center on Corporate Responsibility (Gond & Piani, 2013; Proffitt & Spicer, 2006) can stimulate shareholder engagement. Given that recent institutional scholarship points to government regulation as arguably the greatest source of isomorphic pressures for "voluntary" social and environmental practices (Gond, Kang, & Moon, 2014; Knudsen, Moon, & Slager, 2015), institutional theory directs our attention to the potential key role of legislation in terms of encouraging shareholder engagement.

The Role of Legislation in Responsible Behavior

The body of academic research finds that legislation and legal systems are important factors influencing corporate governance (e.g. Bauwhede & Willekens, 2008; Chizema & Buck, 2006; Grosvold & Brammer, 2011; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998). Legislation can also encourage more responsible behavior on the part of firms (Campbell, 2007; Chih, Chih, & Chen, 2010; Knudsen et al., 2015) and investors (e.g. Bengtsson, 2008; Juravle & Lewis, 2009; Sievanen, Scholtens, & Rita, 2011). Drawing on institutional theory, Campbell (2007) argues that corporate social responsibility (CSR) behavior is associated with the level of state and industry regulation, enforcement by state agencies, and legal institutions that facilitate dialogue between companies and their stakeholders. In line with these institutional theory predictions, recent CSR scholarship provides mounting evidence that governments in emerging markets such as China, India, and Indonesia have made forays into the formal regulation of CSR standards, sustainability reporting, and responsible investor behavior (Kumar, 2014; Marquis & Qian, 2014; Waagstein, 2011), and it is pertinent to ask to what extent legislation in these emerging markets has impacted responsible investor behavior.

In terms of investor behavior in developed markets, Bengtsson (2008) and Juravle and Lewis (2009) found that legislation requiring pension funds to include ESG issues in their investment policies boosted the development of Responsible Investment in the UK and in Scandinavia. The academic literature has also investigated the relationship between legal fiduciary duties and Responsible Investment given the controversy with regard to whether taking ESG factors into account is legally permitted for institutional investors. On the one hand, authors with a traditional view of fiduciary duties such as Langbein and Posner (1980: 98) argue that the duty of prudence "reinforces the duty of loyalty in forbidding the trustee to invest for any object other than the highest return consistent with the preferred level of portfolio risk". As stated by Sandberg (2013), this is often understood as prohibiting trustees from considering various non-financial issues in investment decisions. On the other hand, a report commissioned by the United Nations Environment Programme's Finance Initiative (UNEP FI) to the law firm Freshfields Bruckhaus Deringer (known as the 'Freshfields Report') concludes that integrating social and environmental issues is possible and mandatory when such issues are financially relevant and when they are supported unanimously by the beneficiaries (Freshfields Bruckhaus Deringer, 2005), while legislative reforms in a number of jurisdictions such as Manitoba in Canada (Manitoba Laws, 2014) either expanded or clarified the notion of fiduciary duties by explicitly allowing trustees to consider non-financial issues (Richardson, 2008). Hence, the discussion as to whether fiduciary duties allow the adoption of Responsible Investment is ongoing.

Previous studies have also acknowledged that regulatory changes can encourage more collaborative shareholder engagement – notably, in 1992, the amendments to the federal proxy regulations of the US Securities and Exchange Commission (SEC) allowed investors to communicate and coordinate with other investors, making it easier for shareholders to form coalitions (Anabtawi & Stout, 2008; Choi, 2000). Legislation can also foster particular engagement strategies over others; for example, voting turnout is higher in the US because private pension funds are mandated to vote by the Department of Labor's regulations governing proxy voting (Mallin, 2001). Furthermore, questioning from investors can incentivize regulatory bodies to change shareholder engagement legislation. For example, in 1976, the SEC revised Rule 14a-8 allowing the submission of resolutions on social issues after a group of investors sued the SEC for allowing Dow Chemical to exclude the group's proposal which recommended that the firm discontinues the manufacturing and selling of napalm (Dhir, 2006; Proffitt & Spicer, 2006). As the above studies demonstrate, the academic literature has analyzed the relationship between legislation and responsible behavior in developed countries, including different forms of shareholder engagement, while, to our knowledge, this is the first study to specifically investigate the impact of regulations on private shareholder engagement in emerging markets.

In developing/emerging countries, the legal environment is typically portrayed in the literature as being characterized by a lack of regulation and/or legal enforcement (Dentchev et al., 2015; Estrin & Prevezer, 2011; Tan, 2009). In the sphere of environmental concerns, studies report that regulation on these issues is looser and less likely to be enforced by governmental agencies in developing countries (Kusku & Zarkada-Fraser, 2004; Lang & Ho, 2000). Moreover, Estrin and Prevezer (2011) observe that BRIC countries either have an ineffective legal system with weak contract enforcement (e.g. China) or a well-established legal framework with a low level of implementation (e.g. India).

A number of researchers claim that developing countries keep social and environmental standards and the corresponding level of enforcement low for reasons such as the lack of resources and staff for effective enforcement (Nielsen, 2005), or in order to attract and maintain foreign investment (Mwaura, 2005) and to promote economic development (Arnold, 2010). Mwaura (2005) argues that the Kenyan government has been reluctant to impose stringent human rights regulations on the premise that companies would relocate to other countries or would be reluctant to enter the Kenyan market. In Bangladesh, Nielsen (2005) notes that the national laws banning child labor were not enforced because the Bangladesh Department of Labor and Inspectorate lacked sufficient resources, staff, and logistical support to adequately monitor child labor laws. Moreover, the low level of societal expectations in developing countries does not compel local governments to effectively regulate (Ozen & Kusku, 2009). On investor behavior, Sjöström and Welford (2009) observe that the drivers of Responsible Investment that exist in developed countries such as regulation do not exist in the context of emerging markets such as Hong Kong. To sum up, while previous studies have not investigated the regulatory antecedents of shareholder engagement in emerging markets, the extant literature makes an assumption that the legal framework in emerging markets is generally weak or not well enforced and, as such, does not have the power to encourage responsible practices such as shareholder engagement.

RESEARCH CONTEXT: BRAZIL AND SOUTH AFRICA

Brazil

Brazil has a thriving capital market and the world's twentieth largest stock exchange (BM&FBovespa), accounting for US $519 billion in market capitalization and featuring 357 domestic and foreign listed companies as of November 2015 (WFE, 2015). Ownership is highly concentrated as 74 percent of publicly traded companies have a controlling shareholder (CFA Institute, 2009). Most Brazilian companies are controlled by families (Aguilera, 2009) and a few large public pension funds are significant shareholders in many Brazilian companies. For instance, PREVI, the largest pension fund in the country, managing US$74 billion or 26 percent of the total pension fund assets (ABRAPP, 2014), holds 10.4 percent of shares at Banco do Brasil (Banco do Brasil, 2014), 12.26 percent at BRF (BRF, 2013) and 30 percent at CPFL (CPFL, 2014). Petros, the second largest public pension fund, managing nearly US$29 billion

(ABRAPP, 2014), holds 12.1 percent at BRF (BRF, 2013) and 24.45 percent at Lupatech (Lupatech, 2014).

Brazil's legal system is based on French civil law, arguably offering the lowest level of investor protection compared to other legal systems (La Porta et al., 1998). Legislation allows controlling shareholders to retain substantial influence on investee firms. As the law allows shares to be issued without voting rights up to two-thirds of capital stock (Institute of Directors, 2005) and 50 percent for new listed companies (Da Silva, 2002), it is common for insiders to retain voting shares and to issue non-voting shares to outsiders (Black, De Carvalho, & Gorga, 2010). Controlling shareholders also have the right to elect board members in proportion to their shareholdings (CFA Institute, 2009), gaining substantial influence in the strategic decision making of investee companies. A Booz Allen and IBGC (2009) survey suggests that controlling shareholders are largely represented in companies' boards: on average, 30 percent of board members are non-executive directors representing large and controlling shareholders.

Given the large influence of controlling shareholders in Brazil, national legislation provides a number of rights to protect minority shareholders. The Companies Law allows non-voting shareholders representing at least 10 percent of the share capital, and minority voting shareholders owning at least 15 percent of the voting shares, to elect one board member each. The law also gives the option for shareholders representing at least 10 percent of the share capital with voting rights to adopt the cumulative voting system. In this case, for each share the shareholder owns, he can vote as many times as there are seats on the board, increasing his chances to elect a representative. Further, voting shareholders who own 10 percent of the voting share capital, and the group of non-voting shareholders, may elect one Fiscal Council member each. Previous studies indicate that minority rights have been increasingly employed by smaller shareholders: in 1999, Saito and Dutra (2006) found that the majority of Brazilian minority investors were not using the mechanisms provided by the legislation to elect directors onto boards of directors, while, in 2005, Black et al. (2010) found that 41 percent of the 116 Brazilian firms they surveyed had one or more representatives of the minority shareholders.

Encouraging investors to consider ESG issues, the National Monetary Council issued Resolution 3792 in 2009 requiring all Brazilian pension funds to make it explicit in their investment policy whether they consider social and environmental issues in their investment decisions. Although integrating ESG issues was not made mandatory, this piece of legislation brought the topics of Responsible Investment and sustainability to the forefront of discussions in the pension fund industry. A study by Previ (2011) found that 44 percent of the 50 largest pension funds included social and environmental criteria in their investment policies. The impact of this regulation on Responsible Investment and on shareholder engagement has been further examined in the present study.

South Africa

South Africa has the seventeenth largest stock exchange in the world, the Johannesburg Stock Exchange (JSE), accounting for nearly US$790 billion and 382 domestic and foreign listed companies as of November 2015 (WFE, 2015). Shareholder ownership is concentrated in the hands of a number of founding families of large companies (Okeahalam, 2004). In addition, the South African government holds significant ownership stakes in large public and private companies through the Public Investment Corporation (PIC) (Ntim, Opong, & Danbolt, 2012), the asset manager of the Government Employees Pension Fund (GEPF), the largest pension fund in the country, and in the whole of Africa (IFC et al., 2011).

The South African legal system is based on the common law system, known to offer the highest level of legal investor protection (La Porta et al., 1998). The institutional structures and shareholder rights in South Africa tend to be strong in comparison with rights in other emerging markets (Andreasson, 2011; CFA Institute, 2009) and, overall, South Africa is rated among the best performers in corporate governance in these nations (IoDSA, 2009; Judin, 2003 cited in Vaughn & Ryan, 2006). Past history of poor corporate governance practices and the consequent undermining of local and foreign investment in South African corporations were partially responsible for the increase in corporate governance standards in the country and for the development of the King Report (Kakabadse & Kakabadse, 2005). Created in 1994 and now in its third version, the King Report offers improved standards of corporate governance (Andreasson, 2011). Although the King Report has no force of law, in 1995, the JSE made it compulsory for listed companies to disclose the extent of their compliance with it or explain their lack of compliance (Malherbe & Segal, 2001 cited in Vaughn & Ryan, 2006), leveraging the report's application.

The pension fund industry is highly concentrated in South Africa. While there are approximately 14,000 pension funds in the country representing US$250 billion in assets under management (IFC et al., 2011), the GEPF is worth nearly US $94.5 billion (GEPF, 2014). Private pension funds invest the majority of their assets domestically given a limit to foreign investment specified in the Pension Funds Act (Republic of South Africa, 1956). According to the regulation, pension funds are allowed to invest up to 20 percent of the total value of the assets in investments outside of South Africa, and thresholds vary according to asset class (OECD, 2011).

South African legislation has been greatly influenced by the country's historical and social conditions, and the South African government has gone much further than governments in many other countries to legislate social issues in company management (Hamann, 2008). After the end of Apartheid, the government sought to develop a number of regulations to reduce social inequality in the country, including the Employment Equity Act and the Broad-Based Black Economic Empowerment Act (West, 2006). Regulations encouraging consideration of ESG issues by investors were also developed. Effective since 1 January 2012, the preamble of Regulation 28 of the Pension Funds Act states that "*prudent investing should give appropriate consideration of any factor which may materially affect the sustainable long-term performance of a fund's assets, including factors of an environmental, social and governance character*" (Republic of South Africa, 2011). WWF (2013) argues that, although it is too early to assess the impact of the Regulation, a study conducted by SinCo (WWF, 2012) indicates that Regulation 28 has been a powerful driver for increased ESG integration. The outcomes of Regulation 28 on Responsible Investment and on shareholder engagement have been further analyzed in the present study.

RESEARCH DESIGN AND METHODS

Sampling

The selection of the participating organizations was based on critical cases (Bryman & Bell, 2007). Due to the reduced number of cases that can be studied, it is suitable to select extreme situations in which the process of interest is more transparently observable (Pettigrew, 1990). In this study, cases were considered critical when they involved pension funds or asset managers who demonstrated some commitment to Responsible Investment (by being signatories to the UN-supported PRI) and/or shareholder engagement activities (by having regular engagement activities or by being known to be shareholder activists), or interest groups who work closely with investors on ESG issues (e.g., academics, investor associations, etc., henceforth called "non-investors"). Therefore, the PRI signatory list formed the basis for selecting critical cases. Access to the interviewees was facilitated by the fact that one of the authors was working with the PRI Investor Engagements team in 2011 when participant recruitment was taking place. Given that she was working closely with the PRI Brazilian signatories (helping to coordinate one of the collaborative engagements in Brazil) and that she was able to identify and reach out to all of the key South African investors or investment service providers, it was possible to recruit most potential participants from within PRI signatories. Potential interviewees were either contacted directly by the authors or were personally recommended by previously selected interviewees. In total, 44 organizations participated in this study. Twenty participants were interviewed in Brazil (13 investors, 7 "non-investors") and 24 were interviewed in South Africa (12 investors, 12 "non-investors") (see Table 1).

As mentioned earlier, the institutional investors examined were pension funds and asset managers as they were found to be the main institutional investors engaging with listed companies in these two markets. In Brazil, out of the 13 investors, six pension funds and seven asset managers participated, representing assets under management ranging from US$200 million to US$91 billion. In South Africa, three pension funds and nine asset managers were interviewed, representing assets under management ranging from US$527 million to US$138 billion. A combination of small and large investors, corporate and non-corporate pension funds, and independent and non-independent asset managers were included in the sample (for reasons of confidentiality, the number of investors interviewed according to these sub-categories are not disclosed). A reduced number of South African pension funds were interviewed because of the limited number of pension funds who are signatories to the PRI (only four pension funds in South Africa were signatories when data was collected in 2012), suggesting that there is limited interest in Responsible Investment among asset owners in the country. All of the participating investors were PRI signatories, except for one Brazilian and one South African investor, who were selected based on their reputation as activists on corporate governance issues. The investor representatives interviewed were heads of research, investment/portfolio managers, or investment/ESG analysts.

The interviewed "non-investors" were selected based on their knowledge and experience of working closely with investors on Responsible Investment. They comprised a mix of academics, industry/investor association representatives, asset consultants, and independent activists. Asset consultants were not interviewed in Brazil because, according to the interviewees, consultants are not commonly employed by pension funds for the selection of asset managers as they are in South Africa.

Data Collection

This study employed semi-structured interviews as they allow cross-case comparability and permit a fairly clear focus, while providing the flexibility to accommodate other areas of interest that might arise during the interview (Bryman & Bell, 2007). Moreover, this method was selected given the nature of private engagements, which are conducted "behind closed doors" and on which there is a lack of public data, a constraint to researching this topic in contrast with more public forms of engagement (Amalric, 2004; Gillan & Starks, 2003).

Before the main data was collected, a pilot study was held in 2011 by telephone to examine whether the interview guide succeeded in investigating the research objectives. In total, eight investors were interviewed from each country. After the pilot study, the two foreign investors were excluded as the research focus was refined to study the perceptions of local investors.

The main data collection took place between June 2012 and September 2012. We travelled to Brazil and South Africa to interview the participants as preference was given to face-

TABLE 1
List of Participants

Type of interviewee	Brazil	South Africa
Investors	13 investors: 6 asset owners/pension funds 7 asset managers	12 investors: 3 asset owners/pension funds 9 asset managers
Non-investors	7 non-investors: 1 academic 1 industry association 5 investor associations	12 non-investors: 2 academics 1 industry association 4 investor associations 4 investment consultants 1 independent activist
Total number of interviewees	20	24

to-face interviews in the interviewees' offices to enable interviewer and participant to build a rapport (Cooper & Schindler, 2006). Before the interviews, we collected secondary data from corporate documents (e.g., investors' websites, annual and sustainability reports, investment policies) in order to avoid asking questions about issues for which information was publicly available.

To prevent participants drawing on their own idiosyncratic understandings of what shareholder engagement entails, we provided a definition of the term "private shareholder engagement" at the beginning of the interview to explain and emphasize that the focus of the study was on direct, private negotiations between institutional investors and listed companies on ESG issues, hence excluding more public forms of engagement, such as the filing of shareholder resolutions and voting. As Brannen (2005) and Hurmerinta-Peltomäki and Nummela (2006) point out, in cross-national studies, it is important that the researcher confirms that all respondents understand the concepts in a similar way.

The interviewees were asked about (i) their position and main responsibilities within the organization; (ii) how they perceived the state of Responsible Investment and shareholder engagement in their countries; (iii) their own Responsible Investment and private shareholder engagement practices (in the case of investors); and (iv) to what extent they believed that legislation encouraged shareholder engagement behavior in the country. Drawing on our desk-based research into the regulatory context of the two countries and the findings of our pilot study which identified that the Pension Funds Act in South Africa, and the Companies Law and Resolution 3792 in Brazil, specifically include provisions regarding shareholder activism or ESG issues in investment, we decided to ask the interviewees about their perceptions of the influence of these particular regulations (see Appendix 1).

All the participants were interviewed in the country's official language (Portuguese in Brazil and English in South Africa). On average, the interviews lasted 45 minutes. All of the interviews were digitally recorded and later transcribed, except for when the interviewees did not allow the recording (two cases), in which case extensive notes were taken.

Data Analysis

Thematic analysis, which is a "method for identifying, analysing and reporting patterns (themes) within data" (Braun & Clarke, 2006: 79), was used to examine the data as it provides a flexible tool with which to analyze qualitative data in a rich, detailed, and complex manner. The interviews were coded in the language in which they were conducted so as not to lose the meaning in translation. The themes were selected based on a combination of deductive and "inductive" processes. While some of the themes draw from key constructs identified in the literature (deductive approach), others are linked to the data themselves (inductive approach). We coded the transcripts in an iterative process with refinements of the coding categories agreed after each round of coding. The final analysis reflects the agreed coding of the co-authors. In the first step of the analysis, the transcripts were coded according to whether they argued for or against regulation encouraging engagement behavior. Second, they were coded according to the piece of legislation to which the passages referred. Third, the extracts were classified according to type of influence on engagement (direct or indirect) and, finally, they were coded according to their effect on shareholder engagement behavior. The distinction between direct and indirect is based on the definition and classification of shareholder engagement (Goodman et al., 2014; PRI, 2015; USSIF, 2015). Factors were considered to have a direct impact when they specifically affected shareholder engagement behavior on ESG issues, while factors were considered to have an indirect influence when they impacted whether and how investors incorporated or considered ESG issues into their investment processes and decision making in general. A total of 119 passages were coded.

RESEARCH FINDINGS

To investigate whether regulation influences private shareholder engagement in Brazil and South Africa, the interviewees from these two countries were asked whether they believe that legislation encourages shareholder engagement behavior in their countries.

As shown in Table 2, nearly 64 percent of the interviewees (75 percent of the South African and 50 percent of the Brazilian interviewees) reported that they believe that legislation encourages engagement behavior directly and/or indirectly, or that legislation both encourages and limits shareholder engagement. In terms of level of positive encouragement, 9 percent of the interviewees (over 8 percent of South African and 10 percent of Brazilian interviewees) argue that local legislation encourages engagement directly, while 52 percent in the interviewees (62.5 percent of South African and 40 percent of Brazilian interviewees) believe that legislation encourages shareholder engagement indirectly by incentivizing Responsible Investment more broadly. The importance of the indirect impact, as distinguished from the direct impact, was specifically emphasized by some interviewees, as exemplified by quotations such as "I think that it [Resolution 3792] draws attention, but it was not mandatory" or "even though it [Regulation 28] is not very strongly put [i.e. Responsible Investing is not mandatory], it does go a long way to illustrate that there is support for the notion that underpins Responsible Investing from the regulator". Hence the findings suggest that legislation provides indirect encouragement to engagement behavior.

The interviews also investigated the reasons for why the interviewees believe that legislation encourages engagement behavior. The arguments are summarized in Table 3. The reasons raised by the interviewees are discussed in greater detail below. Table 4 provides selected interviewee quotations.

Direct Positive Influence of Legislation

Four interviewees claimed that direct encouragement to engagement behavior occurs through requiring South African pension funds to invest the major part of their assets domestically and through protecting the rights of Brazilian minority shareholders.

In South Africa, two out of 24 interviewees argued that legislation encourages engagement directly by requiring local pension funds to invest the majority of their assets locally. One of the interviewees explained that the bulk of the pension fund

TABLE 2
Interviewees' Perceptions on the Influence of Legislation on Shareholder Engagement

Interviewees claimed that:	South Africa		Brazil		Total	
	n	%	*n*	%	*n*	%
Legislation encourages shareholder engagement	15	62.5	10	50	25	56.8
Directly only	0	0	2	10	2	4.5
Indirectly only	13	54.2	8	40	21	47.7
Directly and indirectly	2	8.3	0	0	2	4.5
Legislation both encourages and limits shareholder engagement	3	12.5	0	0	3	6.8
Legislation does not influence shareholder engagement	3	12.5	5	25	8	18.2
Did not respond, did not have an opinion or were not asked the question (when they were not actively involved with the investment community)	6	25	5	25	11	25
Total	24	100	20	100	44	100

Total value is over 100 percent because some interviewees were categorized into more than one alternative.

TABLE 3
Interviewees' Reasons for Why Legislation Encourages Shareholder Engagement

Interviewees claimed:	South Africa		Brazil		Total	
	n	%	*n*	%	*n*	%
Direct positive impact						
Limited investment universe	2	8.3	0	0	2	4.5
Protection to minority shareholders	0	0	2	10	2	4.5
Indirect positive impact						
Increased awareness of Responsible Investment	10	41.7	7	35	17	38.6
Increase of pension fund and asset consultant interest in the asset managers' Responsible Investment practices	5	20.8	0	0	5	11.4
Pension fund less wary of violating their fiduciary duties	6	25	1	5	7	15.9

investments must be invested domestically since the Pension Funds Act limits the exposure that a South African pension fund may have to international investments. This interviewee then argued that the reason for why this regulation encourages shareholder engagement is related to the limited investment universe in South Africa. By investing domestically, a pension fund would be able to invest in a range of 150–200 JSE-listed companies, which is a smaller investment universe than that of an American or European pension fund, which would invest in nearly 300 companies (Quotes 1 and 2, Table 4). Therefore, as argued by another interviewee, given the restricted number of investee companies in South Africa, it is more beneficial for pension funds to engage in discussion with the investee companies to encourage changes in ESG behavior rather than divest.

In Brazil, two out of 20 interviewees argued that legislation encourages engagement directly, claiming that the Brazilian Companies Law encourages engagement by minority shareholders through protecting their rights. One of the interviewees noted that the Companies Law offers specific instruments to protect minority investors because they are in an unfavorable position in the Brazilian environment where voting shares are often in the hands of controlling shareholders (Quotes 3 and 4, Table 4), which in turn provides greater bargaining power to minority investors who engage in private engagements:

TABLE 4
Interviewees' Reasons for why Legislation Encourages Shareholder Engagement – Selected Interviewee Quotations

Representative quotations supporting direct impact of legislation

Quote 1. "*There is a small investment universe in South Africa, so it is possible to engage with companies, so it is not like some of your, you know, US or European or UK pension funds that have got investments from 300 companies, in the South African context, you are looking at about 150 to 200 companies maximum that are companies that the pension fund would be invested in. And in most instances, it is focused on the top 100 listed companies in the JSE, certainly for the listed portfolio and so they would need to engage with pro-performers within that top 100 universe*." (South African Pension Fund)

Quote 2. "*[T]he South African market is quite a small concentrated market, so the investment universe is quite small and the reason for that is we have Pension Fund regulation [the Pension Funds Act] which limited the exposure that a pension fund may have to international investments. So South Africa wasn't as badly affected by the financial crisis because we had limited exposure to international markets. The bulk of our investments had to be within South Africa, so investment managers in a sense, because there is a limited number of possible investments on the JSE, Johannesburg Stock Exchange, specifically for listed equities, your investment universe is quite small*." (South African Pension Fund)

Quote 3. "*The Brazilian law considers minority investors weak. Weak and unprotected. Hence, it [the law] has established a few instruments ... which is true because you have the shareholder, you have voting shares that are normally in the hands of the controlling shareholder, and you have preferential shares that do not have the right to vote. So, to redress [this situation], the [Companies] law offered [minority shareholders] the election of the Fiscal Council, the election of minority representatives to the Board of Directors. You also have the multiple voting system which is also something to help minority investors*." (Brazilian Non-Investor)

Quote 4: "*It [the Companies Law] allows that preferential shareholders with 10 percent of the company elect a Board member representing minority investors, or shareholders with 15 percent of the voting shares. In this case, if you have a shareholder with 15 percent of the capital, s/he can elect ... s/he can say at the AGM 'I will elect'*." (Brazilian Non-Investor)

Representative quotations supporting indirect impact of legislation
On increased awareness of responsible investment

Quote 5. "*I think Regulation 28 and CRISA has got the South African market talking a lot more openly about Responsible Investment. Previously, it was really just the few PRI signatories and maybe a handful of PRI non-signatory investors, so that could be pension funds and asset managers that were talking about sustainability issues*." (South African Pension Fund)

Quote 6. "*In terms of awareness, there appears to be many more conversations about Responsible Investment and it's probably driven mostly by Regulation 28 rather than CRISA [Code for Responsible Investing in South Africa]. CRISA is guidance, but Regulation 28 is regulation and it appears that Regulation 28 has ensured the interest of the asset owners, so all of a sudden now, there seems to be a big focus on Responsible Investment*." (South African Asset Manager)

Quote 7. "*So I would say they've both [Regulation 28 and the Code for Responsible Investing in South Africa] been very important in terms of putting the dialogue on the map, you know*." (South African Asset Manager)

Quote 8. "*Today, the law [Resolution 3792] is too broad. And, even though it is broad, pension funds have already started being interested and paying attention to...*" (Brazilian Pension Fund)

Quote 9. "[B]*ecause when you write your investment policy, this topic has to be there. So, eventually, that went through a discussion with the management of the small pension funds. It is a start*." (Brazilian Non-Investor)

Quote 10. "*Absolutely. [Since Resolution 3792 was issued] no pension fund wants to say that it does not address the issue or that it does not consider the subject relevant. Hence, pension funds were concerned about learning about the topic and about making progress in relation to ESG issues*." (Brazilian Pension Fund)

Quote 11. "*I think that it [Resolution 3792] draws attention, but it was not mandatory 'now you have to invest', not least because that was perhaps too difficult to be made, but it certainly drew attention 'maybe this is something that I, pension fund, also have to pay attention to.'*" (Brazilian Non-Investor)

On increased interest in responsible investment

Quote 12. "*I think, from my perspective, a lot more questions from asset consultancies, certainly a lot more queries around how you apply Regulation 28, questions in RFPs, request for proposals, you know*" (South African Asset Manager)

Quote 13. "*So then a lot of questions, so they are coming. So asset owners would send questionnaires about what you consider Responsible Investment to be, how are you responding to CRISA, Regulation 28, how your investment processes are changing as a result of that*." (South African Asset Manager)

(Continues)

TABLE 4
Continued

Quote 14. *"[W]hen Regulation 28 says that we need to now specifically consider these ESG factors, we suddenly started getting questions. But it wasn't in-depth questions. It was question like "what are you guys doing around the ESG issues?" and then really your answer can be anything."* (South African Asset Manager)

Quote 15. *"I would argue that the quality of the questions is often quite bad, people don't really know what they are asking, so they didn't really know whether they were looking at a horse or a donkey, you know what I mean? They just have no idea."* (South African Asset Manager)

Quote 16. *"So it's right this point that many of the trustees are poorly educated in financial matters, especially if it's an occupational fund, especially on the employees' side. There might be shop stewards that are voted by their work colleagues to sit on the board of the pension funds. They probably have quite a low educational skills level as it is, then they come into a quite overwhelming environment of now sitting and become financial managers or trustees of this fund."* (South African Non-Investor)

Quote 17. *"They are not strongly empowered, the trustees in South Africa are not typically very strong in a lot of skills and expertise in investment. They will take a lot of their guidance from the investment consultants and actuaries and then they will take a lot of guidance from the asset managers and they will just expect them to take care of this for the fund."* (South African Non-Investor)

On decreased concern of violating fiduciary duties

Quote 18. *"Regulation 28 has made a requirement for all pension funds under the Pension Funds Act of South Africa to at least consider any issues including ESG issues that will materially impact on the long-term financial performance of any investment. So it is now within the fiduciary responsibility of the pension fund trustee to have at least considered these things"* (South African Pension Fund)

Quote 19. *"Because in the past, I mean, we've experienced this because we've been in this longer than the revise of Regulation 28, in some people's minds there has been that debate that says 'I would not be sacrificing my fiduciary duty' because everybody has been thinking that I have to provide returns and that's it. So the change to [Regulation] 28 provides, at least, recognition which is what we've been saying anyway for a long time that sustainability of a pension fund is not – or at least the financial return is not narrowly related to the numbers."* (South African Pension Fund)

Quote 20. *"And the understanding of fiduciary duty among trustees that you have to focus on financial return and, because there was still that perception that you compromise return by looking at sustainability issues, people felt it was not in line with their fiduciary duties."* (South African Non-Investor)

Quote 21. *"There has been changes in regulation in South Africa [Regulation 28] recently which is increasingly bringing a broader consideration of fiduciary issues to the fore of trustees, including environmental, social and governance factors."* (South African Asset Manager)

Quote 22. *"CRISA is important, but I think that the more important change is this Regulation 28, because it is making the Principal Officers of the pension funds, essentially like the Chief Executive Officer of the company, the head of sort of trustees, these Principal Officers are now beginning to realize that many of these things that they thought perhaps they didn't have to do, it is actually part of their fiduciary duties and they have to do it."* (South African Asset Manager)

Quote 23. *"That said, we've had a change in local legislation last year, the legislation that governs local pension funds which is the Regulation 28 which was amended last year, early in February last year, which states that, as fiduciaries looking after pension fund assets, we should give consideration to all factors as part of a Responsible Investment strategy and consider ESG factors, all factors including ESG factors."* (South African Asset Manager)

Quote 24. *"So oftentimes in the beginning we heard that there was a lot of resistance, a concern coming from some of the pension funds, especially about fiduciary duty." "Then, from the moment that (Resolution) 3792 explicitly states that investment policies must have practices, or, if they don't have any, that they comment, justify, I think those concerns were minimized."* (Brazilian Pension Fund)

> *"The Brazilian law considers minority investors weak. Weak and unprotected." … So, to redress [this situation], the [Companies] law offered [minority shareholders] the election of the Fiscal Council, the election of minority representatives to the Board of Directors. You also have the multiple voting system which is also something to help minority investors.*(Brazilian non-investor)

As noted in the 'Research Context' section, this interviewee referred to the mechanisms facilitating minority shareholders who hold over a certain share threshold to elect representatives onto boards and Fiscal Councils of investee companies and to call for cumulative voting. She argued that investor representatives are the means through whom minority shareholders participate in meetings with the company's management and influence the decision-making process. One small Brazilian asset management firm interviewed considered the election of minority representatives their most effective engagement strategy to promote better governance practices among investee companies. She mentioned that her organization had recently participated in a collaborative engagement with other asset managers representing 20 percent of the market capitalization of a Brazilian listed company and had succeeded in electing a number of members onto the company's board of directors. Another two Brazilian interviewees cited their involvement with a collaborative engagement initiative at the Association of Capital Markets' Investors to elect a member of the board to represent minority shareholders at Petrobras. These examples show that Brazilian investors collaborate with other minority shareholders and actively use the available legal mechanisms to elect board representatives.

Nonetheless, while a number of interviewees provided tangible examples of the direct influence of legislation, the empirical support for a direct influence of legislation was relatively limited. In contrast, there was strong support for an indirect influence.

Indirect Positive Influence of Legislation

The research findings strongly suggest that legislation provides an indirect encouragement to shareholder engagement behavior. According to 52 percent of the interviewees, legislation encourages Responsible Investment more broadly, thereby creating an enabling environment for engagement. Indirect encouragement occurs specifically through raising investors' awareness of Responsible Investment (both in Brazil and South Africa), increasing the interest of pension funds and asset consultants in the Responsible Investment practices of asset managers (in South Africa only), and reducing the fear of pension funds of violating their fiduciary duties with respect to incorporating ESG issues (both in Brazil and South Africa). Each of these arguments is discussed below.

Increased Awareness of Responsible Investment. Nearly 39 percent of interviewees (42 percent in South Africa and 35 percent in Brazil) believe that legislation contributes to improving the level of understanding of investors on Responsible Investment issues.

In South Africa, the interviewees claimed that the level of awareness of Responsible Investment was raised by the recently amended preamble of Regulation 28 of the Pension Funds Act. One South African Pension Fund argued that the South African market started speaking more explicitly about Responsible Investment since the amendment of the Regulation:

> *"I think Regulation 28 ... has got the South African market talking a lot more openly about Responsible Investment. Previously, it was really just the few PRI signatories and maybe a handful of PRI non-signatory investors."*(South African Pension Fund)

One South African asset manager agreed that there appears to be more conversations about Responsible Investment among investors and that the regulation has significantly helped to clarify what Responsible Investment is (Quote 6, Table 4). Moreover, three other South African interviewees observed that pension funds are now in the process of understanding the requirements of the legislation and of evaluating how they can comply with the law, while one South African asset manager noted that consultants and asset managers are also trying to understand Responsible Investment more broadly to serve their clients.

In Brazil, the interviewees claimed that Resolution 3792 improved the level of understanding of Responsible Investment. One Brazilian Pension Fund noted that, even though this resolution approaches the issue in a broad manner and does not require pension funds to incorporate social and environmental aspects in their investment decisions, legislation has encouraged pension funds to pay attention to, and be interested in, the theme (Quote 8, Table 4). Similarly, one Brazilian non-investor claimed that, because the regulation makes it mandatory for pension funds to consider these issues in their investment policies, the executives of the pension funds are required to discuss the topic at some point in order to rewrite their investment policies, which increases awareness (Quote 9, Table 4).

Another Brazilian non-investor argued that legislation had a more focused impact, affecting largely the Brazilian PRI signatories. This interviewee posited that the Brazilian PRI signatories understood the resolution issuance as a sign that the inclusion of social and environmental issues in the investment decisions of the pension funds would become mandatory in the future. As a consequence, the PRI signatories decided to create a new working group within the PRI Brazil Network, the Investment Policy Working Group, to assist pension funds to write their Responsible Investment policies.

Overall, the findings strongly suggest that Regulation 28 in South Africa and Resolution 3792 in Brazil have improved the level of understanding of Responsible Investment issues.

Increase of Pension Fund and Asset Consultant Interest in the Asset Managers' Responsible Investment Practices. Approximately 21 percent of the South African interviewees, representing 56 percent of all South African asset managers interviewed, noted that Regulation 28 has also encouraged pension funds and asset consultants to start asking current and potential asset managers about their Responsible Investment practices.

One South African asset manager noted that there has been an increase in the number of questions that they receive from asset consultancies and questions in Request for Proposals (RfPs) on how they apply Regulation 28:

> *"I think, from my perspective, a lot more questions from asset consultancies, certainly a lot more queries around how you apply Regulation 28, questions in RFPs, request for proposals, you know."*(South African asset manager)

Another South African asset manager mentioned that they have been receiving questionnaires from asset owners inquiring about their approach to Responsible Investment and about how they apply Regulation 28 to their investment processes (Quote 13, Table 4). A third asset manager observed that their clients have been asking them questions to examine how aware they are of Responsible Investment issues. Despite the increase in the level of interest of pension funds and asset consultants, three of the asset managers interviewed noted that the quality of the questions by the pension funds is still rather poor (see Quote 15, Table 4).

The interviewees highlighted that the level of knowledge of pension fund trustees is not only low on ESG issues, but also on investment and finance more broadly. According to one asset manager, the level of investment knowledge of many pension fund trustees is low because they do not come from an asset management or financial services background. Another asset manager claimed that, in a board of trustees, there might be two or three individuals who fully understand investments, while others might not, especially those trustees who represent employees – according to article 7A of the Pension Funds Act, pension members have the right to elect at least 50 percent of the pension fund board members. A non-investor highlighted that employee trustees are usually shop stewards who are voted by their work colleagues to sit on the board of the pension funds and often have a low level of educational skills (Quote 16, Table 4). She observed that, as trustees are not knowledgeable in investment skills, they take advice from asset consultants, actuaries, and asset managers (Quote 17, Table 4). Another non-investor argued that, as pension funds tend not to be financial experts, they delegate their authority to the asset managers who will provide them with expert information.

Hence, the South African interviewees perceived that there has been an increase in the level of interest of pension funds in Responsible Investment issues, as observed by their service providers, even though the nature of the enquiries has been quite superficial and not yet translated into real implementation.

Pension Funds Less Wary of Violating their Fiduciary Duties. Nearly 16 percent of interviewees (25 percent in South Africa, 5 percent in Brazil) argued that legislation makes pension funds less wary of violating their fiduciary duties when incorporating ESG issues in their investment processes.

The South African interviewees claimed that the preamble of Regulation 28 of the Pension Funds Act creates a fiduciary duty to pension fund trustees to at least consider ESG issues in their investment decisions, as exemplified by this statement:

> *"Regulation 28 has made a requirement for all pension funds under the Pension Funds Act of South Africa to at least consider any issues including ESG issues that will materially impact on the long-term financial performance of any investment. So it is now within the fiduciary responsibility of the pension fund trustee to have at least considered these things."*(South African Pension Fund)

One South African non-investor noted that, prior to the amendment of Regulation 28, pension fund trustees perceived that the incorporation of ESG issues was not in line with their fiduciary duties as they believed that ESG integration compromised financial returns (Quote 20, Table 4). However, the interviewees argued that Regulation 28 now expands the fiduciary duties of pension fund trustees to include the consideration of ESG issues.

Likewise, in Brazil, one Pension Fund argued that, before Resolution 3792 was issued, pension funds were concerned that the inclusion of social/environmental issues in investment decisions could be perceived as against their fiduciary duties. However, the Pension Fund claimed that, after these issues were incorporated in law, pension funds interpreted the regulation as a signal from the government that the inclusion of social and environmental factors into investment processes is considered good practice:

> *"So oftentimes in the beginning we heard that there was a lot of resistance [to Responsible Investment], a concern coming from some of the pension funds, especially about fiduciary duty … Then, from the moment that (Resolution) 3792 explicitly states that investment policies must have practices, or, if they don't have any, that they comment, justify, I think those concerns were minimized."*(Brazilian Pension Fund)

Therefore, legislation in both countries contributed to making pension funds less worried about breaching their fiduciary duties by incorporating ESG issues in their investment decisions.

DISCUSSION

In this paper, we analyzed to what extent regulations influence private shareholder engagement attitudes and behavior of pension funds and asset managers with listed companies in Brazil and South Africa; in particular, we investigated the role of the Pension Funds Act in South Africa and the Companies Law and Resolution 3792 in Brazil. Drawing on 44 in-depth semi-structured interviews with pension fund representatives, asset managers, and other investment players, the research findings suggest that legislation provides limited direct encouragement to private engagement attitudes and behavior. However, legislation encourages attitudes toward Responsible Investment by enhancing investor understanding of Responsible Investment, increasing the interest of pension funds and asset consultants in the Responsible Investment practices of asset managers, and reducing the fear of pension funds of violating their fiduciary duties, thereby promoting an enabling environment for engagement.

Interviewees suggested that Regulation 28 in South Africa and Resolution 3792 in Brazil, respectively, increased the level of awareness of Responsible Investment within pension funds. Even though both pieces of legislation do not explicitly demand pension funds to include ESG issues in their investment decisions, the interviewees perceived that they helped to bring the discussion about Responsible Investment to the forefront of the pension industry. Similar laws to the Brazilian regulation requiring pension funds to disclose how social and environmental information is processed in the construction of investment portfolios exist in the UK, Belgium, France, Netherlands, and Germany (See, 2009). Mathieu (2000) highlights the impact of the disclosure legislation in the UK, noting that over half of the pension funds incorporated ESG factors into their investment decisions shortly after the regulation was introduced, while Bengtsson (2008) argues that legislation was largely responsible for the rise of Responsible Investment among state-controlled pension funds in Scandinavia. Solomon (2010) defends the idea that these types of disclosure requirements for pension funds act as incentives for trustees to adopt such policies because they would probably be embarrassed to state in their investment policy that they do not have any type of Responsible Investment concern. Moreover, there is an understanding among some interviewees that the Brazilian regulator may still amend Regulation 3792 to become more stringent and that investors must be prepared. Hence this study suggests that regulation in both countries enhances investor understanding of Responsible Investment.

Another indirect impact on engagement relates to the inclusion of ESG issues in Regulation 28 in South Africa and in Resolution 3792 in Brazil. The research findings indicate that, by incorporating ESG issues, legislation rendered pension funds less concerned about breaching their fiduciary duties, duties which require trustees to manage funds in the best interests of the underlying owners or ultimate recipients of the funds (Sandberg, 2011). The literature on Responsible Investment discusses at length the fact that pension funds are fearful of acting against their fiduciary duties (e.g. Hawley & Williams, 2006; Hoepner, Rezec, & Siegl, 2011; Richardson, 2011; Sandberg, 2011), as pension funds often interpret fiduciary duties as prohibiting consideration of any factor other than those directly related to maximizing shareholder wealth (Hawley & Williams, 2006). Nonetheless, as noted earlier, some jurisdictions such as Manitoba in Canada, Illinois in the US, and the UK expressly allow trustees to take ESG considerations into account provided that their duties of prudence are met (Richardson, 2008). In Illinois, the Illinois Pension Code was amended in 2005 to prohibit state investment in Sudan and companies doing business with or in Sudan (Dhooge, 2006). In the UK, the UK Law Commission's Guidance to Pension Fund Trustees (Law Commission, 2014) recommends to trustees that non-financial factors may be taken into account if trustees have good reason to think that scheme members would share the concern and if the decision does not involve a risk of significant financial detriment to the fund – a similar approach to the one suggested by the "Freshfields Report". Likewise, in Brazil and South Africa, the interviewees reported that, after the inclusion of ESG issues in the legislation, either by requiring pension funds to consider ESG issues or to disclose the level of ESG considerations in their investment policies, institutional investors are less concerned about breaching their fiduciary duties toward their beneficiaries, increasing the incentives for the adoption of a Responsible Investment approach.

Further, the interviewees reported that the inclusion of ESG issues into legislation increased the level of interest of South African pension funds in the Responsible Investment practices of asset managers. Nevertheless, the interviewees recognized that the quality of the questions of pension funds is still rather superficial and not yet translated into effective implementation. The interviewees also posited that not only are South African trustees not knowledgeable about Responsible Investment issues, but they also lack an understanding of investment issues more broadly due to the professional background of most South African trustees, especially those nominated by the employees. The lack of trustee investment skills and expertise seems to be an issue in developed countries as well (Clark, 2004; Clark & Urwin, 2008; Kakabadse & Kakabadse, 2005; Kakabadse et al., 2003; Monks & Minow, 2011; Myners, 2001). In the US, Monks and Minow (2011) state that, as trustees of public pension funds may come from diverse backgrounds (e.g., employees, retirees, and political appointees), their expertise may lie in areas other than investment. Similarly, in the UK, Myners (2001) and Kakabadse et al. (2003) observe that neither do British trustees have professional qualifications in finance nor are they properly trained to take office. Solomon (2010) and Tilba and McNulty (2013) add that, as most UK pension fund trustees lack investment expertise, they often rely on the expertise of external service providers such as actuaries, investment consultants, and investment fund managers, deferring to them strategic asset allocation decisions. Our interviews support the literature, indicating that the lack of trustee knowledge is not restricted to developed countries and to investment issues, but it extends to emerging markets and to ESG issues. As a result of their low level of expertise, South African pension fund trustees transfer their Responsible Investment responsibilities onto their asset managers which, at this moment, is occurring through trying to understand their Responsible Investment practices further. Hence, the research findings and the literature suggest that, in both developed and emerging countries, pension fund trustees lack investment knowledge and, in one sense, shift their responsibilities to their service providers.

In general, this study strongly suggests that legislation can encourage shareholder engagement in at least some of the more developed emerging markets such as Brazil and South Africa, even though this finding may not be representative of all emerging markets. While previous scholarship argued that the legal environment in developing and emerging markets is characterized by a lack of regulations encouraging responsible behavior (e.g., Ozen & Kusku, 2009; Rahim & Alam, 2014), or that ESG-related regulations in these countries are unsophisticated and ineffective (e.g., Estrin & Prevezer, 2011; Mordi, Opeyemi, Tonbara, & Ojo, 2012), our research findings indicate that Brazil and South Africa feature characteristics more similar to developed countries in terms of the sophistication of the legislation on ESG issues directed at investors. Emphasis on governance, environmental, and social issues by the governments of both countries – as reflected by broad-based development legislation in South Africa (such as the Employment Equity Act and the Broad-Based Black Economic Empowerment Act) (West, 2006) and by laws protecting minority investor rights and strict environmental regulations in Brazil (SustainAbility, 2006) – is possibly the reason why ESG issues were incorporated into pension fund legislation. As this study found that Brazil and South Africa have ESG legislation in place encouraging responsible investor behavior, our findings contradict the literature which purports that there are significant differences in corporate behavior between common and civil law countries (e.g. Grosvold & Brammer, 2011; La Porta et al., 1998; Zattoni & Cuomo, 2008). Rather, this paper indicates that, instead of examining the effect of national institutional configurations (e.g. Anglo-American versus Continental European business systems; common versus civil legal systems), it may be more fruitful to disaggregate these arrangements and examine the influence of different institutional variables on corporate governance practices and responsible behavior, as argued by some researchers (e.g. Aguilera & Jackson, 2003; Fransen, 2013; Heugens & Otten, 2007).

This paper also highlights the need for a more fine-grained examination of emerging markets in order to better understand how institutional frameworks in different countries influence corporate governance practices. The literature has treated emerging markets in a homogeneous manner (cf. Aaronson, 2005; Ozen & Kusku, 2009; Rahim & Alam, 2014; Yoshikawa, Zhu, & Wang, 2014), often considering their formal institutional arrangements such as legislation and legal enforcement as underdeveloped or non-existent. As argued by

Hah and Freeman (2014), given the differences between Asian emerging economies in terms of political and legal systems and cultural norms, research findings in the Asian region cannot be generalized to the whole of Asia. Likewise, this study indicates that within emerging markets there are significant institutional differences which must be taken into consideration in corporate governance studies for a better analysis of governance practices in these nations.

CONCLUSIONS AND IMPLICATIONS

This study strongly suggests that legislation encourages shareholder engagement indirectly by encouraging Responsible Investment more broadly. By studying the impact of regulation on shareholder engagement in emerging markets, this study makes a number of academic and practical contributions.

Firstly, this research contributes to the academic literature related to private investor engagement, particularly in emerging markets. Even though the adoption of shareholder engagement by institutional investors is increasing worldwide (PRI, 2011), the amount of literature on the topic is limited, particularly on private engagement strategies, given issues related to data access (Amalric, 2004; Gillan & Starks, 2003; Rehbein et al., 2013). Moreover, as Gifford argues (2008: 256), "there needs to be exploration of the shareholder engagement context across different jurisdictions and cultural differences." The existing academic studies tend to concentrate on studying engagement practices in the UK and the US (e.g. Clark & Hebb, 2004; Gifford, 2010), while less effort has been put into analyzing engagement outside these two Anglo-Saxon contexts (Bauer et al., 2013; Sjöström, 2008). To our knowledge, only three academic works (Choi & Cho, 2003; Chow, 2010; Gond & Piani, 2013) study private engagement in emerging markets. Therefore, the present study helps to fill a substantial gap in the literature with regard to this particular area of research.

Secondly, this research contributes to scholarship applying the institutional perspective as a useful lens through which to analyze shareholder engagement in developing/emerging countries. While institutional theory has been applied to research corporate governance widely (e.g. Bauwhede & Willekens, 2008; Grosvold & Brammer, 2011; Heugens & Otten, 2007; Zattoni & Cuomo, 2008), to our knowledge, the institutional perspective has scarcely been used to analyze shareholder engagement in emerging markets (except for Adegbite, Amaeshi, & Amao, 2012), while, to our knowledge, this is the first piece of research using institutional theory to specifically investigate more private forms of shareholder engagement. Prior research from an institutional perspective has put much emphasis on coercive isomorphism pressures with regard to government policies on Responsible Investment. As one recent study noted, "policies addressing issues with a more economic focus such as socially responsible investing (SRI) and fair trade are addressed through partnering type policies (fair trade) and mandating (SRI)" (Knudsen et al., 2015: 93), *inter alia* pointing to a number of European countries (including France, Belgium and Britain) where the government passed legislation stipulating reporting requirements for public pension funds. However, the present research points to the importance of the normative isomorphism function of government legislation in terms of endorsing and facilitating (rather than mandating) changes in investor behavior on social and environmental issues through influencing the basis of the discourse among investors on ESG issues, and these normative indirect pressures appear to be more effective in changing investor behavior than perhaps previously anticipated in the literature. At the same time, this paper highlights the need to disaggregate corporate governance institutional arrangements into individual variables to more accurately examine the influence of the institutional environment on governance practices.

In wider terms, this study responds to a call made recently in this journal for research that investigates "governance phenomena in relatively unexplored countries and/or in cross-country research projects taking into account the institutional forces developed at the national level" (Kumar & Zattoni, 2015: 1) and to a call for more qualitative research to "generate fresh new theoretical insights about corporate governance practices that are both rigorous and relevant" (Zattoni, Douglas, & Judge, 2013: 119). According to a review by McNulty, Zattoni, and Douglas (2013), only a small fraction of governance studies adopt qualitative methods, with the majority investigating issues related to boards of directors such as non-executive directors and board committees, often in the British setting, while considerably less research has focused on issues related to investors and shareholders, and on non-European contexts. Hence this study contributes to filling a gap in the qualitative governance research by carrying out a comparative analysis of governance practices of two emerging markets.

As for practical contributions, this study draws investors' attention to the importance of a thorough understanding of the local legal environment of the companies with which they engage. For example, this research indicates how the combination of regulation limiting foreign investment from South African pension funds and the restricted investment universe increases the importance of the engagement strategy for local investors. It also identifies and discusses the legal mechanisms that are available to minority shareholders in Brazil willing to engage with investee companies as an insider in the boards of directors. Further, it shows how the incorporation of ESG issues into national legislation contributed towards redefining the concept of fiduciary duties for pension funds.

This research finally offers insights to governments interested in fostering engagement practices in their countries. Given that this study found a positive indirect influence of legislation on the level of engagement, governments from other countries could also consider developing ESG-related regulations for pension funds to reduce trustee fear of violating their fiduciary duties and to encourage investors to adopt more Responsible Investment practices, without the need to prescribe specific mandatory investment policies.

Like any other study, the present study has a number of limitations. First, given our finding that the level of sophistication of the legislation in Brazil and South Africa is more similar to that of developed countries than other emerging markets, it may not be possible to generalize the research findings to all emerging markets. Second, the interview sample is largely comprised of PRI signatories as priority was given to interviewees who value Responsible Investment practices, hence this study cannot claim to be representative of all institutional investors in Brazil and South Africa. Third, by interviewing investors who value Responsible Investment practices, this study focused on identifying the factors that encourage shareholder engagement rather than factors that may discourage shareholder engagement in these nations. Nonetheless, this research study clearly addresses a gap in the current literature and it provides rich empirical insights from two leading emerging markets.

FUTURE RESEARCH

Our study provides a much needed window for understanding shareholder engagement in Brazil and South Africa, but future research would benefit from follow-up studies. At the time of the interviews, some changes to the institutional contexts were taking place, and, according to the interviewees, the full effects of these changes had not yet been felt. In South Africa, it is still uncertain what the full effects of Regulation 28 may be. In Brazil, a possible amendment to Law 3792 is unconfirmed thus far. Moreover, in April 2014, the Brazilian Central Bank issued Resolution 4327, requiring that financial institutions establish and implement a policy of social and environmental responsibility (Banco Central do Brasil, 2014), creating an additional driver for financial institutions to incorporate ESG issues in Brazil. Follow-up work would particularly benefit from longitudinal studies to investigate how institutional influences as well as the attitudes of investors and non-investors toward shareholder engagement and Responsible Investment change over time.

While we cannot generalize the research findings to all emerging markets, our results may be of considerable relevance for those emerging markets with significant assets employing Responsible Investment strategies such as South Korea and Malaysia (ASrIA, 2014) and, in particular, emerging markets whose regulatory institutions incentivize investor responsible behavior, as is notably the case with the Mexican Pension Fund regulator (CONSAR), which recommends pension fund administrators to disclose whether investee companies have social responsibility certifications (Montes, 2015). Therefore, this study highlights the need for research on shareholder engagement in emerging markets that disaggregates corporate governance institutional arrangements into individual variables to reach a more fine-grained perspective on these nations. Given that there are significant institutional differences within emerging markets, future studies examining institutional variables individually would be more useful to investigate how the institutional context encourages or curbs shareholder engagement in these nations.

Our main finding that rising legislation encourages shareholder engagement and Responsible Investment in some emerging economies stands in contrast to the widespread axiomatic assumption in the political CSR literature that national governments are progressively losing the power to regulate the private sector in a globalized economy (e.g., Mäkinen & Kourula, 2012; Scherer & Palazzo, 2011; cf. Frynas & Stephens, 2015) and, in particular, that emerging and developing economies either lack sophisticated social and environmental regulation or are unable to effectively enforce regulation (e.g., Dentchev et al., 2015; Tan, 2009). Our findings are even more significant given that regulation impacted investor behavior through normative – rather than coercive – isomorphism channels, falling in line with wider scholarship in sociology which suggests that governments employ signaling processes in order to shape norms and standards for organizations to follow, without the need for mandatory regulation (e.g. Dobbin & Sutton, 1998; Edelman, 1992). We hope that – in a modest fashion – our study will serve to stimulate more research into the role of formal institutions in influencing shareholder engagement and Responsible Investment in emerging and developing markets, and – in wider terms – will help toward a re-assessment of the role and potential of formal social and environmental regulations in emerging and developing markets.

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APPENDIX

Appendix 1: Interview guide to institutional investors

Definition of shareholder engagement

In this study, shareholder engagement is defined as direct negotiations between investors and portfolio companies regarding the company's strategic and operational matters. For the purposes of this research, only shareholder engagement between institutional investors and listed companies on environmental, social, and corporate governance (ESG) concerns will be considered. Filing resolutions and voting at Annual General Meetings will not be considered engagement.

Main interview questions:

1 Please state your position and main responsibilities.
2 Please describe the state of Responsible Investment and shareholder engagement in the country: are institutional investors incorporating ESG issues into their investment decisions and engaging with investee companies on these issues?
3 Which is the approach to Responsible Investment of your organization? Is your organization engaging with companies at the moment on ESG issues?
4 In your opinion, what encourages shareholder engagement? Then specifically raise the impact of legislation (refer to the Pension Funds Act – including Regulation 28 – in South Africa and the Companies Law and Resolution 3792 in Brazil).

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