

To divest, or not to divest? A key question for investors seeking to promote sustainability goals

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Environmental, social and governance (“ESG”) concerns increasingly drive major investment decisions by institutional and retail investors alike. The strategy for investing in companies that already prioritize ESG goals is clear, but the strategy for investing in other organizations is more complicated.

When considering an investment in an organization that is not currently promoting ESG practices (or not *sufficiently* promoting ESG practices), investors face two options:

divest or retain their investment. This article examines the pros and cons of each approach based on recent research and examples and, ultimately, argues that investors can effectuate a greater impact on organizations when they maintain their investments and take an active role in driving internal change.

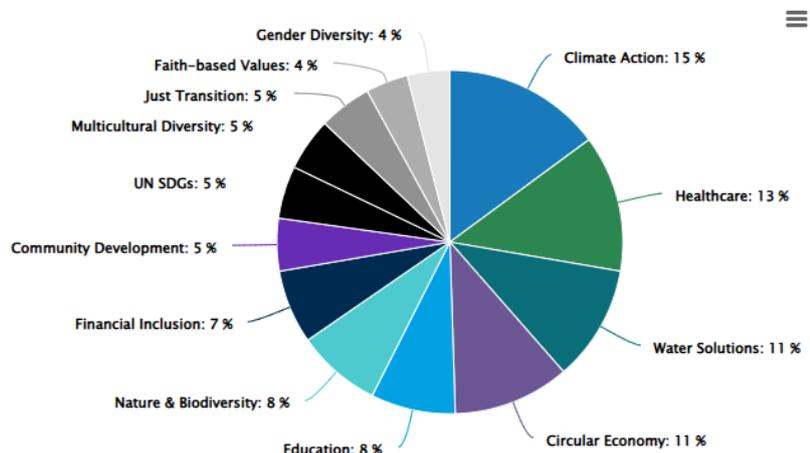
Background

Over the past seven years, investors have increasingly selected their investments based on environmental,

social, and governance goals.¹ ESG broadly stands for sustainable corporate practices and policies relating to critical global issues like climate change, fair labor standards, and sufficient internal controls. Under the ESG framework, corporations are held to a set of standards related to their sustainability efforts which allow investors to assess each corporation’s ESG impact.²

Investors increasingly rely on these standards, and prioritize corporate sustainability, when making

Top sustainable investing themes ranked



Source: Morgan Stanley Institute for Sustainable Investing, January 2024

investment decisions. This marked increase has been confirmed by several recent studies. For example, in January 2024, Morgan Stanley published a report containing the results of an investor survey which found that “more than half of investors say they plan to increase sustainable investments in the next 12 months.”³ The same study concluded that climate action was among the most important of the concerns to investors.⁴

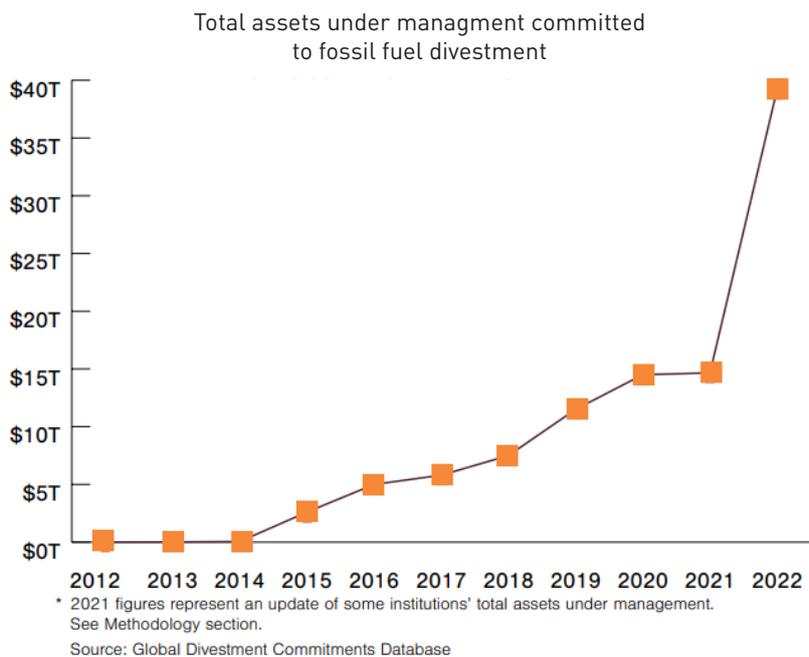
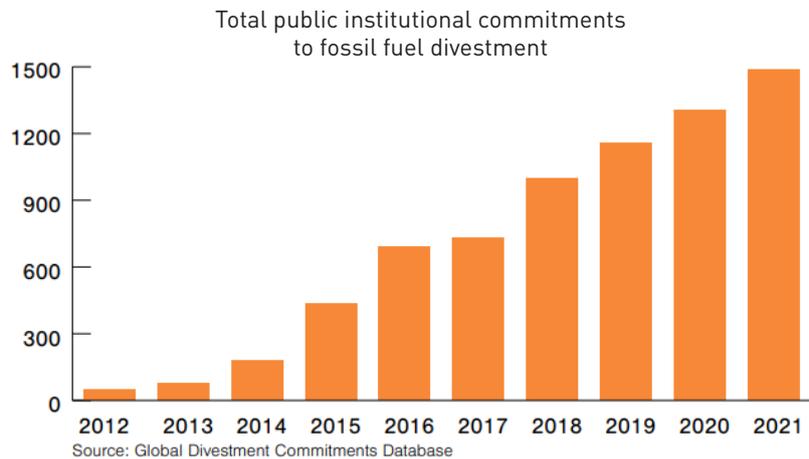
The Institute for Energy Economics and Financial Analysis issued a report in June 2024 that confirmed “inflows into sustainable [investment] funds remain strong, especially in Europe.”⁵ In a May 2024 study, ISS-Corporate similarly identified high shareholder interest in governance goals within the U.S.⁶

The global rise of ESG-driven investing has prompted institutions and investors to consider the efficacy of various investment strategies in advancing their ESG aims. These considerations beg the question: what strategy has the greater impact on corporations, divestment or retention?

The Divestment Approach

As investors consider various strategies for enhancing corporations’ commitment to ESG practices, divestment appears to be an obvious option. CNN defines divestment as the practice of “sell[ing] off [] shares of a company to avoid complicitly in activities [investors] deem unethical or harmful.”⁷ At its core, the goal of this strategy is to signal to corporations that their continued engagement in such practices will result in a loss of shareholder funds.⁸ Consider for example, a large institutional investor invested in a variety of publicly traded corporations. If a corporation were found to be engaging in corrupt practices, the institutional investor

Growth in divestment commitments



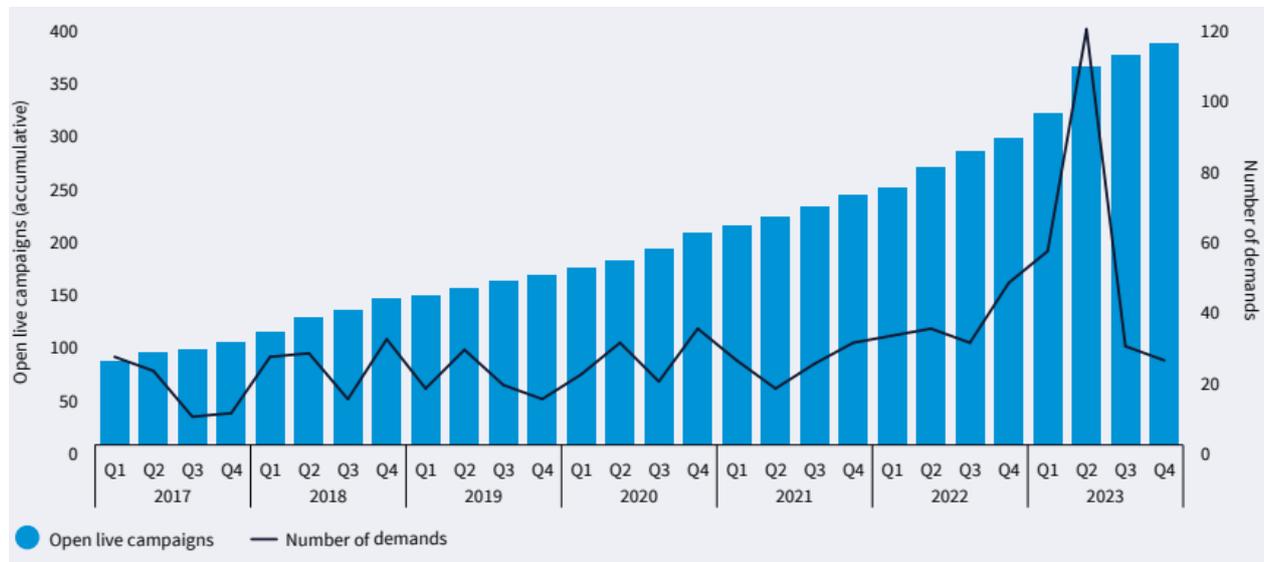
may vehemently disagree with the company’s corrupt and illegal activities. In order to demonstrate the institution’s disagreement, the institutional investor could sell off all of its shares (in some cases totaling millions of dollars) to send a clear message that the institution would not stand idly by as the corrupt practices continue.

Calls for the implementation of this divestment strategy were widely

publicized in 2024—particularly on college campuses. That is, students called upon their universities to divest from various corporations associated with poor environmental standards.

A group of students at Columbia University, known as “Sunrise Columbia,” are working to fight the climate crisis and have called for complete divestment from fossil fuel companies.⁹ To support their calls for divestment, the students cited

Live campaigns in Europe



Source: Activist Investing in Europe 2024

to several points in the University’s history where officials divested from organizations that failed to align with the University’s mission. As another example, in 2015, Columbia University made the decision to divest from the private prison industry in the wake of student protests, and in 2017 the University made a similar divestment decision to cut ties with companies generating over 35 percent of their revenue from thermal coal production. Now, students are pointing to these examples to call for complete divestment from fossil fuel companies.¹⁰

Harvard University faced similar calls for divestment in 2021 when the Climate Defense Project, together with local officials, faculty, and alumni, filed a complaint against the University alleging that its continued investment in fossil fuel companies violated its fiduciary duty.¹¹

Universities are not the only institutions willing to divest from organizations like fossil fuel companies. Indeed, a joint report by the Institute for Energy Economics and Financial Analysis, Stand.earth,

C40, and the Wallace Global Fund found that 1,485 institutions involving \$39 trillion in assets have publicly committed to divesting from fossil fuel companies.¹²

Does Divestment Have Investors’ Desired Effect?

As evidenced by the above examples, the divestment strategy has gained traction among many investors and institutions. Even so, several experts question the true impact of divestment in reshaping organizations’ commitment to ESG practices.

One working paper, *The Impact of Investing*, published in 2021, concluded that divestment does not have the desired effect that ESG-minded investors are seeking.¹³ Mainly, the paper found that too few investors were divesting from the at-issue organizations to have a significant impact—meaning that, in most cases, organizations could continue on with existing practices without feeling compelled to change. In addition to eliminating shareholders’ voices in calls for change, divestment also consolidates ownership into the hands

of the remaining investors who are likely indifferent to concerns about climate change or other critical issues.¹⁴

While seemingly attractive on its face, divestment may not have the desired impact unless the level of divestment is significant enough to hinder a company’s overall financial structure. Bill Gates acknowledged this reality in 2019 when he stated that “[d]ivestment, to date, probably has reduced about zero tons of emissions. It’s not like you’ve capital-starved [the companies] making steel and gasoline.”¹⁵

Retaining Investments To Promote Internal Change

While divestment has not had the full, desired effect, investors do have an alternative strategy: maintain their investments and push for change. At first glance, such a strategy may appear counterintuitive, but research and industry examples demonstrate that investors have made significant progress by advocating for change within organizations—*i.e.*, in their capacity as shareholders. Indeed, when analyzing this strategy, Harvard Business School senior lecturer Mark

Kramer stated “[i]f you want to do impact investing with publicly traded securities, you have to be actively engaged with management.”¹⁶

Shareholders are uniquely positioned to engage with management due to several specific rights which legally allow them to vote on company proposals, raise concerns about corporate management and advocate for solutions.¹⁷ In the case of divestment, investors relinquish these key rights upon the sale of their shares. However, when investors maintain their shares, they may utilize these privileges to advance ESG aims.

This strategy gained significant media attention in 2024 when Engine No. 1, a small hedge fund aimed at fighting climate change,¹⁸ engaged in activist activities in an effort to create long term change at ExxonMobil—initiating a battle for board seats. However, Engine No. 1 is just one example of many institutions engaging in activist investing that vary by form and degree of hostility. For example, in 2023, German investment institution, Union Investment, was key in initiating seven activist campaigns against German companies. European

shareholders have continued to follow suit evidenced by their increasing engagement in activist efforts.¹⁹

In addition to taking an activist role, shareholders of publicly traded U.S. corporations may avail themselves of other rights. For example, in some cases, it makes sense for shareholders to utilize U.S. investor protection laws that compel engagement rather than simply encouraging it. Many Fortune 500 companies are incorporated in the jurisdiction of Delaware in the U.S. to take advantage of a robust set of laws that have developed for corporate governance. Because these major companies are subject to Delaware law, investors may initiate engagement with U.S. corporations via various jurisprudence in Delaware laws developed to effectuate good governance. Specifically, Delaware General Corporation Law Section 220 provides investors with the ability to access corporate books and records to, among other things, investigate breaches of fiduciary duty, suspected corporate wrongdoing, mismanagement, or governance shortfalls. Thus, in the event that collective shareholder action and

corporate communications prove ineffective, investors can demand direct documentation by the company. This documentation will allow the asset manager to better understand each company’s ESG practices and sustainability efforts and will help engagement efforts because investors will then be armed with relevant company documents. Through a Section 220 demand, asset managers can directly investigate ESG practices and sustainability efforts, engage with companies on these issues and then propose and negotiate specific corporate initiatives or reforms to address these issues. And, beyond investigations, investors are afforded the opportunity to engage in litigation as needed to compel reforms.

With these avenues for engagement and effective change, the case for the retention strategy is becoming increasingly strong in both the U.S. and Europe. Shareholders’ continued investment and involvement in these efforts will drive meaningful internal change to promote sustainability efforts worldwide and continue to preserve, and in many cases, drive up shareholder value.

¹See Ramnath N. Iyer, *ESG Investing, Steady Growth Amidst Adversity*, INSTITUTE FOR ENERGY ECONOMICS AND FINANCIAL ANALYSIS (June 10, 2024), <https://ieefa.org/resources/esg-investing-steady-growth-amidst-adversity#:~:text=Environmental%2C%20social%2C%20and%20governance%20,remain%20strong%2C%20especially%20in%20Europe>.

²See Tom Krantz & Alexandra Jonker, *What is Environmental, Social and Governance (ESG)?*, IBM: TOPICS (Jan. 24, 2024), <https://www.ibm.com/topics/environmental-social-and-governance>

³*Individual Investors’ Interest in Sustainability is on the Rise*, MORGAN STANLEY: INSTITUTE FOR SUSTAINABLE INVESTING (Jan. 26, 2024), <https://www.morganstanley.com/ideas/sustainable-investing-on-the-rise>

⁴See *id.*

⁵Ramnath N. Iyer, *ESG Investing, Steady Growth Amidst Adversity*, INSTITUTE FOR ENERGY ECONOMICS AND FINANCIAL ANALYSIS (June 10, 2024), <https://ieefa.org/resources/esg-investing-steady-growth-amidst-adversity#:~:text=Environmental%2C%20social%2C%20and%20governance%20,remain%20strong%2C%20especially%20in%20Europe>.

⁶See Jun Frank, *Pro-ESG Shareholder Proposals Regaining Momentum in 2024*, ISS-CORPORATE (May 22, 2024), <https://www.iss-corporate.com/library/pro-esg-shareholder-proposals-regaining-momentum-in-2024/>

⁷Nicole Goodkind, *What is Divestment? And Does it Work?*, CNN: BUSINESS (Apr. 28, 2024, 7:30 AM), <https://www.cnn.com/2024/04/28/investing/stocks-lookahead-divestment-college-protests/index.html#:~:text=That%20action%20is%20intended%20not,activists%20targeting%20endowments%20during%20demonstrations>.

⁸See *id.*

⁹See Sunrise Columbia, *Divestment Unites Us, From Environmental Justice to a Free Palestine*, COLUMBIA SPECTATOR (Mar. 28, 2024, 6:47 PM), <https://www.columbiaspectator.com/opinion/2024/03/08/divestment-unites-us-from-environmental-justice-to-a-free-palestine/>.

¹⁰See *id.*

¹¹*Invest Divest 2021: A Decade of Progress Towards a Just Climate Future*, DIVESTINVEST (Oct. 26, 2021), https://www.divestinvest.org/wp-content/uploads/2021/10/Divest-Invest-Program-FINAL10-26_B.pdf.

¹²See *id.*

¹³See Jonathan B. Berk & Jules H. Van Binsbergen, *The Impact of Investing*, STANFORD GRADUATE SCHOOL OF BUSINESS: FACULTY & RESEARCH (Aug. 27, 2011), <https://www.gsb.stanford.edu/faculty-research/working-papers/impact-impact-investing>.

¹⁴See Adam Aston, *Why Divestment Doesn’t Work — and Just Won’t Die*, TRELIS (Jul. 24, 2024), <https://trellis.net/article/why-divestment-doesnt-work-and-just-wont-die/>

¹⁵*Id.*

¹⁶Lane Lambert, *ESG Activists Met the Moment at ExxonMobil, But Did They Succeed?*, HARVARD BUSINESS SCHOOL: WORKING KNOWLEDGE (Feb. 16, 2023), <https://hbswk.hbs.edu/item/esg-activists-met-the-moment-at-exxon-mobil-but-did-they-succeed>.

¹⁷See generally Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. § 78j; Securities Act of 1933, Section 11, 15 U.S.C. § 77k; 8 Del. C. § 220.]

¹⁸See Lane Lambert, *ESG Activists Met the Moment at ExxonMobil, But Did They Succeed?*, HARVARD BUSINESS SCHOOL: WORKING KNOWLEDGE (Feb. 16, 2023), <https://hbswk.hbs.edu/item/esg-activists-met-the-moment-at-exxon-mobil-but-did-they-succeed>

¹⁹*Activist Investing in Europe 2024*, Skadden & Mergermarket (2024), https://www.skadden.com/-/media/files/publications/2024/02/the-informed-board/activist_investing_in_europe_2024.pdf?rev=8d8a6aa2daa74afab28ba9d57542cef2&hash=5EA5FB36851012F9D8D19F06DAD9AB30.