Abstract: This study examines empirically the efficiency of private collaborative dialogues between Nordic institutional investors and companies included in the MSCI (Morgan Stanley Capital International) World stock market index. It contributes to an understanding of the conditions that allow active institutional investors to elect to work with more receptive and progressive companies and improve the efficiency of private engagement and dialogue. Stakeholder silence theory and Gond et al.’s model of company perceptions of enablers and barriers to the success of engagement are introduced to analyse the efficiency of private dialogue. The study investigates a proprietary dataset covering the characteristics of 109 complete dialogue processes related to material environmental, social, and corruption issues. The dialogues are led by a professional engagement agent in collaboration with its Nordic clients. The multivariate regression analysis shows that sustainability risk, bureaucracy, and experience are the specific conditions under which the target company can become more receptive to activism by making more progress to address institutional investors’ requests during the hidden dialogue process.

Keywords: sustainability risks; investor activism; private dialogue; engagement; efficiency

1. Introduction

Institutional investors concerned about sustainability risks of the investee companies have utilized private engagement and dialogue as the sustainable and responsible investment (SRI) strategy of nonfinancial activism [1–7]. Institutional investors are aware of a range of ways in which sustainability changes can present material opportunities for the investee companies to exploit [8]. Private engagement and dialogue refers to a sequence of direct communications where target companies take actions to make progress towards addressing specific sustainability changes demanded by institutional investors [4,6,7,9,10]. Existing research has claimed that companies frequently engage in private dialogues with their institutional investors. It underscores the advantages that result from collaboration taking place behind closed doors and without public attention [11]. Company managers and active institutional investors can negotiate solutions to material sustainability issues, develop flexibility in working together, understand each other’s constraints, and come to agreement on company actions that can reduce environmental, social, and corruption risks in the long term [2,5,11–16]. Private dialogue represents a potentially effective mechanism of corporate governance where “social change championed by shareholder activism largely occurs” [1,5,17]. Many studies have examined a visible and formal dialogue in the context of shareholder proposals filled by institutional investors. Research outcomes include the model of shareholder proposal process, responses of companies to shareholder proposals, the antecedents of proposal withdrawals, and the impact of proposal withdrawals on the sustainability performance of target companies [11,15,18–20].

The purpose of this study is to provide an understanding of the conditions that allow active institutional investors to elect to work with more receptive and progressive companies and improve the efficiency of private collaborative dialogue. The study will explore hidden dialogue in the form...
of a standalone intervention or a precursor to a shareholder proposal [5,21,22]. This engagement tactic is confidential and unobservable to researchers. Academic evidence is relatively scarce [17]. Few broad-scale empirical studies draw on proprietary information provided by a sole institutional investor who is predominantly a corporate governance engager [23,24]. These studies present evidence of a successful private engagement process in which both parties reach an amicable arrangement. Company-level outcomes of successful dialogues include increases of market value, profitability and transparency, and reduction of downside risks [18,23–25]. However, academic research conducted so far has not fully accounted for the enabling conditions under which private engagement creates shareholder value. In particular, there is little research on the role of companies in the process of private engagement [26]. In interactions with certain target companies, active institutional investors can realise more communicative action and opportunities to address sustainability risks [4,11]. This study argues that success levels can vary between private dialogue processes. Target companies can commit to sustainability changes at different degrees and have specific constraints to achieving the success of engagement [9,27]. Some companies can be more willing to take sustainability actions, more willing to implement the changes of active institutional investors, and be more progressive to lead the dialogue process to success [4,5,15,28]. This study will address a literature gap with regard to the company-related factors of an efficient dialogue process.

The study empirically explores the question as to what conditions can explain the success level of the private dialogue. It focuses on different levels of company receptivity to the demands of active institutional investors. Company receptivity is defined as the level of making progress and taking actions in the process of implementing changes required by institutional investors for managing sustainability risks. Prior broad-scale empirical research has typically accounted for engagement success by using a dummy of a complete, satisfactory dialogue process [23,24]. The dummy variable alone does not capture the degree of engagement success to allow for comparisons across private dialogues. Dummy variable does not facilitate an understanding of company receptivity to institutional activism. Company receptivity can shape the progress and actions made towards achieving the goal of private dialogue. The study builds on the stakeholder silence theory to explain that investee companies can take actions to meet the private demands of institutional investors in relation to increased sustainability risks. It reveals the attributes of power, legitimacy, and urgency of institutional investors’ claims in the private collaborative engagement tactic [5,21,29]. The theoretical model of Gond et al. [26] on the company perceptions of enablers and barriers to successful engagement is further used to develop hypotheses. The hypotheses specify the conditions that can determine the degree of company-specific motivations in the private dialogue process. A unique dataset of 109 complete dialogues with Morgan Stanley Capital International (MSCI) World Index companies between 2005 and 2013 was used to empirically find out the relative importance of the identified conditions. This study shows theoretical and empirical support to the proposition that the hidden dialogue can be an efficient form of institutional investor activism. The results offer insights to institutional investors about targeting the investee companies with more inherent opportunities to reduce sustainability risks.

The study provides evidence on private dialogue that is triggered by environmental, social, and corruption incidents when a company has violated social norms, such as UN (United Nation) Global Compact principles. An incident can expose institutional investors to financial risk that can span over a long-term period and the lack of trust and common ground towards company management of sustainability risks [30]. In this study, the private dialogue process was carried out by a professional agent in collaboration with Nordic institutional investors who use their voice to influence MSCI World companies. The online collaborative platform coordinated by the agent provides opportunity to mobilize knowledge and form coalitions among Nordic activists for productive private dialogue [2,5,21]. For each dialogue with a target company, the agent made the assessment of company receptivity performance to implement specific improvements that can reduce the risks connected with the sustainability incident. For example, company-specific improvements are to increase disclosure of information on management of sustainability risks, adopt and demonstrate policy and routines
that address sustainability risks in business operations, increase energy efficiency, and comply with international standards on sustainability.

The remainder of the study is organized as follows. Section 2 provides a theoretical framework for the study and reviews prior research on active ownership and private engagement to derive at hypotheses on the conditions under which successful dialogue process can occur. Section 3 describes the dialogue data and sample and provides empirical evidence on the determinants to explain the conditions under which target companies are expected to contribute to a higher process performance of dialogue. Section 4 describes the empirical results, discusses the results and limitations of the study, and mentions future research directions.

2. Theory and Prior Research

2.1. Related Literature

This study contributes to several strands of research on the efficiency of institutional investor activism. First, it relates to the broad-scale empirical literature studying efficiency of successful dialogues in driving company change and creating value for active investors. This little strand of literature analyses the post-engagement outcomes of successful private dialogues. For example, by focusing on a sole institutional investor who has extended its traditional governance concerns into thematic environmental, social, and governance (ESG) engagements, Hoepner et al. [23] provide evidence that shareholder engagement reduces the downside risk of portfolio companies when governance and environmental topics are addressed. The risk-reduction effect of private ESG engagements is consistent across the measures that capture the distribution of negative returns that fall below the 0%-return-threshold and an investment value at risk. Furthermore, Dimson et al. [24] show that target companies improve accounting performance and governance, increase institutional ownership, and decrease stock return volatility after successful engagements with a large institutional investor who commits to SRI. The cumulative abnormal return is more pronounced for the themes of governance and climate change. Increases in the return of assets, the ratio of sales to the number of employees, and shareholdings by the asset manager, pension activists, and SRI funds are more pronounced for the engagement topics on environmental and social issues. Barko et al. [25] find that companies with poor ex ante ESG performance ratings obtain higher ESG scores after the engagement with the investment management company specializing in activism in relation to corporate social responsibility issues. The results also show the positive sales growth and excess stock returns of target companies after successful engagements. Using coordinated engagements on corporate social responsibility principles through the Collaboration Platform provided by the Principles for Responsible Investing (PRI), Dimson et al. [31] demonstrate that successful engagements are followed by improved profitability, increased sales growth, and enlarged ownership. The findings of the study suggest that successful engagements create value for the target companies in the medium to long horizon. Increased activist holdings reveal that such activists are shareholders with ultra-long-term holdings and substantial ownerships that enable them to boost their voting rights and strengthen their voice during collaborative engagement.

Second, this study is related to a small body of academic research on the opportunity factors to successful engagement. This research stream develops different measures of engagement efficiency. Barko et al. [25], Dimson et al. [31], Dimson et al. [24], and Hoepner et al. [23] conceptualize the efficiency of investor activist as a successful engagement. The studies define successful engagement as one that provides a satisfactory outcome to the institutional investor and achieves the stated engagement goal. Dimson et al. [24] categorize cases in which the changes are implemented as successful engagements. Barko et al. [25] consider the engagement as successful depending on whether or not the target company sufficiently adjusts its policy on one or more ex ante determined ESG dimensions. Furthermore, Dimson et al. [31] claim that investor-related factors are crucial for successful engagements. The study examines investment managers who engage across national boundaries and have a structured engagement strategy. The study finds that success is achieved when
the lead investor is in the same geographic region as the target company, the supporting investors are international, and investors have a high stake in the target company. Success rates are higher when active investors are more numerous, have a higher level of assets under management, and own a higher proportion of the target company. Barko et al. [25] find that the presence of a large controlling shareholder, high short-term growth and a larger cash reserve are associated with a lower likelihood of successful engagements. The likelihood of successful engagements is reduced when active investors demand a material change in form of reorganisation from the target company and increased when the demand of active investors stimulates the target company to be more transparent on its ESG policies. Moreover, Bauer et al. [18] define an efficient dialogue as one in which active institutional investor and company reach a satisfactory settlement that leads to the shareholder proposal’s withdrawal. A settlement indicates that the board implements the proposal, either completely or partially, to satisfy the sponsoring shareholder and convince him or her to withdraw the proposal. The results document that success of private negotiations for a proposal’s withdrawal is determined by the sponsoring shareholder, such as institutional investors and labor unions, insider ownership, such as chief executive officer ownership, and the topic of the proposal. To sum, this literature models the efficiency of engagement as a binary variable indicating that a dialogue is complete, and the institutional investor takes no further actions.

Another body of academic literature [9,27] focuses on the company’s choice of engagement efficiency level. It considers three options, such as seek to omit the proposal (i.e., the lowest level of efficiency), send the proposal to a vote and negotiate a withdrawal of the proposal (i.e., the highest level of efficiency). Clark et al. [9] find that the level of company engagement is associated with different types of social issues, such as silence, contestation, consensus, and perennial. Consensus and perennial social issues are likely to result in a low level of engagement. Proposals regarding contested social issues lead to engaging with shareholders at a high level. Clark and Crawford [27] show that the engagement efficiency levels defined by company responses to shareholder proposals can be a form of a financial incentive tactic of companies. The results also indicate that companies with low environmental performance level, a lack of an environmental record (nonstarters), and a varied record (mixed bags) are likely to engage with active investors for a withdrawal of the proposal. Finally, using the three categories of company responses to shareholder proposals, McDonnell et al. [32] measure a company’s receptivity to activist demands. They find that more receptive companies are willing to negotiate with activists and improve their management of sustainability risks. The study argues that social proxy proposals create perceptions of risk among industry analysts and investors. Companies respond to the proposal by adopting social management devices, such as issuance of a corporate social responsibility report and creation of a corporate social responsibility board committee, to provide information to stakeholders that can form more balanced assessment of risk. The study also documents that companies that adopt a social management device become more responsive and open to social challenges. They develop opportunity structures within the engagement process. The present study makes an important contribution with respect to this literature. It examines the efficiency of hidden dialogue by focusing on the agent’s perceptions of the variance in company progress and actions to implement sustainability changes negotiated by institutional investor activists during the engagement process.

Finally, this study extends the literature that applies stakeholder silence theory to describe the effectiveness of shareholder proposals on sustainability risks in terms of managerial actions [5,21,29]. Gifford [21] applies stakeholder silence theory to analyse the factors that can enhance shareholder silence. Stakeholder silence is defined as the degree to which managers give priority to the claims of various stakeholders (including those of their shareholders) [21] (p. 92). The study uses a qualitative research design to examine three leading institutional investor organisations. The organisations frequently use public activism, such as voting and shareholder proposals, to engage with company management. The study by Gifford [21] supports the model of stakeholder silence based on the stakeholder’s possession of power, legitimacy, and urgency. It finds that the business case and values
of the target company’s managers are the most important factors contributing to shareholder silence. Cundill et al. [5] classify stakeholder silence in terms of managers’ identification and prioritization of the stakeholder itself and the claim of the stakeholder. The authors further argue that stakeholder silence theory can be used to describe both managerial perceptions and actions when companies are under formal pressure from investor activists. In particular, Eesley and Lenox [29] define stakeholder silence as company actions taken in a response to stakeholder request. The authors explore the nature of the interactions between secondary stakeholder groups, such as employees, customers, and stockholders, and responses of target companies. The findings of the study support stakeholder silence theory redefined in terms of actions. It provides evidence that secondary stakeholder requests are likely to be addressed by target companies when stakeholders’ actions are taken by groups with greater power and whose requests are more legitimate.

2.2. Theoretical Framework

In order to explain the efficiency of hidden dialogue in terms of company receptivity in relation to taking actions to address sustainability concerns of institutional investors, this study adopts stakeholder silence theory as an underlying theoretical framework. Gond and Piani [16], Gifford [21], Eesley and Lenox [29], and Cundill et al. [5] have applied this theory to argue that successful institutional investor engagements through shareholder proposals can result in changes in sustainability performance of target companies. Gond and Piani [16] argue that stakeholder silence theory provides suitable guidance to explain the engagement process. Institutional investors reshape managers’ perception of both institutional investors and sustainability issues attributes using collaborative negotiations over improvements in company performance. Cundill et al. [5] and Eesley and Lenox [29] argue that stakeholder silence can be achieved when a company takes actions to address the sustainability demands of activists. Stakeholder silence theory determines the three attributes that can trigger managerial actions in relation to shareholder demands. These are power, legitimacy, and urgency [5,15,21]. Gond and Piani [16] and Gifford [21] argue that, by accumulating these three attributes, institutional investors can mobilize their enhanced status in the eyes of managers to reshape the legitimacy and urgency of their sustainability claims. This study applies the three attributes that determine managerial actions to the private dialogue tactic used by Nordic institutional investors to influence global companies.

Drawing on Gond and Piani [16], stakeholder power has three sources, such as coercive power, utilitarian power, and normative power. Company managers can prioritize changes in sustainability activities because Nordic institutional investors combine and leverage their coercive power (the power of having the right to vote or file proposals on sustainability issues at Annual General Meetings), utilitarian power (the power of sell shares from a company with poor performance on sustainability issues), or normative power (the power of exerting reputation threat on a company based on its sustainability performance). Gond and Piani [16] argue that collaborative investors combine their various forms of power to acquire company managers’ attention and prioritisation of their sustainability demands. Large and powerful institutional investors are generally regarded as important and influential in the collaborative engagement process with companies [2]. In line with Gond and Piani [16], Goodman et al. [2] conclude that institutional investors are able to apply traditional sources of power and affect management decision-making.

Based on Cundill et al. [5], the legitimacy attribute of silence represents the perception of company managers that the actions of active investors are desirable, proper, or appropriate within some system of social norms. Eesley and Lenox [29] propose that legitimacy is granted to the stakeholder group and the specific changes requested by the stakeholder. In this study, active institutional investors can collectively shape the perceived legitimacy of their demands by using a collaborative engagement platform of their professional agent. The agent works together with its clients to build an investment and business case for private dialogue on sustainability risks in order to achieve collaborative changes in company practices. Accordingly, pragmatic legitimacy is formed. Moral legitimacy is built by qualifying engagement case based on company noncompliance with international principles and conventions,
such as the UN Global Compact. Cognitive legitimacy draws on the perception of company managers that the demands of active institutional investors on sustainability improvements can be considered as the typical expectations from financial markets. Logsdon and Van Buren [17] and Goodman et al. [2] view that a high degree of legitimacy of the relationships between institutional investors and the target company can potentially provide opportunities for an efficient behind-the-scenes form of dialogue.

Further, urgency is related to the sustainability issue raised by activists. It represents the extent to which the claims of active institutional investors call for immediate actions [5, 21]. Drawing on stakeholder silence theory, Cundill et al. [5] categorise the attributes of urgency into the claims’ time-sensitivity and criticality. These attributes of urgency are in line with the analytical framework developed by Gifford [21] for the analysis of effective institutional investor engagement on sustainability issues. In the present study, the demands of institutional investors are of time-sensitive nature, because a collective engagement decision to target the company is made in response to recently alleged violations of social norms in the form of material sustainability incidents. The criticality attribute of the tactic reflects the importance of the institutional investors’ demands due to potential financial risk inherent in sustainability incidents. Kruger [33] shows that stock markets react strongly negatively to negative corporate social responsibility incidents. A negative reaction indicates that substantial cost and financial risk are associated with the incidents of corporate social irresponsibility. In sum, the private dialogue tactic of this study displays the attributes of the theoretical model of stakeholder silence, such as power, legitimacy, and urgency. The presence of the three attributes is likely to contribute to a successful and efficient dialogue process. The study now moves to explain the specific conditions that can explain a more effective dialogue.

2.3. Hypothesis Development

Dialogue is a relation process between active institutional investors and target companies [34]. Solomon and Solomon [6] state that the mechanism of private dialogue shifts away from institutional investors initiating the engagement process towards companies beginning to utilize the engagement process as a means of reducing their long-term sustainability risks and improving sustainability practices and public disclosure. Feraro and Beunza [11] suggest that dialogue results in an emergence of communicative action from strategic action of institutional investors and target companies. Based on Habermas’s theory, the participants involved in the dialogue process pursue individual goals under the conditions that they can harmonize their plans of action on the basis of reaching a common understanding of situation [11].

Prior research claims that the specific conditions within which a target company operates are central factors of the efficiency of dialogues [26]. The company context relates directly to the possibility of emerging communicative action on the sustainability issue at stake. For example, prior literature on the determinants of sustainability performance of companies finds that companies that invest in sustainability practices and policies are likely to do it at various levels [35]. When a company is under pressure from institutional investors, the level of uncertainty that the company faces can explain more efficient dialogue [4]. The level of uncertainty depends on a company’s resources.

The resource-based view literature emphasizes that the effective dialogue is based on internal processes and routines that are organizationally embedded in companies’ interpretations of required changes [36]. The demands of active investors require a company to exhibit a specific capability to manage sustainability risks and integrate sustainability practices into business processes. Accordingly, the company-specific context can explain variations in the levels of success of private dialogues. Based on the theoretical model of Gond et al. [26], this study identifies company-related constraints to successful dialogue. In particular, companies that are unwilling to act upon institutional investor requests are expected to have a lack of sustainability practices, deal with low industry-specific sustainability risks, have bureaucratic burdens preventing changes in internal practices, and have a lack of resources in terms of experience in sustainability-related interactions with active investors.
This study aims to empirically examine the relative importance of these specific conditions to achieve higher levels of company receptivity to sustainability activism.

Socially responsive companies have developed solid ties and constructive contributions with their stakeholders. It helps target companies to meet the sustainability demands of active institutional investors. McDonnell et al. [32] argue that more socially responsible companies are more likely to be more progressive in improving their sustainability practices and more receptive to the demands of active investors. Rehbein et al. [4] suggest that target companies with good sustainability performance tend to be more interested in implementing the sustainability changes raised by active investors. These companies have prior knowledge of potential internal and external benefits of improving sustainability performance, such as resource utilization and reputation. Therefore, the following hypothesis is proposed.

Hypothesis 1: Company-specific sustainability risk is negatively related to the receptivity of a target company.

Complexity of company operations is likely to be an important determinant of dialogue efficiency. The demands of active institutional investors can require changes in the organization. They can affect a range of internal organizational functions used to manage sustainability activities [36,37]. The management literature, however, offers contradictory arguments for the influence of complexity on company actions. Rueda-Manzanares et al. [36] argue that complexity makes it more difficult for companies to assume important commitments, identify the key strategic factors, use valuable resources and capabilities, and take rational and economically effective actions. In contrast, Brown and Eisenhardt [38] argue that complexity can ease change. Russo and Fouts [37] claim that companies with complex operations can generate the type of innovative culture that enhances the actions of companies to manage sustainability risks. Under the conditions of complexity, companies are more likely to develop more flexible and less bureaucratic organizational structures. These structures can facilitate the efforts of companies to reduce sustainability risks of their operations. In contrast, company bureaucracy can prevent changes in internal practices and external reporting on improved sustainability performance [26]. Thus, the following hypothesis is proposed.

Hypothesis 2: Company-specific complexity is positively related to the receptivity of a target company.

Prior research suggests that industry-specific sustainability risk can explain companies’ incentives to improve their sustainability performance [39,40]. Sustainability impacts of an industry (e.g., water use, greenhouse gas emissions, and injuries) form the specific context in which the target company operates. Sustainability impacts lead to industries implementing or being subject to different standards, sanctions, and stakeholder pressures. These constitute differing degrees of financial risks for companies. Target companies can better prioritize their sustainability-related activities when they operate in industries with high sustainability risk. Severe social and environmental externalities lead to increased pressure on companies to respond [40]. Companies are likely to exhibit a higher level of engagement in sustainability changes and attain more sustainability initiatives under the conditions of high industry-specific sustainability risk [41,42]. Hence, the following hypothesis is proposed.

Hypothesis 3: Industry-specific sustainability risk is positively related to the receptivity of a target company.

Finally, prior research finds that companies that are frequently targeted by activists become more receptive to activist claims [32]. When companies are chronically targeted, they can expand sustainability practices in two ways. They undertake structural reforms to address the demands of activists and disclosure reforms to communicate the sustainability changes made. These reforms create new opportunities for more efficient future dialogues. Repeated investor activism can create specific resources meant to assist in managing activist demands; for example, corporate governance structure [32]. In addition, companies that accumulate a history of interactions with investor activists
can develop sufficient knowledge to meet new investor demands [26]. By prompting companies to improve sustainability practices and internal structures during the dialogue process, active investors can make companies less activist-resistant. Thus, the following hypothesis is proposed.

**Hypothesis 4:** Company-specific dialogue intensity is positively related to the receptivity of a target company.

### 3. Method and Data

#### 3.1. Model Specification

When testing the receptivity of target companies in successful dialogue processes, the study runs a multivariate, linear regression of the following type:

\[
RECEP_{it} = b_0 + b_1SUS\_CRISK_{it-1} + b_2\text{COMPL}_{it-1} + b_3SUS\_IRISK_{it-1} + b_4\text{INTENS}_{it-1} + b_5\text{CONTROL}_{it-1} + e_{it-1}
\]

The dependent variable, RECEP, is the receptivity of a target company to institutional investors’ demands. It is the variance in a company’s progress to act upon institutional investors’ requests during the dialogue process. The variable is measured as a progress rating (one = “none” and five = “excellent”).

The independent variables are based on the theoretical model of Gond et al. [26] and address the specific conditions that can explain the variation in company receptivity to sustainability activism (H1, H2, H3, and H4). SUS\_CRISK denotes the sustainability risk of the company. To calculate this variable, the study uses the environmental and social ratings of company-specific risk. The dimensions are assessed on a seven-point numerical scale from the lowest company risk (zero = “a”) to the highest company risk (six = “c”). COMPL denotes company-specific complexity. It is measured by employment (i.e., logarithm of number of employees) [36,37].

SUS\_IRISK denotes the sustainability risk of the industry in which the company operates. The variable is measured by the environmental and social ratings of general industry risk. The dimensions are assessed on a seven-point numerical scale from the lowest industry risk (zero = “a”) to the highest industry risk (six = “c”). INTENS denotes the engagement intensity of the company. It is calculated by the number of dialogue processes per company during the research period.

CONTROL denotes a control variable of company size. Larger companies attract more attention from external constituents and need to respond more openly to the demands of institutional investors. Smaller companies can have fewer resources for making sustainability changes. Company size (SIZE) is measured by logarithm of total assets [43,44].

The error term takes into account the influence of potentially omitted variables that are not explicitly present in the Model 1. \(i\) denotes a dialogue process, \(i\) indicates the year when a dialogue process is categorized as a successful, complete case, and \(t-1\) is the year when a dialogue process begins.

Following Bauer et al. [18], the study treats each dialogue as a single observation in the empirical analysis. Hence, the analysis is based on the dialogue case level. The regression parameters of Model 1 are computed using robust standard errors adjusted for potential misspecification of Model 1 [45]. In particular, linear regression is estimated using ordinary least squares (OLS) with White-corrected standard errors in the presence of heteroskedasticity. For the regression parameters of Model 1, the study reports two-tailed \(p\)-values. Due to potential outliers in the data, the variables of complexity (COMPL) and size (SIZE) are transformed to the logarithm form and winsorized at the 10th and 90th percentiles (\(p = 0.1\)). The empirical method is consistent with Rieda-Manzanares et al. [36] and Guenster et al. [44]. Rieda-Manzanares et al. [36] use multiple regression analysis for the data that include Likert scale dependent variables. Guenster et al. [44] use the log transformation of financial variables and the White heteroskedasticity-consistent OLS estimator.
3.2. Data

The engagement dialogue data has been obtained from an established professional engagement agent specializing in SRI services without managing clients’ underlying assets. Since 1992, the agent has provided sustainability ratings on global companies to institutional investors for assessments of a company’s risks. In 2005, the agent launched the Engagement Forum, which is a collaborative platform to propose and be involved in an engagement process. The agent initiates a private dialogue with companies that have been involved in systematic business conduct or an isolated issue that has severe consequences for the environment or humans. A private dialogue case builds upon systematic screening of companies regarding their compliance with international norms, such as the UN Global Compact. The screening universe comprises over 20,000 companies from the portfolios of Nordic clients. Sustainability information is acquired through news articles, public documents and incoming reports. It is then grouped by industry sectors and sent to analysts for assessments. Analysts investigate alleged violations of international norms in the form of sustainability incidents and advise institutional investors if the incident qualifies as a private dialogue case with material sustainability risk. Using the Engagement Forum platform, Nordic institutional investors, who work with the agent, make individual and collaborative decisions to target a company in response to a sustainability incident. The Nordic clients involve themselves in a systematic dialogue process with specified engagement goals. The goal of engagement is to resolve the immediate problem, mitigate increased sustainability risk, and improve sustainability performance of the company. The agent coordinates and advises its clients and represents them in interaction with target companies. The institutional investors can choose the level of participation in the private dialogue process. They can participate personally in meetings and conference calls with target companies to discuss the required improvements of sustainability practices. They can also review engagement reports published on the Engagement Forum platform. To engage with companies, the agent uses various engagement tools, including mail dialogue, faxing, calls, meetings, conference calls, site visits, and proxy voting. When the engagement goal is achieved, required changes are perceived to reduce sustainability risk.

The Engagement Forum database has provided access for this study to data records on engagement case reports, the companies’ identifiers, and the process status of case reports. The database contains the characteristics of 976 engagement cases for the period 2005–2013. The study includes complete engagement dialogues by the end of the research period. The dialogue process is categorized as a complete case if the goal of the dialogue process is achieved, and the dialogue case is closed before filing a resolution. From the agent’s data records, the study obtains the areas of private dialogues, the receptivity variable, and the engagement intensity variable. The variable of company receptivity is based on the agent’s perceptions on company willingness to implement sustainability changes during the dialogue process.

Company-specific sustainability risk rating and industry-specific sustainability risk rating are obtained from the agent’s Risk Rating database. The company-specific sustainability risk rating reflects the company’s ability and preparedness to handle company-specific environmental and social risks. Indicators of the environmental risk rating include environmental policy and targets, environmental management system, environmental certification, use of renewable energy sources, emission levels, and recycling of products or equipment. The indicators of the social risk rating reflect the management of relations with employees, communities, and suppliers. The individual environmental and social risk ratings are added to arrive at an overall company-specific sustainability risk rating.

Industry-specific sustainability risk rating is defined as the sustainability risk of the industry in which a company operates. The industry sustainability risk score reflects the direct risks of the industry and the indirect risks that result from dependencies on other industries. Industry-specific environmental risk covers greenhouse gas emissions, energy usage, water consumption, waste handling, and hazardous materials. Industry-specific social risks are based on health and safety concerns (e.g., poisoning, burns, accidents involving contact with chemicals, inhalation of toxic fumes or injuries connected with working with machines), fatalities, injuries, gender, sex, and religious discrimination.
The individual environmental and social risk ratings are added to arrive at an overall industry-specific sustainability risk rating.

Risk ratings are based on information obtained from annual and interim reports of companies, surveys, and site visits. Evaluation also uses information by nongovernmental organizations, the media, and the international network of analysts. The risk ratings include the largest listed companies in the world from the MSCI World stock market index. The ratings are issued twice a year, in June and December. The dimensions of company- and industry-specific sustainability risk are assessed on a seven-point non-numerical scale from the lowest risk (a) to the highest risk (c). For empirical analysis, the non-numerical company-specific and industry-specific risk ratings are converted into numerical scores in which companies with the lowest risk (a) receive a rating equal to zero and those with the highest risk (c) receive a rating of six.

The number of employees and total assets variables are obtained from Thomson Reuters Datastream. The study aggregates the engagement data with the financial data by company ISIN code and company name. Overall, after excluding temporary and incomplete dialogue cases and cases with missing financial data, the sample of private dialogues was left with 109 complete dialogue processes for the period 2005–2013.

4. Results and Discussion

4.1. Results

Table 1, Panel A shows the distribution of successful dialogues across the environmental, social, and corruption areas of sustainability risks. The area of labor rights risk has the larger proportion of successful dialogues (37.9%), followed by the area of human rights risks (29.1%), and the area of environment (26.2%). The area of corruption risk has the lowest proportion of successful dialogues (6.8%). Table 1, Panel B shows the descriptive statistics for dependent and independent variables. The average company receptivity, which indicates how well the company implements the required changes, is 3.57. The average target company has the company-specific sustainability risk of 6.20, the industry-specific sustainability risk of 8.74, and the engagement intensity of 1.64 cases.

Table 1. Summary and Descriptive Statistics. (Panel A): Distribution of dialogues. (Panel B): Descriptive statistics.

| Sustainability Risk     | Number of Valid Cases | % Sample  |
|-------------------------|-----------------------|-----------|
| Environment             | 27                    | 26.21%    |
| Human rights            | 30                    | 29.13%    |
| Labor rights            | 39                    | 37.86%    |
| Corruption              | 7                     | 6.80%     |
| Total                   | 103                   | 100.00%   |

| Variables   | Mean | SD  | Number of Observations |
|-------------|------|-----|------------------------|
| RECEP       | 3.57 | 0.93| 62                     |
| SUS_CRISK   | 6.20 | 2.20| 77                     |
| COMPL       | 10.50| 1.15| 102                    |
| SUS_IRISK   | 8.74 | 3.27| 77                     |
| INTENS      | 1.64 | 0.86| 109                    |
| SIZE        | 16.86| 1.32| 105                    |

Notes: Panel A reports frequency distribution of dialogue processes across sustainability risks. Panel B displays the descriptive statistics for 109 complete dialogues. All financial variables are winsorized (p = 0.1). RECEP is progress rating. SUS_CRISK is company-specific sustainability risk rating. COMPL is logarithm of number of employees. SUS_IRISK is industry-specific sustainability risk rating. INTENS is engagement intensity. SIZE is logarithm of total assets.
Table 2 presents the results of regression analysis. The results show that company receptivity to sustainability changes required by active institutional investors is negatively and significantly associated with company-related sustainability risk (−0.114, \( p = 0.004 \)), dialogue intensity (−0.289, \( p = 0.008 \)), and company size (−0.221, \( p = 0.080 \)). Complexity of company operation is positively and significantly associated with company receptivity to the demands of active institutional investors (0.414, \( p = 0.000 \)).

| Variables   | RECEP  | RESP  | TOTAL |
|-------------|--------|-------|-------|
| SUS_CRISK   | −0.114 | −0.109| −0.223|
|             | (0.004)| (0.003)| (0.001)|
| COMPL       | 0.414  | 0.438 | 0.852 |
|             | (0.000)| (0.000)| (0.000)|
| SUS_IRISK   | 0.017  | 0.032 | 0.050 |
|             | (0.539)| (0.252)| (0.320)|
| INTENS      | −0.289 | −0.181| −0.471|
|             | (0.008)| (0.180)| (0.031)|
| SIZE        | −0.221 | −0.323| −0.545|
|             | (0.080)| (0.004)| (0.013)|
| Intercept   | 3.610  | 5.028 | 8.639 |
|             | (0.067)| (0.006)| (0.011)|
| Num. of obs.| 93     | 93    | 93    |
| Adj. R²     | 0.241  | 0.282 | 0.307 |

Notes: \( p \)-values are presented in the parentheses. All reported \( p \)-values are two-tailed. A coefficient of a variable in bold indicates that the variable is statistically significant at least at the 10% level. RECEP is progress rating. SUS_CRISK is company-specific sustainability risk rating. COMPL is logarithm of number of employees. SUS_IRISK is industry-specific sustainability risk rating. INTENS is engagement intensity. SIZE is logarithm of total assets. RESP is response rating. TOTAL is total score of progress and response ratings.

Overall, the study finds empirical support for hypotheses H1 and H2. In particular, the findings provide support for H1, stating that low company-specific sustainability risk is the condition under which higher company receptivity can be achieved. Target companies tend to be more receptive to sustainability activism when they want to preserve a low level of sustainability risk. H2 is also supported. High company-specific complexity leads to increased receptivity of target companies during the dialogue process. More complex and less bureaucratic target companies are more willing to change internal practices and act upon the requests of institutional investors. Finally, the results support H4, that company-specific dialogue intensity explains company receptivity. However, it decreases the progress that the target company makes to address sustainability concerns of active institutional investors. Companies that are more frequently targeted by investor activist in relation to several sustainability incidents tend to make slower progress towards implementing specific changes.

In the additional test, the study operationalises company receptivity by the responsiveness of companies to the requests of active institutional investors. The variable is measured as a response rating (one = “none” and five = “excellent”). It is based on the agent’s perceptions on how well the target company responds to the requests for comments on the dialogue issue during the dialogue process. Table 2 reports the results of the impact of specific conditions on company responsiveness to institutional investor activism. Company complexity has a significant and positive relationship with company responsiveness (0.438, \( p = 0.000 \)). Company-specific sustainability risk and company size have negative and significant association with company responsiveness (−0.109, \( p = 0.003 \) and 0.323, \( p = 0.004 \), correspondently). The findings show that target companies with low sustainability risk are more responsive, which makes private dialogue more effective. More efficient private dialogue in terms of company responses is also achieved when institutional investors target companies with a higher number of employees and lower total assets. Finally, the study adds the receptivity factors of company responsiveness to institutional investors and company willingness to act upon
the requests of institutional investors. The results are consistent with the primary ones reported above. The aggregated variable of dialogue efficiency is negatively and significantly associated with company-related sustainability risk (−0.223, \( p = 0.001 \)), dialogue intensity (−0.471, \( p = 0.031 \)), and company size (−0.545, \( p = 0.013 \)). Complexity of company operation is positively and significantly associated with the efficiency of the dialogue (0.852, \( p = 0.000 \)).

4.2. Discussion

This study investigated the company conditions that are important factors of more efficient private engagement and dialogue on sustainability risks. The study uses stakeholder silence theory by considering the attributes of silence that determine companies’ perceptions and actions when they are under pressure from active institutional investors. The theoretical model of Gond et al. \([26]\) provides important insights on company perceptions of distinct enables and barriers to a successful engagement process. Drawing on this model, the study empirically examines the enabling factor of company receptivity that is a company willingness to act upon an institutional investors’ request during the private dialogue process. The constraining factors of company conditions include company-specific sustainability risk, complexity of company operations, industry-specific sustainability risk, and intensity of dialogues. The data comes from the proprietary records of a professional engagement agent who leads private collaborative dialogues with MSCI World companies on behalf of, and with, the active involvement of Nordic institutional investors. The results of the study suggest that lower company-specific sustainability risk, higher complexity, and lower intensity lead to increased receptivity of target companies to activism, which, in turn, improves the efficiency of private dialogues.

This study contributes to the literature on institutional investor activism by addressing the scholarly debate on what makes it effective. Scholars in finance have suggested that agency theory can be suitable for explaining investor-company behind-the-scenes interactions with regards to sustainability issues \([23–25,31]\). Social movement theorists have explained the effectiveness of private dialogues on sustainability risks through the formation of shared interests and social ties between active institutional investors and target companies. Adopting stakeholder silence theory, this study contributes to this literature by placing the success of hidden dialogues as a specific form of investor activism on managing the risks of sustainability incidents in the frame of company perceptions of attributes of silence. Furthermore, the study contributes to prior literature by focusing on the variation in the agent’s perceptions on company progress to address sustainability claims of active institutional investors during the dialogue process in order to explain the success level of private dialogue. This analysis is motivated by the fact that target companies can engage in private dialogue at different levels \([9,27]\). The empirical findings confirm that, under certain conditions, target companies become more progressive or activist-receptive and more willing to take actions to improve sustainability practices. This study also has practical implications for growing active institutional investors when engaging in a hidden dialogue process, by demonstrating how they can improve the efficiency of their dialogues with investee companies.

Several potential limitations of the study provide opportunities for future research. The conclusions of the study are relevant for Nordic institutional investors who use the Engagement Forum in a collaboration led by the agent to engage with companies regarding sustainability risks. The specific Nordic engagement approach can, however, be extended to other commercial agencies and asset managers that provide engagement services. The study is also limited to a relatively small number of complete dialogues and the agent’s perceptions of their efficiency levels. Further research can focus on symbolic and substantive actions of company management, which can extend the understanding of outcomes of a successful dialogue process.

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