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AVOIDING TURBULENCE: A REVIEW OF RYANAIR

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Please read the important disclosure at the end of the article.

Responsible investment has been core to Newton's investment approach since our inception in 1978, when we began actively voting on our clients' shares. Since then, our responsible investment approach has grown to include environmental, social and governance (ESG) integration and active engagement across all our strategies. This is done to identify risks and opportunities which have the potential to affect companies' performance over the long term. As part of this process, all potential investments are subject to an ESG review before being formally recommended, and in early 2016 we conducted a review of Ryanair.

What were the red flags?

At the time of investment consideration, a number of governance concerns were identified at Ryanair. The board was just 9% independent, which does not meet UK Corporate Governance Code standards. Its membership included just one female, and two-thirds of the board was comprised of Irish nationals; to us, this demonstrated a lack of diversity. In recent years, a light has been shone onto this issue as an increasing amount of research suggests that a lack of diversity can negatively affect a company's financial performance.

These concerns were heightened as Ryanair's CEO is notoriously outspoken and known for having a turbulent relationship with trade unions. The role of the board is supervisory, and, as investors, we seek to gain assurance that it provides sufficient and healthy challenge to the management of a company. However, in the case of Ryanair, we were concerned that a board lacking independence and diversity would not offer this challenge to the CEO.

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Remuneration is an issue that has attracted considerable investor attention in recent years. As an investor, we are encouraged by transparent disclosures by companies and evidence that remuneration is used to incentivise long-term, strategic thinking. However, Ryanair disclosed little information in relation to executives' bonuses or the long-term components of their pay, raising questions on how they were being incentivised to run the company over the short and long term.

Employee relations were also identified as a potentially material issue following extensive labour disruptions.

Ryanair has a seasonal schedule whereby the number of flights is increased or decreased owing to varying demand throughout the year. As a result of this seasonality, the company does not ensure that employee compensation agreements remain constant across this time. On the upside, this has led to lower labour costs and lower fares, benefiting both the company and investors; however, on the downside, this leads to an unhappy workforce which feels increasingly unable to engage with management.

Tensions have been further inflamed by failed union negotiations across multiple European countries, where unionisation levels are high and company engagement is commonplace. As a result, we were aware of a potential risk to the company's bottom line. Customer demand for low-budget, short-haul flights is known for its flexibility – customers are likely to pick the cheapest and most convenient options for their journey. This can lead to considerable surges and falls in demand. This means that well-timed industrial action can cause major disruptions.

This risk materialised between 2014 and 2016, when, following increased media coverage, Ryanair saw strikes in Norway, Sweden, Spain, Denmark and France, and was fined €8.3 million over labour-law violations in France. The company was also forced to cancel up to 50 flights a day, affecting an estimated 400,000 passengers.

More recently, workforce tensions have continued. On 12 October 2018, following Ryanair's decision to close bases and reduce fleets, the European Cockpit Association accused it of declaring war, and called for the management and board of directors to "change [their] confrontational and counterproductive approach". The company maintained that this action was in response to rising oil prices and declining fares, which many of the low-budget airline companies are experiencing.

How do we integrate ESG research into investment decisions?

After discussing these concerns with our sector analyst, our ESG research was circulated to the whole investment team. This flagged our concerns to the portfolio managers and made sure that this analysis formed part of the overall investment decision.

This example demonstrates how a company's handling of ESG risks can negatively affect its financial performance. It also highlights why we undertake ESG analysis before recommending all companies for investment.

Want to find out more?

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