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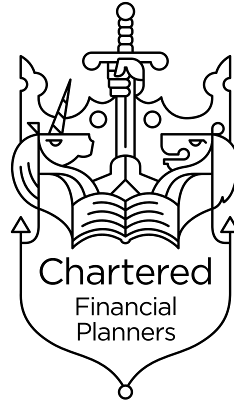

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GUIDE TO

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INVESTING

GENERATING THE BEST OUTCOMES BY INVESTING RESPONSIBLY AND SUSTAINABLY

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GUIDE TO

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INVESTING

Generating the best outcomes by investing responsibly and sustainably

Once a niche approach thought to come at the expense of returns, Environmental, Social and Governance (ESG) strategies have proven that they can be market-beating. If you're someone who wants to make a positive difference, you might be interested to know how you, your money and the things you care about could all benefit from sustainable investing.

The coronavirus (COVID-19) pandemic has shown the fragility of the planet, its complexity and interconnectedness in terms of demand and supply in trade and commerce, and how these can be under threat if not sustainable. ESG investing was already on a trajectory to reshaping the investment landscape in this new decade, but the COVID-19 outbreak is now likely to quicken the pace of this reshaping.

Investing reimagined

Today, we're seeing our world change faster than ever before, as economic, geo-political and environmental challenges abound. And as investor momentum builds, some argue that companies can no longer afford to discount their ESG ratings.

A growing body of evidence also points to a relationship between sustainability initiatives and strong business results. A meta-study from the University of Oxford[1] showed that companies with better sustainability practices tended to have better operational performance and often superior stock price performance relative to companies rated lower for ESG.

Sustainable strategies

The abbreviation ESG was first used in a 2004 report published by the United Nations called 'Who Cares Wins', which argued that the consideration of specific environmental, social and governance factors in investment decisions could have a positive impact on society as well as the financial markets. Since then, it has come to represent much more than a set of investment criteria.

ESG investment strategies, like any other form of investing, still come with risk. This means there's a chance you may get back less than you put in. And remember that a sustainable investment should be seen as a medium-to-long-term commitment, meaning you should be prepared to invest for at least five years.

New generation of investors

Investors are increasingly aware that it is possible and increasingly necessary to make a profit while positively and proactively protecting people and the planet. We can expect to see a considerable demographic shift with millennials citing ESG investing as their top priority when considering investment opportunities.

ESG integration spans all the asset classes, and there are various investment possibilities by which ESG goals can be achieved. These include screening investments based on ESG factors, the use of investment vehicles designed to achieve specific ESG objectives (such as 'green bonds'), and making investments in companies that aim to have a positive impact on particular ESG issues.

We can't afford not to care

The three pillars of ESG cover a wide range of issues

1. Environmental

Investors, consumers and governments are placing renewed emphasis on climate change and sustainability. This factor examines the extent to which a company is taking a 'green' approach. The number of potential criteria within the environmental factor is vast. It might, for instance, involve analysing how dependent a business is on fossil fuels, how much waste it is producing or how it treats animals.

Alternatively, it might look at any significant environmental risks that a business is taking, such as if it regularly fails to meet government regulations. Factors include carbon emissions, water usage, pollution, packaging waste, sustainable building, land usage and energy efficiency

2. Social

This examines how the company manages its relationships with people including employees, suppliers, customers and local communities.

In terms of employees, this criteria might include whether a business has any diversity or inclusiveness policies, or how it treats its staff.

When it comes to suppliers, this assesses the businesses a firm works with, for example, whether a manufacturer outsources production to factories with poor practices. Treating customers fairly is also likely to have a long-term impact on performance and may cover whether the business has sufficient consumer protection in place.

Many consumers and investors want businesses to benefit society, so an ESG investor may look at whether a company helps people it doesn't necessarily buy from, sell to or employ. Factors include employee health and safety, supply chain labour standards, privacy and data security, product safety and employee developments.

3. Governance

The reasoning behind analysing a company's governance practices is clear. A business that is run properly is more likely to succeed over the long term than one that isn't. When it comes to assessing a company's governance, common criteria can include whether it uses open and transparent accounting practices or whether shareholders can vote on important decisions.

It also looks at how much it pays its board, including bonuses, board diversity, and how much it spends on developing new products and services. Factors include business ethics, corruption and political instability, conflicts of interest, and tax transparency.

What are ESG ratings?

ESG ratings are an objective evaluation of a company's commitment to sustainable business practices.

A company's ESG score is independent of the industry in which it operates. A specific stock can have a strong rating, even if the broader industry lags behind, and vice versa. For example, not all oil and gas companies have low ESG scores, while not all tech companies have high scores.

ESG scoring methods vary across sectors. E, S and G factors are given different weightings depending on the industry a company operates in. The specific issues taken into account will also differ, determined by what is most relevant and material to company performance in each case.

Mainstream concern

Increasingly, investors are becoming aware that it is possible and necessary to make a profit while positively and proactively protecting people and the planet, and as such are making investment decisions after measuring the sustainability and societal impact of a sector or company.

The world is facing a rising tide of societal challenges, from the potential chaos associated with the breakdown of our climate, to unsustainable levels of waste and pollution, as well as vast and growing social inequality. These events are leading many investors to play a more pivotal role in directing capital to where it is most needed. ■

MAKING A DIFFERENCE AND A RETURN

Whether there are specific causes that you want to put your wealth to work for, or if you believe that companies that are run well will do well, we can help you find the approach that works best for you. For more information or to discuss your investment goals, please contact us.

Source data:

[1] https://yoursri.com/news/arabesque-partners-and-oxford-university-update-sustainability-meta-study

WANT TO FIND OUT MORE ABOUT ESG INVESTING?

Investing with consideration of environmental, social and corporate governance criteria has increased significantly in recent years. For many, it reflects an understanding of their need for long-term sustainable investment performance and their ambitions for a better world.

For more information about ESG investing, please contact us – we look forward to hearing from you.

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