ESG moves beyond niche into the mainstream

By Premal Ranchod

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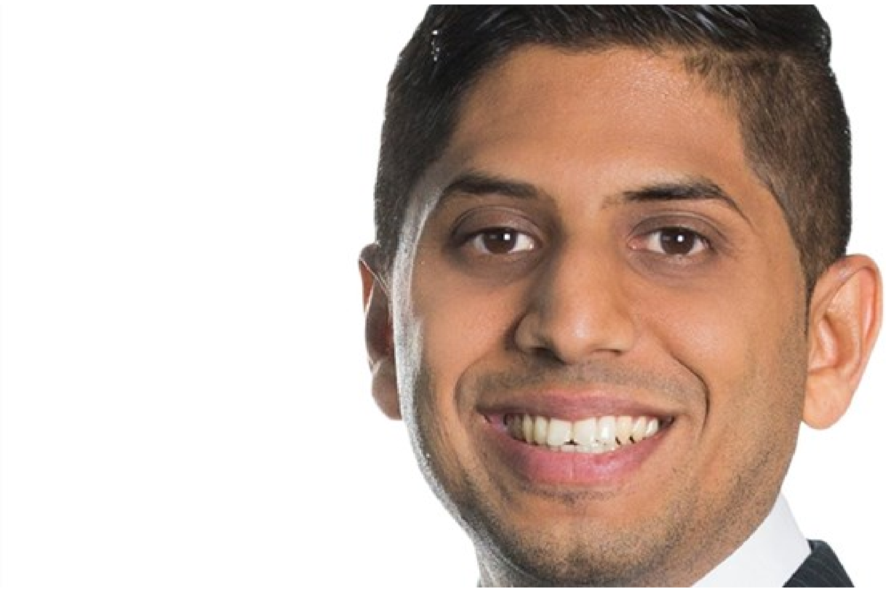
Socially responsible investing has long been considered niche, but as the impact of investments is being measured beyond just financial returns, environmental, social and governance (ESG) considerations has shifted into the mainstream.



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The numbers also point to increased attention in this space. Morningstar reported global fund flows into sustainability themed funds amounted to $71bn between April and June 2020, bringing the total of assets managed to $1trn.

On a quest for more transparency

Considering the allocation to oil and gas sectors globally, these are significant contributors to carbon emissions. Ten years ago, you could not see a portfolio without it, but fast forward to today, an asset manager finds difficulty in navigating a host of risks such as carbon tax, lack of disclosure in financial statements, and weak leadership around ESG concerns. This makes ultimate investment propositions problematic. Analysts and activists alike are on a quest for more carbon emissions data and climate-related reporting information to be disclosed in trying to measure the footprint of their investments.

Investment management companies have a fiduciary duty to not only achieve the best possible returns at acceptable levels of risk, but also to act in the best interests of the wider community and environment within which they operate. ESG factors can directly affect the short- and long-term financial performance of businesses through operational and reputational reasons. For this reason, the returns on investment from such companies can be compromised, and are important.

For example, whether it is an oil spill related to a large petroleum company, workforce unrest at a global mining company, or false carbon emission reporting from a leading car manufacturer, these all lead to headlines which have caused massive drops in the share prices of major organisations as well as creating material issues for stakeholders and society. If your investment portfolio held shares in the organisations at fault, the value of your investment would have dropped given the impact on their reputation.

Risks, reputation, return and impact are all linked

And that is precisely why an investment approach which considers such risks (and opportunities) is preferred – it is better positioned to deliver superior risk-adjusted and sustainable investment outcomes.

The expression against ESG issues that cause harm across the globe has been unrelenting. We are witnessing scientists, governments, regulators, corporates, and civil society sitting up and taking note. The magnitude or materiality of issues are so impactful that the past is no longer a prologue.

2020 is the tipping point

The hot discussions in 2021 for ESG professionals across the globe will no doubt centre on climate and quantifying materiality, and how to balance whether ESG issues have economic significance or if they satisfy shareholder interests only. Reporting authorities will look to standardise sustainability reporting frameworks in an effort to allow markets to price for risk and opportunities.

ABOUT THE AUTHOR

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