



# Remarkable Rise Of ESG Investing

## *Environmental, Social and Governance Investing Basics*

Responsible investing is widely understood as the integration of environmental, social and governance factors – hence the ESG acronym – into investment processes and decision-making. ESG factors cover a wide spectrum of issues that traditionally are not part of financial analysis, yet may have financial relevance for investors.

ESG factors might include how corporations respond to climate change, how good they are with water management, how effective their health and safety policies are in the protection against accidents, how they manage their supply chains, how they treat their workers and whether they have a corporate culture that builds trust and fosters innovation.

### **History of ESG**

The term ESG was first coined in 2005 in a landmark study entitled “Who Cares Wins.” Today, ESG investing is estimated at over \$20 trillion in assets and its rapid growth builds on the Socially Responsible Investment (SRI) movement that has been around much longer.

But unlike SRI, which is based on ethical and moral criteria and uses mostly negative screens, such as not investing in alcohol, tobacco or firearms, ESG investing is based on the assumption that ESG factors have financial relevance.

In fact, today there are thousands of professionals from around the world holding the job title “ESG Analyst” and ESG investing is the subject of news articles in the financial pages of the world’s leading newspapers. Many investors recognize that ESG information about corporations is vital to understand corporate purpose, strategy and management quality of companies. It is now, quite literally, big business.

But what explains the remarkable rise of ESG investing and what does this mean for the future?

### **Why ESG Matters**

Cynics may argue that responsible investing is just a fad. But a closer look at the forces that have driven the movement over the past 15 years suggests otherwise.

First, technology and the rise of transparency are here to stay. Gathering and processing data will become ever easier and cheaper. Smart algorithms will increasingly allow for better interpretation of non-traditional financial information which seems to be doubling in volume every couple of years.

Second, environmental changes, in particular climate change, will with scientific certainty put a growing premium on good stewardship and low

carbon practices as natural assets will appreciate in value over time.

Finally, people everywhere are increasingly empowered by technology. ESG investing allows them to express their own values and to ensure that their savings and investments reflect their preferences, without compromising on returns.

## The Rise of ESG

The rise of ESG investing can also be understood as a proxy for how markets and societies are changing and how concepts of valuation are adapting to these changes.

The big challenge for most corporations is to adapt to a new environment that favors smarter, cleaner and healthier products and services, and to leave behind the dogmas of the industrial era when pollution was free, labor was just a cost factor and scale and scope were the dominant strategies.

- For analysts, ESG data is increasingly important to identify those companies that are well positioned for the future and to avoid those which are likely to underperform or fail.
- For individual investors, ESG investing offers the opportunity to vote with their money.
- For policy makers, it should be a welcome market-led development that ensures that the common good does not get lost in short-term profit making at any cost.

## Today's use of ESG

In terms of overall assets, the report says money managers as a whole incorporate ESG factors “fairly evenly” across environmental, social and

governance categories. Money managers incorporate social factors slightly more than environmental and governance criteria. As the report shows, social criteria incorporation by money managers increased 39% from 2016 to \$10.8 trillion in 2018.

Even so, “climate change” is identified as the most important specific ESG issue considered by money managers in asset-weighted terms; the assets to which this criterion applies more than doubled from 2016 to 2018, reaching more than \$3.0 trillion.

Further the report found that “conflict risk” was the leading social criterion at \$2.3 trillion assets under management, while assets managed with “human rights” criteria were next, at \$2.2 trillion.

Continuing a trend that began years ago, criteria related to climate change and carbon emissions remained the most important environmental issue for these institutions, affecting \$2.2 trillion.

According to the report, “public funds” represent both the largest value of ESG assets under management and the largest number of institutional investors incorporating some form of ESG in their investments. Insurance companies rank second in value of ESG assets under management, although only a few institutions are involved.

## ESG is Here to Stay

ESG investing has matured to the point where it can greatly accelerate market transformation for the better. As corporations and investors experience growing influence and power, their actions and decisions increasingly shape the future. Provided that political framework conditions based on openness and global rules do not deteriorate further, market-led changes will act as a force for good on a truly massive scale.