Introducing Sustainable "ESG" Investing

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Biography

Quintin has worked for actuarial and investment consultancy firms and a multi-national European bank, including wide experience in quantitative fund and risk analysis. He is a Fellow of the Institute of Physics, a Chartered Fellow of the CISI and a Chartered Wealth Manager. Quintin has applied skills gained from his Oxford University Physics Doctorate and while working in engineering to finance. He is the second UK graduate from the Sustainable Investment Professional Certification (SIPC) programme and joined P1 Investment Management in January 2017, founding their ethical and sustainable investing proposition.

Introduction

In a previous article, Quintin Rayer introduced ethical investment. In this follow-up article, he looks at sustainable investing with its focus on 'ESG' factors.

Different terms are used in ethical investing, such as responsible, sustainable or socially responsible investing (for definitions of these terms see [1]). Companies are encouraged to promote practices including environmental stewardship; consumer protection; human rights and support the social good [1], [2]. One focus is on environmental, social justice and corporate governance (ESG) issues.

Sustainable Investing

In sustainable investing, funds are directed into companies with business practices capable of being continued indefinitely without causing harm to current or future generations, or exhausting natural resources (i.e. not 'unsustainable'). A key definition for sustainable investing comes from the 1987 Brundtland report in which sustainability is defined as ensuring development meets the needs of the present without compromising the ability of future generations to meet their own needs [3]. The UN Principles for Responsible Investment (PRI), launched in April 2006 [4] linked sustainable investment with environmental, social and governance (ESG) factors [5].

ESG Investing

1. **Environmental**, including CO2 emissions, or carbon-intensity; forest and woodland degradation; pollution; usage of scarce resources; mining activities which generate toxic by-products; intensive agricultural methods and so on.

2. **Social**, including corporate social responsibility (CSR); child labour; modern-day slavery; hazardous and exploitative working conditions, including 'zero hours' contracts; aggressive corporate tax reduction methods; and displacement of indigenous peoples.

3. **Governance**; weak internal corporate controls may let management circumvent company policies, increasing risks of irresponsible behaviours, corruption and bribery. Weak governance may mean that non-executive directors do not hold executives in check, with possible damage to the company as well as the owners' interests, and increased risk of excessive executive remuneration.

Outsourcing and Externalisation

Companies may outsource production to countries or other companies operating less sustainably. A company might claim ethical operations, while not looking too deeply into its suppliers' practices. Best practice requires companies to scrutinise their resource chains and monitor the entire production process, from origin through to ultimate disposal of products after use.

The costs of production can also be externalised [6]. Companies consume resources and create waste. Ideally, all costs associated with resources consumed and waste disposal during manufacture would be included in the price of goods created, including disposal after use.

Externalising costs can also apply to forcing labour to subsidise activities and saving money with potentially health-damaging practices or inadequate wages. Failure to invest in appropriate governance and management structures can result in company staff undertaking activities boosting earnings, but with the tab ultimately being picked up by society or taxpayers. The company saves money on management and governance, while the taxpayer pays the cost of dealing with problems that may arise as a result. The company externalises these costs to the taxpayer when it should pay them itself.

Why this Matters

Individuals may recognise the challenges facing humanity as a result of threats such as global warming, as well as many social issues. Global awareness of corruption also raises recognition of the importance of good governance. Sustainable ESG investing is one approach to addressing these challenges.

Beyond retail consumer choices, more people are using ethical considerations to guide their investments as well. In February 2019, according to the Investment Association, there were £16.8 billion of assets in the UK ethical funds sector, an increase of £1.4 billion since February 2018 [7].

Sustainable investors select companies that help tackle the challenges of environmental, social and other problems while avoiding companies that engage in unsustainable behaviours. They use the influence of financial markets to reward companies with positive behaviours while reducing capital available to those participating in unacceptable activities. Individuals can direct their savings into ethical investment funds and can often make decisions regarding pensions savings so that these are also invested ethically. In short, ethical investors seek to "do well, while doing good".

References

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A new era for UKSA - update

Readers may recall from the front page of the last edition of The Private Investor that an initial meeting of Board representatives of UKSA and ShareSoc was to be held to discuss the framework for a merger of the two organisations.

That meeting has now taken place and provided positive recommendations for consideration by both Boards. UKSA's Chairman Colin Colvin intends to circulate a detailed update by the end of this month giving the reaction from the respective Board meetings.

UKSA Chairman Colin Colvin