ESG INVESTING – BREAKDOWN OR BREAKTHROUGH?

By Robert Rubinstein

In the age of pandemics we need to build an economy based upon well-being, not unbridled capitalism. How are we doing?

Great news! One of the largest pension funds in the world, ABP, has achieved its sustainability targets. We should celebrate, shouldn't we? Are massive money flows and claims of investment into ESG a sign of success, or are they a sign of failure? I believe ESG is just going slower in the wrong direction.

For several decades, ESG and Impact Investing have been heralded as the way to address societal and environmental challenges. However, the present state of affairs must bring into question the efficacy of this strategy. The following challenges seem insurmountable, particularly if we just look at Covid-19:

- Climate Change Destruction;
- Biodiversity loss;
- Water Shortage;
- Food shortage;
- Health Crisis (Diabetes);
- Income Inequality;
- Pollution;
- Threat of War;
- Covid-19.

And the list goes on.

One can only conclude that ESG and Impact Investing are either too weak and not effective, or they are not large enough, or the entire methodology of environmental, social, governance, and financial risk and reward needs to be redesigned.

Many asset owners and asset managers have signed the PRI and require Limited Partners (LPs) to sign these Principles as a prerequisite to get a mandate. LPs sign but rarely follow the guidelines and there is little to no oversight of those who sign.

If we look at 'Engagement' as a strategy to show whether an investment manager or asset owner is ESG compliant, we must conclude that this is fraught with problems. For instance, why are investors doing ESG or Engagement? Are they doing this to be part of the Fitness Club, even though they don't want to do the exercise? Are they doing this because they don't have to change anything and claim they are doing ESG? Are they doing this to create an economy based upon well-being? Or are they doing this because they feel it will increase the value of the company? I haven't seen much proof that Engagement increases the value of a company, or that it creates an economy based upon well-being, but it certainly does give an investor a box to tick and thus gives him an opportunity to be part of the club.

I recently did a roadshow in Asia and visited several family offices interested in ESG and Impact Investing. One family office in particular highlighted the problems with ESG. When I reached their office, I was shocked to see the sign of the company name, with Coal, Oil and Gas Trading in it. Those were the areas where the money was made in the past. Now, the family office wanted to move its assets to low to zero carbon investments and ESG as a strategy appealed to their values. They said to me: 'We don't understand ESG. How is it possible that very toxic companies score so high on the Dow Jones Sustainability Index? Shell and BP are carbon intensive, Pepsico is stimulating diabetes, Virgin Air is a CO_2 producer, Unilever produces unhealthy processed food and cosmetics." I had to explain that those reports and indexes only look at what companies report, not what they do. This is a major failing of ESG analysis.

The most important question is whether we can improve society and the environment with liquid assets. Most companies in the world are not on the stock market and most of the listed companies have huge stranded

Figure 1: Growth of sustainable investing assets by region in local currency 2014-2018

	2014	2016	2018	Growth Per Period		Compound Annual Growth Rate (CAGR) 2014–2018
				Growth 2014–2016	Growth 2016–2018	
Europe	€ 9,885	€ 11,045	€ 12,306	12%	11%	6%
United States	$ 6,572	$ 8,723	$ 11,995	33%	38%	16%
Canada (in CAD)	$ 1,011	$ 1,505	$ 2,132	49%	42%	21%
Australia/New Zealand (in AUD)	$ 203	$ 707	$ 1,033	248%	46%	50%
Japan	¥ 840	¥57,056	¥231,952	6692%	307%	308%

Note: Asset values are expressed in billions. All 2018 assets in this report are as of 12/31/17, except for Japan, whose assets are as of 3/31/18.

Source: Global Sustainable Investment Review, 2018

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assets in old carbon intensive technologies of which investors and lenders won't write down the value. If institutional investors and the Central Banks were serious about reducing CO_2 and about social and environmental destruction, much more money would go into public transport infrastructure, net zero carbon real estate, the secondary market of Development Finance Institutions, Private Equity and Venture Capital. There is no shortage of ways to achieve returns and to have concrete social and environmental benefits. Here are a few:

- Zero Emission Real Estate (New and Retrofit);
- Public Transport Infrastructure;
- Fuel Free Energy;
- Carbon Sequestering (Redd+ and Blue Carbon);
- Invest in the two largest employers in the world;
- Food & Social and Environmental Positive Hospitality;
- Water;
- Affordable Healthcare;
- Climate Resilient Cities;
- Living Wages.

With Wall Street experiencing the largest losses in the shortest period of time due to the coronavirus, some are asking, 'is this the end of Capitalism in its present form?'

Equally, some fear that ESG and Impact Investing (Sustainable Investing) will fall out of favor during this period of hunkering down. But now more than ever, creating an economy based upon well-being is absolutely critical. Investing in companies that integrate social and environmental risks and work for stakeholders, and not just short-term shareholders, will prosper. But we need a fundamentally different approach to ESG and Impact.

We need a society that is resilient and provides a support mechanism for the entire population. This will allow the economy to weather these storms and prevent outbreaks of pandemics and societal collapse.

Various reports and agreements have been instrumental in growing the market. But the big driver of ESG and Impact Investing is resource depletion from emerging markets' economic growth.

Lester Brown, of Earth Policy Institute, has highlighted the stresses coming from China's growth. At 8 percent growth, China would reach US consumption levels in 2030. This would translate to an oil consumption of 60 million barrels per day for China (whereas the present consumption worldwide is about 84 million barrels per day). This massive commodity requirement is even worse if we look at grain, iron ore, paper, coal, steel, and meat. If we next add India to the mix, and then the other three billion in emerging markets and the developed world, one can see that linear growth is not possible at this level of inefficient use of resources. We won't have enough.

'The Western economic model — the fossil fuel-based, automobile-centred, throwaway economy — will not work for China,' says Brown. To avoid conflict for resources, the real opportunity for the financial sector is a massive drive for resource effectiveness or efficiency, which is what sustainability is about. Doing more with less. This also translates into more profitability.

It seems that only true ESG and Impact Investors understand the big picture and the need to look at all risks and returns. This will only grow. Let's face it - a society where businesses' main focus is profit maximisation at the costs of society and environment, is a strategy doomed to fail. «

Photo: Archive TBLI Group

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This article was written by Robert Rubinstein, CEO and Founder of TBLI Group.

Further reading: Articles critical of present system

Impact Investors Want More Data and Less Spin From Financial Companies: https://karmaimpact.com/impact-investors-want-more-data-and-less-spin-from-financial-companies/;

Green recovery can revive virus-hit economies and tackle climate change: https://www.reuters.com/article/us-health-coronavirus-economy-idUSKBN22G2Z7;

New Study Shows That Signing Responsible Investment Principles Doesn't Mean Better Sustainability — or Better Returns: https://www.barrons.com/articles/new-study-shows-that-signing-u-n-principles-of-responsible-investment-doesnt-mean-better-sustainability-or-better-returns-51588507200