

Sustainable investing: How to do it?

Dirk Schoenmaker, Erasmus University Rotterdam & Bruegel

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1. Why sustainable investing?
2. Corporate objective: from shareholder (F) to stakeholder (F, S, E) model
3. Can investment approaches cope with broader perspective?
 - Neo-classical finance: only F dimension in market metrics
 - Answer: adding ESG factors to market metrics?
4. How to do it: new investment approaches
 - Need to analyse company's business model to uncover S + E
 - Fundamental investing

Based on book

Sustainability journey:

Part 1) **why**: sustainability challenges

Part 2) **what**: sustainable companies

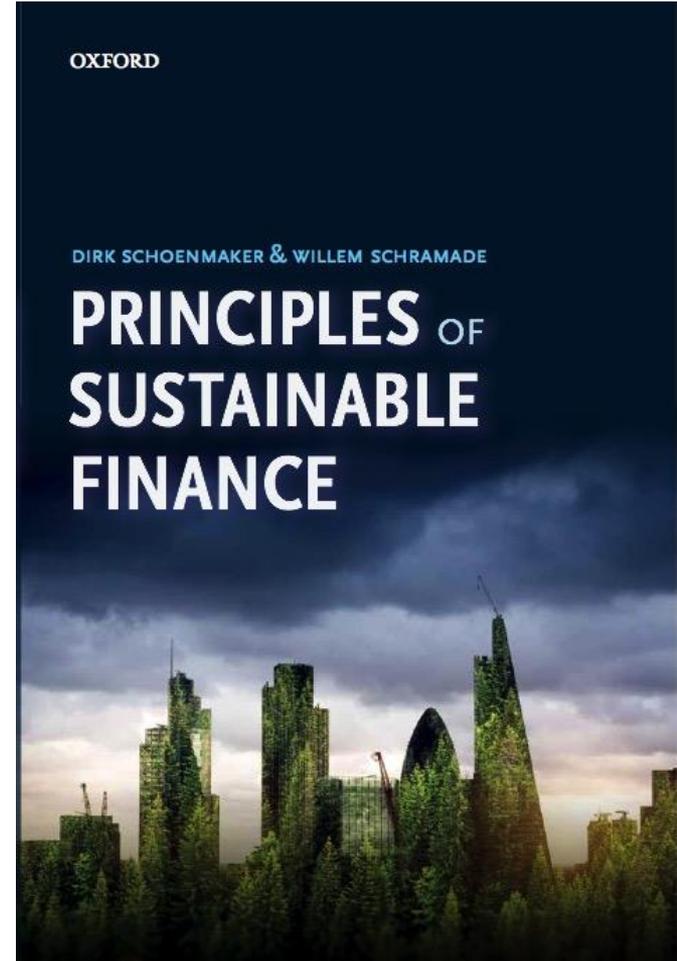
Part 3) **how**: financing of sustainable companies

Part 4) **transition** to sustainable finance

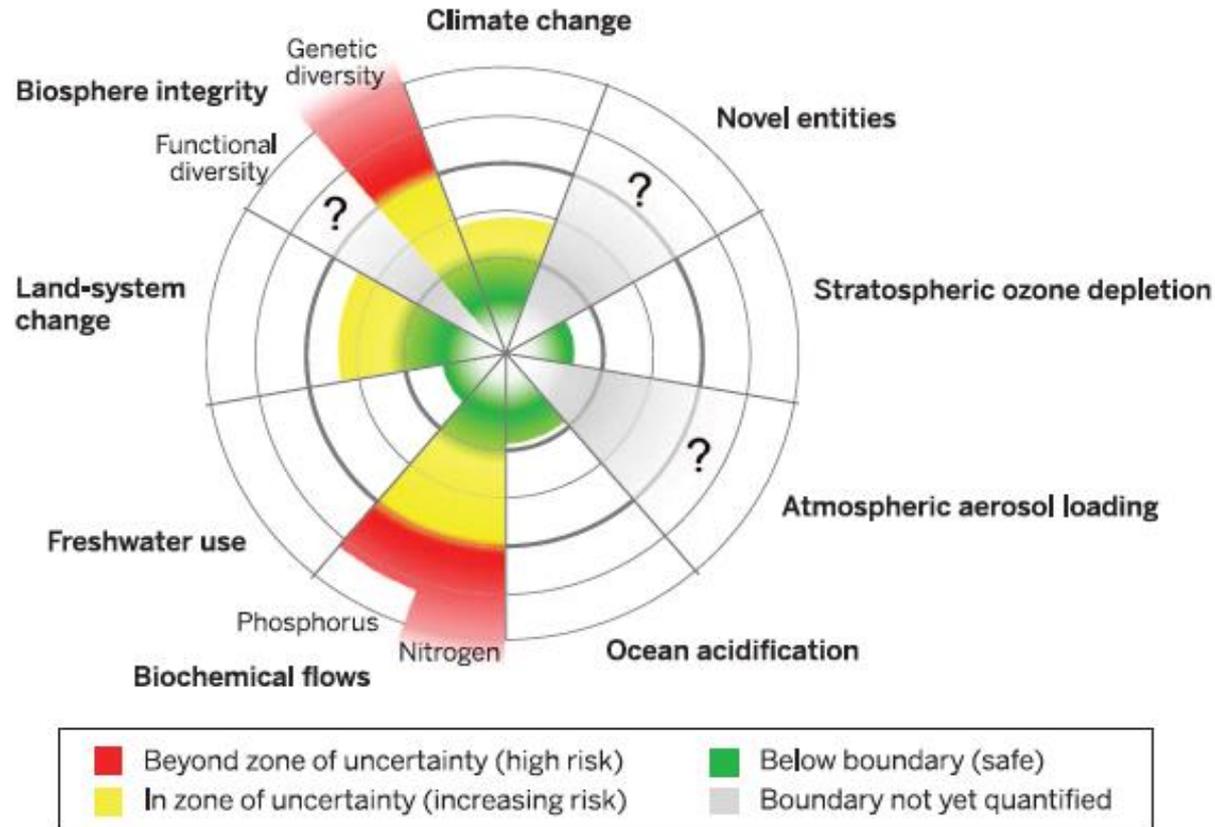
Key message:

From maximising profit **F**

To maximising integrated value **I = F + S + E**



Planetary boundaries framework



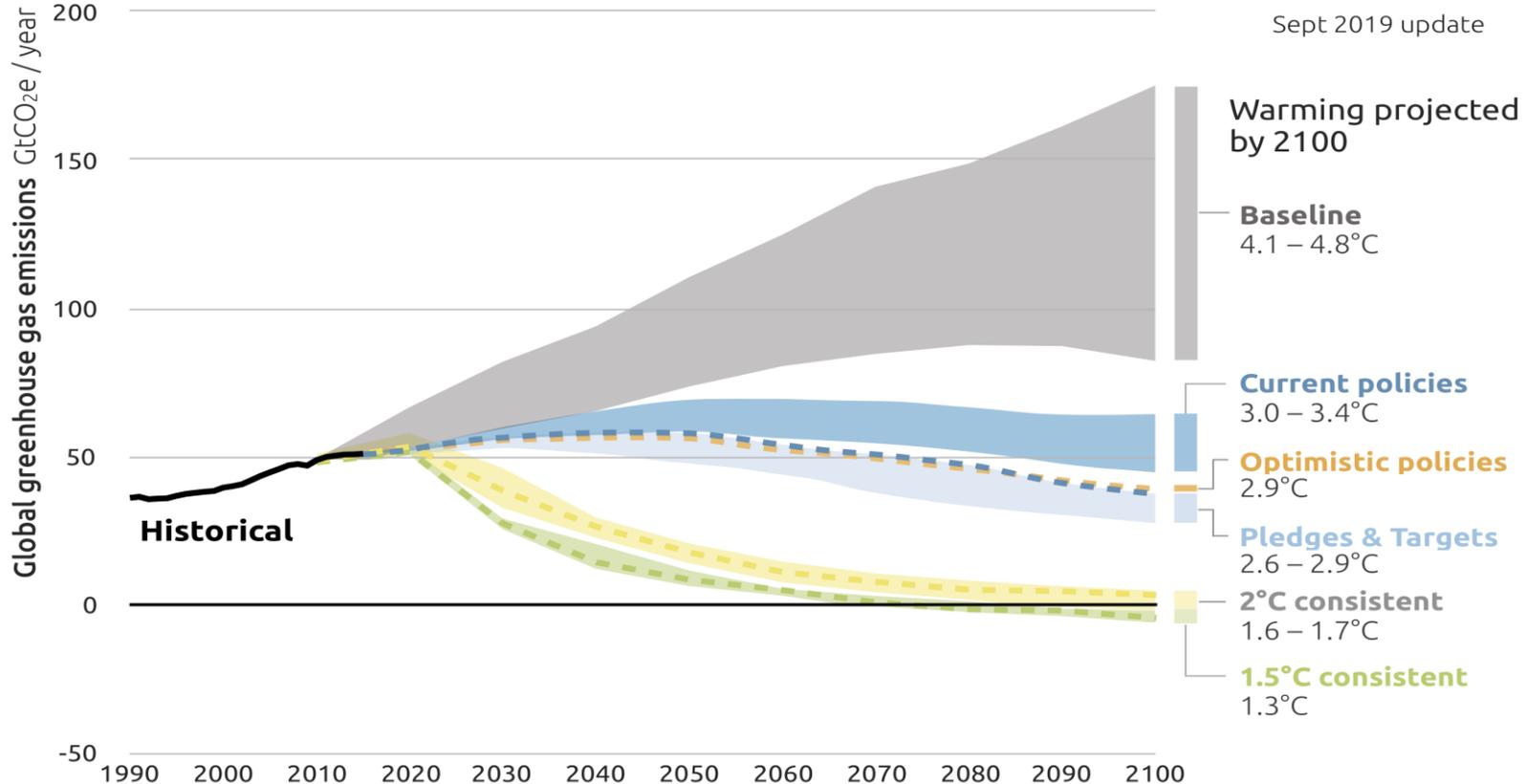
Climate policy gap



Sept 2019 update

2100 WARMING PROJECTIONS

Emissions and expected warming based on pledges and current policies



- Food security (no hunger)
- Adequate income (no poverty with income of less than \$3.10 a day)
- Access to health care and water
- Access to energy and clean cooking facilities
- Education
- Decent work (living wage)
- Gender equality and social equity
- Political voice: right of people to be involved in decisions that affect them

Many people **live below** these social foundations

Global goals for sustainable development

1 NO POVERTY



2 ZERO HUNGER



3 GOOD HEALTH & WELL-BEING



4 QUALITY EDUCATION



5 GENDER EQUALITY



6 CLEAN WATER & SANITATION



7 AFFORDABLE & CLEAN ENERGY



8 DECENT WORK & ECONOMIC GROWTH



9 INDUSTRY, INNOVATION & INFRASTRUCTURE



10 REDUCED INEQUALITIES



11 SUSTAINABLE CITIES & COMMUNITIES



12 RESPONSIBLE CONSUMPTION & PRODUCTION



13 CLIMATE ACTION



14 LIFE BELOW WATER



15 LIFE ON LAND



16 PEACE, JUSTICE & STRONG INSTITUTIONS

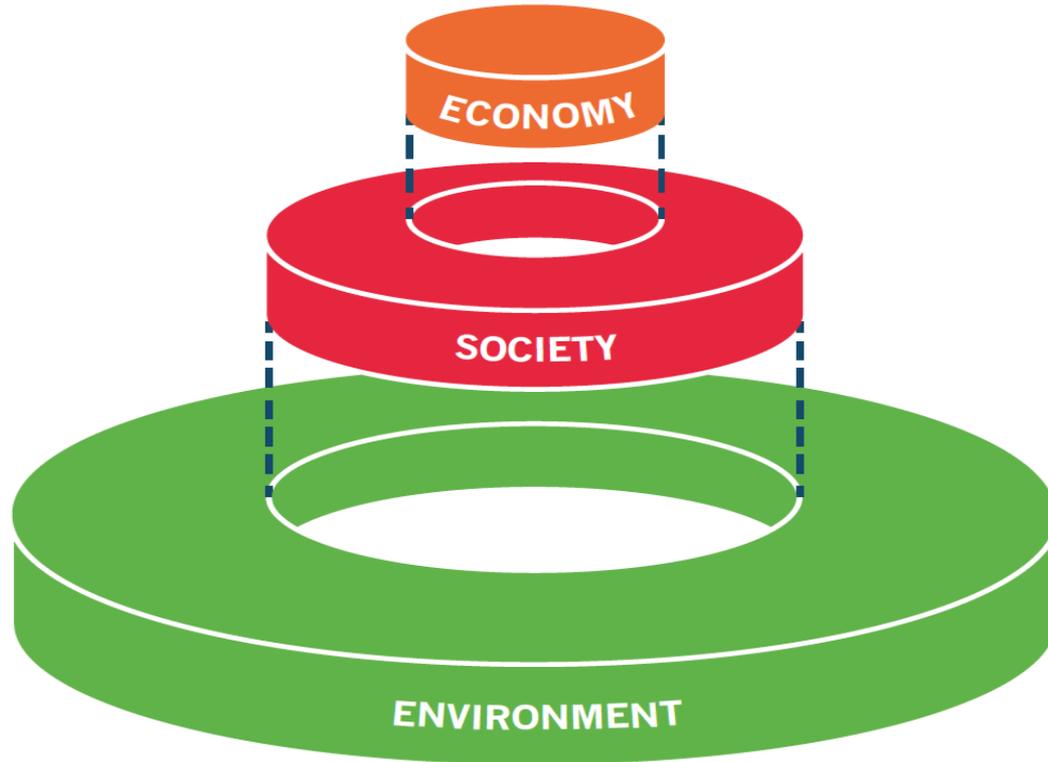


17 PARTNERSHIPS FOR THE GOALS



SUSTAINABLE
DEVELOPMENT
GOALS

Managing sustainable development



▶ financial return and risk: **F**

▶ impact on society: **S**

▶ impact on environment: **E**

Perspectives on externalities

Economist:
a public good which is not
priced



Human rights advocate:
ensuring every person's
claim to life's essentials



Ecologist:
need to operate within
planetary boundaries



➤ Sustainable development: $I = F + S + E$

Principles of sustainable finance

Sustainable Finance Typology	Value created	Ranking of factors
Finance-as-usual	Shareholder value	F
Sustainable Finance 1.0	Refined Shareholder value	F > S & E
Sustainable Finance 2.0	Stakeholder value	S & E > F
Sustainable Finance 3.0	Common Good value	S & E > F

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PRINCIPLES OF SUSTAINABLE FINANCE



Blind spots of the financial system

Integrated value of tobacco companies:

+ Profit

+ Employment

- Premature death

- Extra costs

healthcare

Net negative

Financial system

only notices:

+ Profit

Net positive

Why integrate sustainability?

Why would financials and corporates look at sustainability?

- Anticipation of regulation / taxation (e.g. carbon tax)
- Reputation – pressure from NGOs / consumers
- Future-proof: transition to SDGs by 2030
- Moral responsibility of financials and corporates

Main transitions

- Energy transition
- Circular economy
- Natural food/land restoration

Government policies may be fast or slow

- Transition is about true price and re-employment

Question for investors

- Are investee companies prepared for the transition?

How to do sustainable investing?

HLEG (2018): fiduciary duty of investors

- Yes, excellent to include sustainability in fiduciary duty

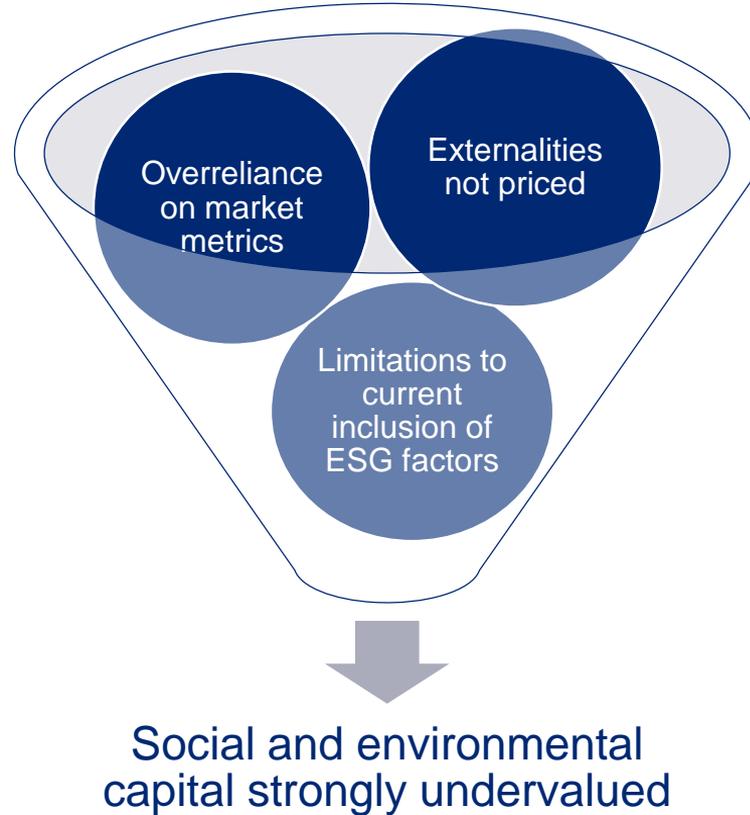
Who should be leading sustainable investments?

- HLEG (2018): taxonomy of sustainable investments – no, administrative approach by officials
- Our proposal (2019): market-led approach through fundamental investing

Traditional versus long-term investing

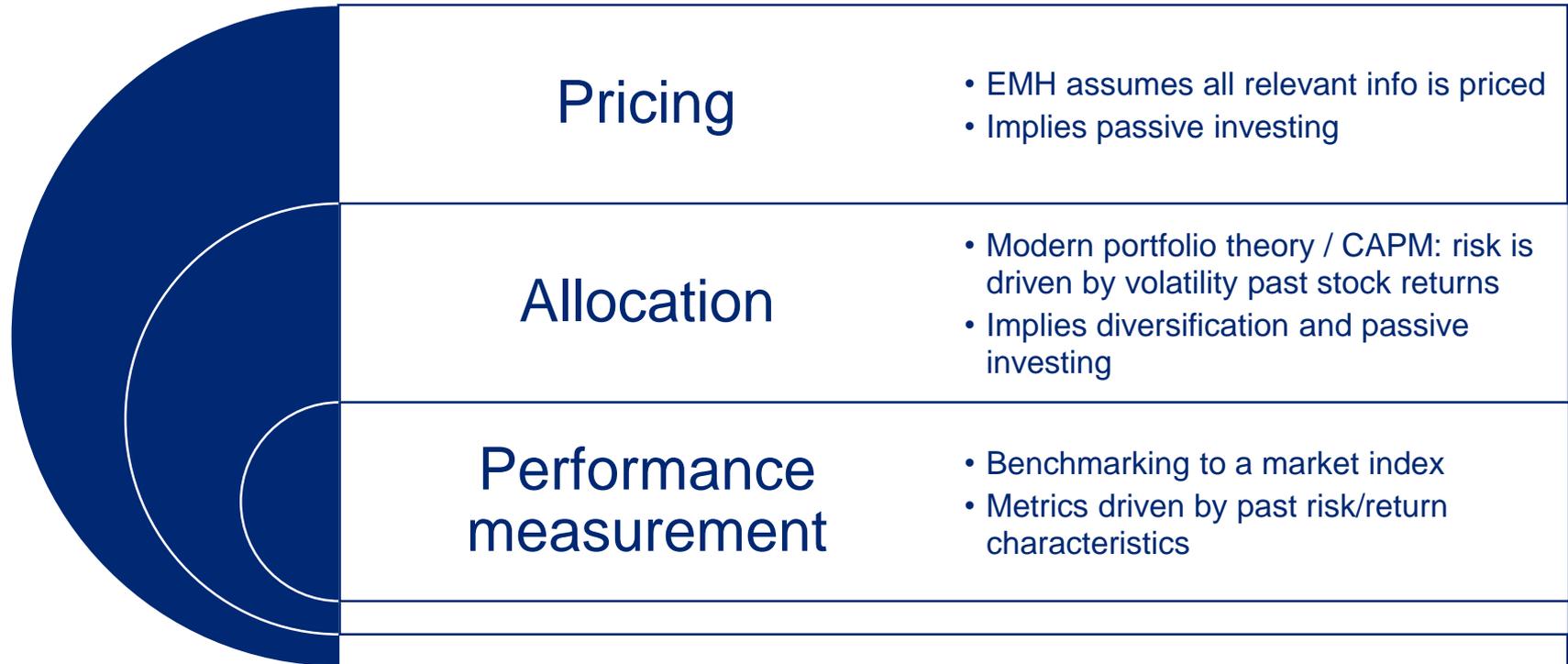
Dimension	Traditional investing	Long-term value creation
Typology	Sustainable Finance 1.0	Sustainable Finance 2.0
Market framework used	Efficient Markets Hypothesis	Adaptive Markets Hypothesis
Pricing of S and E dimension	Irrelevant or already priced in	Priced as market participants learn
Value maximisation	Max F	Max I = F + S + E
Value indicator	Earnings per Share (EPS)	Sophisticated DCF with scenarios for internalisation
Portfolios	Extremely diversified	More concentrated
Dialogues with corporates	Limited	Deep
Performance horizon	12 months	Years or decade

Current financial system fails to achieve societal goals

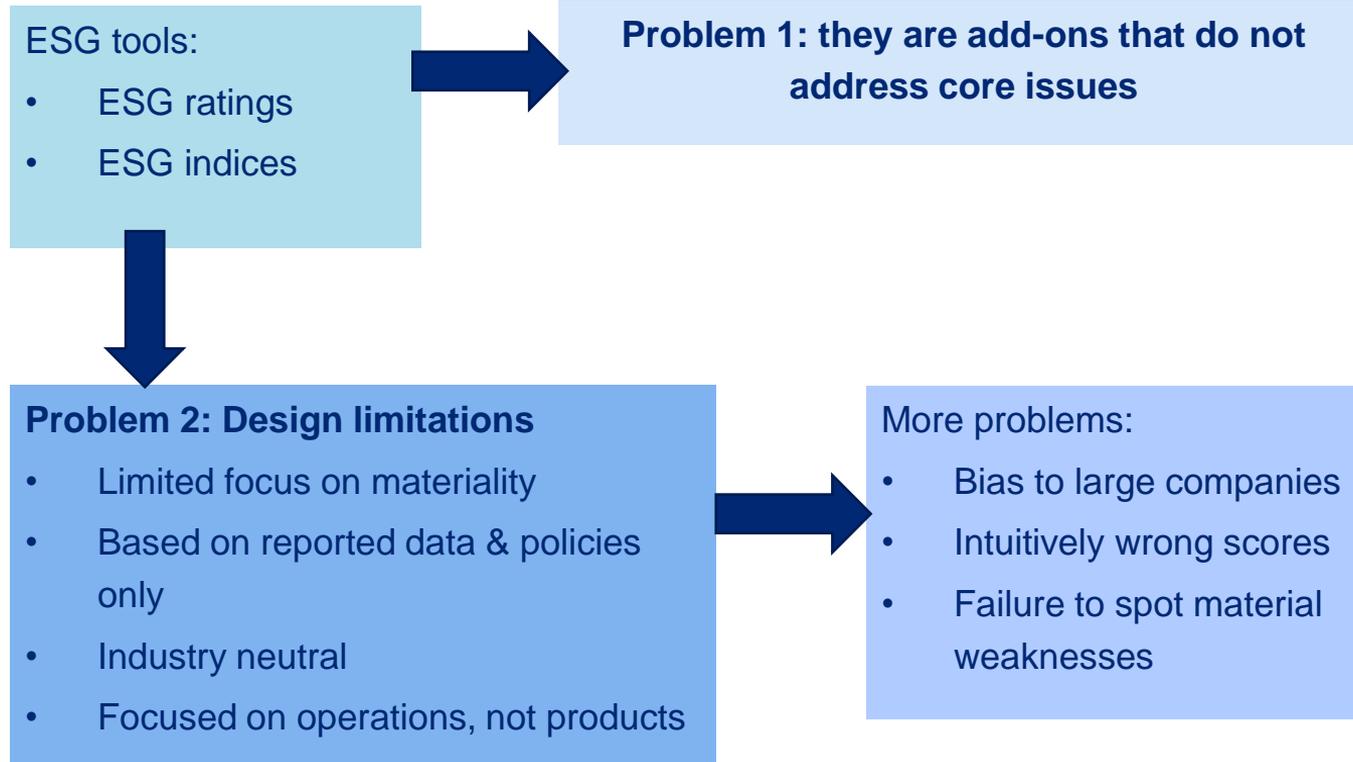


Overreliance on market metrics (F dimension)

Current investment practices have no role for E and S: unrealistic in a full world



Limitations to approaches for inclusion of ESG factors



Solving it with an active investing approach

Pricing: from EMH to AMH

Allocation 1) from ESG factors to fundamental sustainability analysis

Allocation 2) from extremely diversified to more concentrated portfolios

Engagement

Alternative measures of performance

Pricing: from EMH to AMH

EMH

Instantaneous incorporation
of all relevant information

All ESG information is either
irrelevant or already priced

Unrealistic

AMH

Degree of market efficiency
depends on market ecology

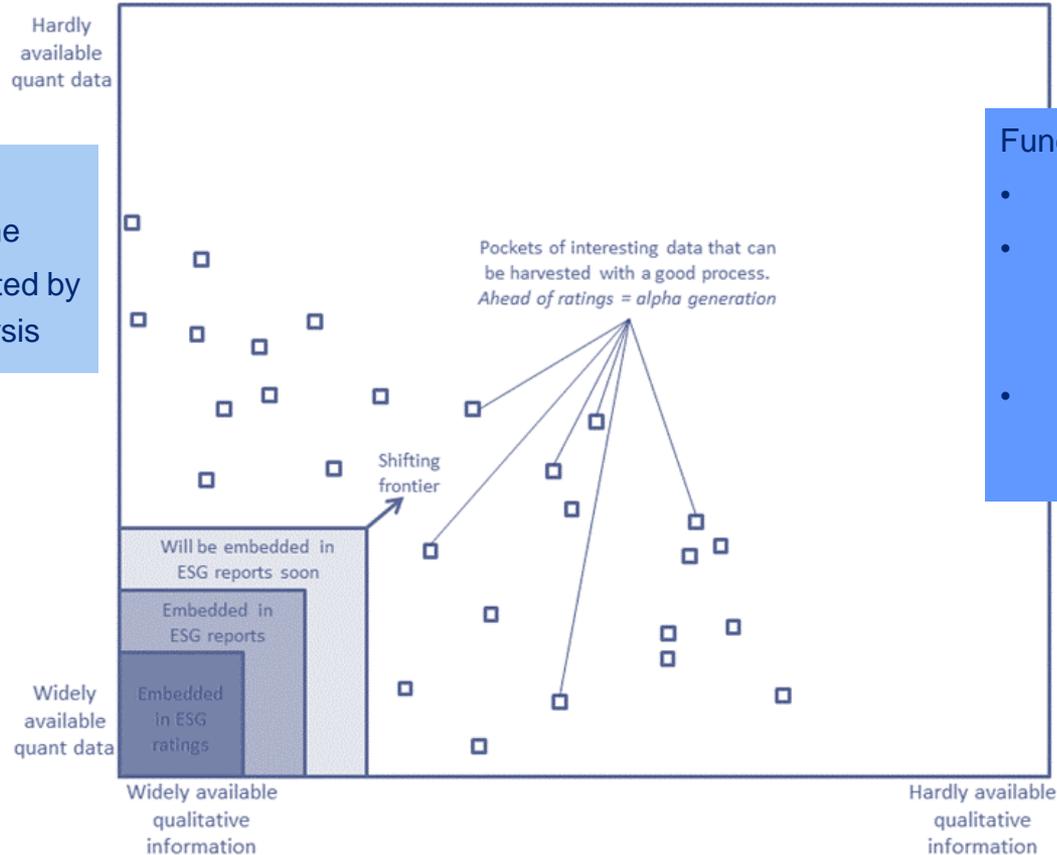
Pricing of ESG information
depends on the number and
quality of market participants
that take ESG seriously

Plausible

Allocation 1) from ESG factors to fundamental ESG analysis

ESG factors

- should improve over time
- Need to be complemented by fundamental ESG analysis



Fundamental ESG analysis:

- Materiality assessment
- Hit investment process in all stages – including valuation
- Challenges: mindsets and data – see chapter 8

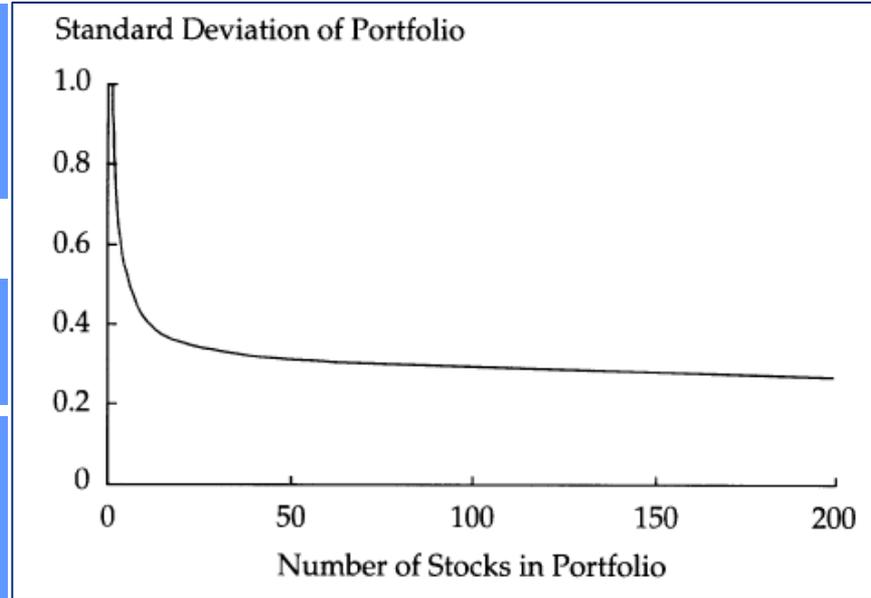
Allocation 2) from diversified to concentrated portfolios

Pension funds may hold thousands of different securities



Serious engagement not feasible...

... while not necessary from a diversification perspective....



Investors and corporates to exchange funds & ideas:

- Pressure to end unsustainable practices
- Improve reporting
- Share best practices

Engagement is costly:

- Time intense
- Requires deep knowledge, patience & coordination



Ideally:

- Integrated process from analysis and selection to engagement
- Integrated teams for portfolio management and engagement



Engagement in practice:

- Not feasible for large portfolios
- Shallow (disconnected from investment case) and/or narrow: voting, not dialogue

Companies:

- Financial reports

Investors:

- Benchmarking performance to market index (relative returns)

Sustainability

- ESG ratings



Investors:

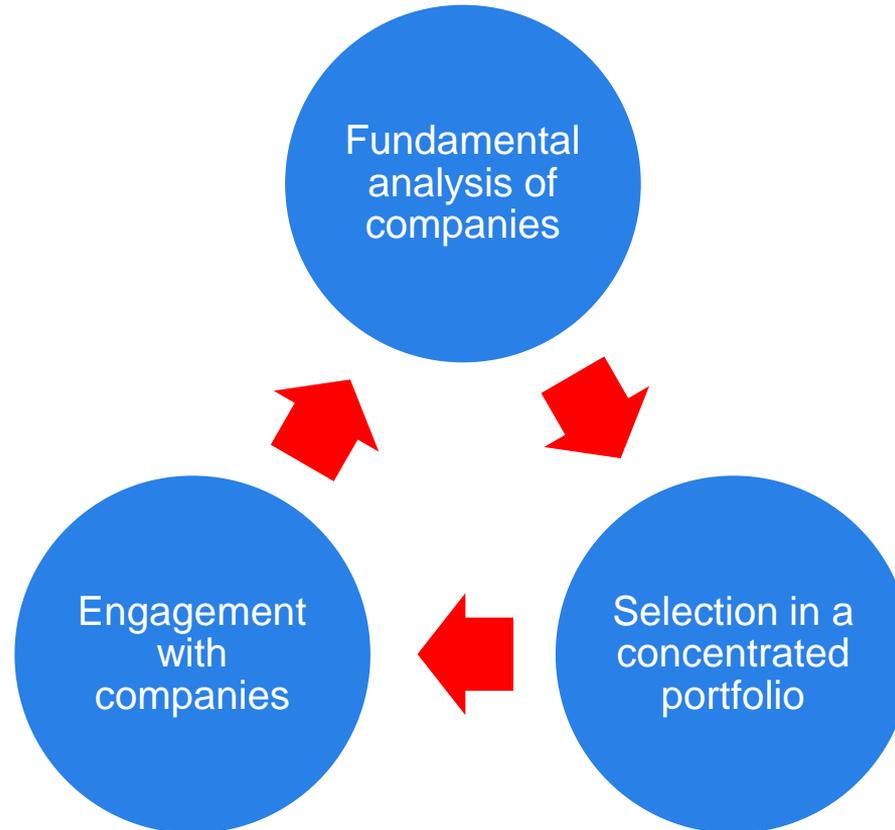
- From ESG (input) to SDGs (output: impact)
- Absolute returns



Companies:

- Integrated reporting is slowly emerging
- Examples:
 - Philips Annual Report
 - ABN AMRO Impact Statement

Virtuous cycle of sustainable investing



Does sustainability reduce financial return?

- Finance: Yes, because you reduce the universe of investments
- Ethics: Yes, you forego return by doing good

New paradigm

- By focusing on material ESG issues, you can get higher (or equal) financial return
- First academic studies are emerging (see Chapters 8 to 10 of the book)

Conclusions

Long-term value creation to achieve SDGs

- From narrow F dimension
- To integrated value: $I = F + S + E$

Finance is about anticipating events and pricing them in today

- Finance contributes to swift(er) transition
- Need for LT patient capital

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