Environmental, Social, and Governance Investing as a Solution to Responsible Growth Problems

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(The following is an excerpt from a larger project.)

Introduction

Environmental, Social, and Governance (ESG) investing attempts to incorporate the very same three themes into market research and stock selection. As a subset of Sustainable, Responsible, and Impact (SRI) investing, the goal of ESG investing is to accumulate returns while also accomplishing some sort of moral good, or at least avoiding some evil. The investing focus remains relatively new and has been defined as investor driven. However, given both the catalyst and ad hoc nature of ESG strategies, there is limited convergence in the defining of terminology and focus. This means that there is considerable room for variation in ESG products and from this perspective, ESG may or may not meet investor expectations. This paper will examine the goals and impacts of ESG investors, and delve into whether the investors are right to claim a moral high ground over traditional fund managers. This topic is especially relevant today as ESG has grown by more than 97% globally in the past 20 years (Skroupa, 2017). ESG investing now accounts for trillions of dollars, and there are thousands of funds who claim to be ESG compliant, each with a different definition of what they are claiming.

As someone interested in working somewhere along the spectrum of SRI investing, an analysis of ESG criteria and their efficacy helps me to both narrow down where I would like to work and get a better understanding of the industry. More importantly however, I want to work in SRI because I want to enact positive change on my community and the world using the finance industry. Analyzing ESG’s actual impact on communities and corporations gives insights into whether they fit my career goal. This paper is not a personal investigation though. The perspective held in the discussion is that both institutional investors and regular individuals making investment choices can benefit by increasing their knowledge of ESG’s strengths and drawbacks.

Summary Comments

ESG investing can be a valuable tool to leverage money to create societal change, and upgrade the quality of an investment portfolio. It provides risk management benefits if used properly. When deciding how to use ESG funds, investors must first find funds that match their goals, as ESG definitions vary wildly. Investors should also look for more active funds that work to directly fund change. They should keep in mind however, that the more active an ESG fund gets, the more likely it is that the fund is no longer considering ESG as a risk management tool, and the returns on fund holdings may, as a result, be negatively impacted.

The decision to think sustainably while investing is one that more individuals and institutions employ now more than ever before; however, the rationale for the focus on ESG is heterogeneous. Additionally, the lack of consistency in the defining of the parameters that constitute ESG, the proprietary nature of screens for ESG and the investor led deployment of ESG maybe short-term obstacles to an understanding of the focus of ESG investing. As the space continues to grow, there is general belief that there will be a convergence of expectations and decision-making criteria. Further, as investor interest in ESG continues to increase, there is reason to believe that ESG investing will play a key role in shaping our world in the years to come.