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The ABCs Of ESG: Reflecting Today's Investor Values


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What do the climate activist Greta Thunberg and the failed **WeWork** IPO have in common?

For corporate officers in the current economic environment, the link between a hard-partying entrepreneur and a teen activist who's grabbed the mantle of leadership on raising concerns about climate change is how investors see them. At a time when it's vital to look beyond shareholder interests and expand a sense of obligation to all stakeholders, Neuman and Thunberg sit in nearly exact opposition to each other.

A quick scan of the headlines shows a changing world, where viewpoints that were previously marginalized are getting plenty of attention. Public companies – or those considering raising capital – must take notice and demonstrate that they can adapt to both regulatory shifts and a new, more nuanced set of investor values.

To illustrate this phenomenon, look at the momentum for corporate statements that address environmental, social and governance principles – the ESG factors. As these criteria become part of a new corporate standard, they are being scrutinized for their substance – and investors are making serious decisions about their capital commitments based on how companies walk the walk, not just talk the talk.

At a recent **Citigroup**-sponsored **Investor Relations Academy** conference in New York, ESG took center stage for a full day of the weeklong event. Discussions focused on activist investors, and panel discussions, industry leaders and global experts addressed these issues in depth.

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WeWork's failed IPO is actually a reflection of bad business practices and a lack of ESG principles, particularly the questionable conduct of former CEO Adam Neuman. When governance issues are enough to sway billions of dollars in investment capital from firms such as Blackrock and Vanguard, it's clear there's a deepening, direct relationship between investor perception and investor support.

The plunge in WeWork's fortunes provided a timely– and shockingly expensive – example of what can happen when ESG issues aren't adequately addressed. The company lost $39 billion in pre-IPO valuation since the stock listing was scrapped and Neuman was removed in September.

In her scalding address to the **United Nations General Assembly**, teen climate activist Greta Thunberg posed her concerns about global warming as an issue that affects the rich and the poor, the smallest nations and the largest superpowers, the humblest home businesses and the largest multinational corporations, modern corporate leaders must consider the interests of all their stakeholders – not just the shareholders who stand to profit.

Corporate leaders seeking capital from a global shareholder base must similarly acknowledge their global stakeholder base and internalize the requirements and standards of ESG principles. The rise of activist investors on the one hand and the increase in capital allocation to passively managed funds are a potent combination that must be heeded. Activists will seal the fate of companies whose management won't engage with them or can't showcase the visibility and importance of shared values.

There's substantial capital backing true diversity across gender and ethnic lines, and an awareness of corporate environmental impact. Passively managed funds will take care of the rest, by making investment decisions based on algorithms and eliminating any emotional aspect to an investment decision.

As ESG and its philosophical counterpart, socially responsible investing (SRI), get quantified, those evaluations will affect investment decisions whether they're made by active managers or algorithmic trading models. According to **J.P. Morgan Chase & Co.** research, in the first half of 2018, nearly $23 trillion was invested in funds with socially responsible investment principles. The **2018 Global Sustainable Investment Alliance Review**, which tracks SRI in the five major global markets, found $30.7 trillion in SRI-conforming assets under management at the start of 2018, a 34 percent increase in two years.

In the last decade, SRI investments under management have more than tripled in net asset value. It's not just major institutions putting their money where their values are. As ESG-based exchange-traded funds proliferate, ESG-based ETFs grew to $11 billion in capital and there is a clear indication, backed up by capital flows– that this combination of "values" investing is consistent with better, longer-term investment practices, suggesting this will turn from a trend to a prevailing set of shifted values. To understand these changes and help companies approach ESG with a long-term, global sensibility, we offer these suggestions:

Emphasize the importance of ESG values in every corporate department. Incorporate these principles in addressing corporate governance, environment and societal impact throughout the company, and educate executive leadership to help ESG become part of the corporate DNA at every level of the organization.

Make your ESG principles credible and substantive at first glance – that's what investors expect.

Specifically, investors will see an all-male board of directors, or one that features a single woman, as out of date with forward-looking Wall Street sensibilities.

Choose to focus on several ESG criteria that are relevant to your company specifically and highlight how you intend to implement ESG-related changes on a clear, concise timeline.

Explain to investors how achieving ESG-related benchmarks is connected to management incentives and communicate those expectations to all stakeholders.

Be sure to include directors when the company makes significant announcements. Make directors available when large investors wish to meet with them and coordinate these strategic moves to make sure investors' voices are reflected in the way that the company operates.

Be sure to include any ESG-related steps you have taken in your investor presentation, IR website or communication to investors and be fully prepared to answer questions on the topic.

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