Sustainable, Responsible and Impact Investing

Podcast Episode #2 for January 2022 – Host Only, No Guest

[Host]

Hello everyone, thank you for joining us for a new podcast episode For Her. My name is __________, and I'll be your host for today's segment. In this episode, I am going to introduce a topic that is being discussed more and more these days but not everyone fully understands – I'm talking about socially responsible investing.

Do you live your life according to your ideals and values? Do you believe in giving back to your community and are passionate about protecting the environment? Do you want a safe, sustainable and equitable society for your children and your grandchildren? What if you could make investment choices that support your financial well-being and your personal values?

Sustainable, Responsible & Impact Investing may be exactly what you're looking for! There continues to be a growing demand by investors globally for investments that consider environmental, social and governance factors in the selection and managing of investments, all while offering competitive returns.

Now there's a lot of different terminology that I am going to be covering today. Some terms are used inter-changeably…correctly, and some incorrectly. So I will try to help make heads and tails of all these for you today.

Sustainable, Responsible and Impact investing, acronym is SRI, also used for Socially Responsible Investing, allows you to be socially responsible in your investment choices. If you are concerned about environmental and social issues and believe that your investment choices can make a positive change, you're not alone. Women not only tend to use their philanthropic power to give to causes they feel passionate about, but they also are more likely to invest in ways that reflect their social and environmental values.

Companies that place high value on better Environmental, Social and Governance practices, the acronym commonly used here is ESG, are said to be better at managing risk and opportunities. If they are properly managing these challenges, they should have less risk of disasters, scandals and lawsuits that can impact its share price and value. These companies consider their environmental impact, address social concerns within their communities, and operate with strong and transparent corporate governance structure. SRI professional fund managers choose to invest in these companies.

There are several ways to be a socially responsible investor. An SRI portfolio manager can use negative and positive screening which means it either excludes or includes companies in a portfolio based on higher ESG performance compared to its peers.

Negative screening excludes companies based on specific ethical criteria, for example: weapon manufacturing, alcohol, tobacco or companies operating in oppressive regimes.

In the case of positive screening, think of companies that are corporate sustainability leaders – that are committed to and set positive examples that contribute to the environment or add to the community. Some examples of positive screening would include companies that ensure equal opportunities for employees, support forestry sustainability and clean water treatment.

Therefore, we can say that socially responsible investing, SRI, is a well-defined framework for choosing investments based on environmental, social and governance, ESG, criteria. Some might argue that impact investing has evolved out of SRI to the broader investment community. The difference today is that impact investors are far more proactive in their intention for positive impact as opposed to merely avoiding the negative impacts.

Historically however, this isn't all that new. In the 19th century, the Methodist Church refused to invest in slave labour- and tobacco-related industries and similar companies. The Vietnam War of the 1960s and 1970s saw a resurgence of themed investments, with student demonstrators trying to force disinvestment from war-related industries. A similar disinvestment pattern was highly effective against Apartheid in South Africa. In other words, highly aware investors who examine the nature and conduct of the companies they invest in have been around for some time. So, the resurgence of SRI's can simply be referred to as a revised modern version of a pre-existing investment methodology.

Before we go ahead, I would like to dwell more on the criteria of ESG which seems to stand fundamental in the process of sustainable investing, let us detail the E, S, and G factors-

Environmental (E) - As the name suggests, these factors impact the environment and take into account the company's practices to reduce carbon emissions, have a sound waste disposal system, and a lot of focus on energy and water conservation. Basically, a strong focus on a greener environment.

Social (S)- This factor focuses on the well-being of the company's employees and society. An S-compliant company will take care of factors like employee welfare, gender equality, pay parity and regularly contribute towards other relevant social causes.

Governance (G)- Corporate governance is the core of this factor as it emphasizes regulatory compliances, grievance redressals, effective whistleblower policies, ethical conduct, and strong internal controls against wrongdoings. Some funds even look at corporate board compositions to ensure there is both gender and racial diversity on the Board of Directors for the organization.

The level of compliance to ESG standards can be determined with the help of an ESG score allotted to companies by research organizations like MSCI and Morningstar. The scores determine the level of ESG compliance for companies and are dynamic in nature, meaning with the changes in regulations, standards, and the company's own initiatives, the scores can keep changing.

The MSCI ESG score reflects how well the companies manage their ESG risks versus their peers. So, a company with a score of AA and AAA will be an industry leader in terms of managing its ESG risks and so on.

Morningstar's ESG score measures the ESG risk associated with that particular company or mutual fund. The score is provided on a scale of 1 to 50, with 1 being the lowest risk and 50 being the highest. Morningstar also provides a breakup of E, S, and G scores.

However, you, as an investor, need not be worried about the details of how these scores are calculated. But when deciding which ESG Fund you want to invest in, a comparison of the scores can give you an idea about which fund is better rated and why that is. This is where you will want to speak to your financial advisor, inform them of your values and let them help you in finding the right investment that aligns with your values and of course is aligned to your overall financial planning requirements.

Even with that suggestion, I know many may still end up with piles of background research, which is fine, it helps your learning process. But there's a lot to cover and you likely can't spend the time a professional can on researching and comparing all the required details. I have got you covered on that end as well. I will be enlisting a rational analysis of a narrowed down number of funds.

Just as you have joined this podcast today, this will also help your learning – so let me get back to it.

To ascertain how thoroughly a fund takes into account environmental and social issues, before investing you should evaluate whether or not the following factors or standards are being fulfilled:

- Fund purity
- Quality of the Environmental, Social and Governance (ESG) approach;
- Transparency;
- Voting and commitment policy
- Sector and normative exclusion policy

Simply put, ESG focused companies have the potential to generate more wealth for stakeholder by:

Lower Risk: Strong ESG focused companies tend to have an above average risk management mechanism that helps in lowering the probability of any extreme events from taking place.

Improved financial performance: Strong ESG Integration into business practices can lead to companies with grater competitive advantage over others, which generally translate into higher profitability and higher free cash flow to the companies.

Improved Valuation: Companies with strong ESG integration have shown to command higher/premium valuation, as strong ESG practice leads to a lower cost of capital and higher cashflow which in turn translates to higher valuations.

Higher Return to Shareholder: Shareholder can aim to enjoy higher return on their investment with companies who have strong ESG practices simply because of higher valuation, lower probability of occurrence of extreme event and long-term competitive advantage.

Just to clearly outline my point here - ESG is not necessarily ethical or values based investing, it's a tool to enhance risk adjusted returns - a very powerful tool. And I don't think it's long before ESG integration will be considered table stakes even part of traditional investment analysis.

But socially responsible or ethical screening with positive or negative screens is sort of the next level. Negative screens can tend to be values based, such as tobacco, slave labor, slave labor, even fossil fuels. Positive screens, means purposely investing in companies, moving them in the right direction on an environmental, social and governance basis – I'm just reiterating what I had mentioned before as I know this is a lot of information.

Now a question I hear often is why this is a hot and popular topic among women?

Responsible investing can improve the risk reward equation for investors. And that's fabulous in of itself. It makes sense for everybody, not just for women. But there's more to it. Like money is power, and with power comes responsibility. And I think that's the key for women. Many women feel responsible not only for themselves, we feel responsible for our children, our wider families, our communities, even our co-workers. So, it's not surprising to imagine that women could have a heightened sense of responsibility that extends to even the planet itself and empathy for all people. So you know, thinking about our investments and the world beyond the footprint of our day to day life seems to come naturally for women, more so than maybe for most people.

And so how empowering must it be, then, when a woman discovers that she can use her own money, her own investment decisions, the power of her own financial wealth to lever that money to make positive change in the broader world around her. That's an incredibly powerful thing. Women are truly driving this, this space, and this movement, and this includes millennials as well. The younger generation is thinking about where the world's going to be in, 30,40, 50 years, and then high net worth individuals as well can be seen to appreciate responsible investing more than ever these days.

Have you ever just curious, do you know of any examples or ever seen anything that's ever happened, where our investment choices, from an ESG standpoint has made a difference where we've had an impact, and companies did make it have a different direction? Because of it?

Another question or actually it’s more of a statement – that is that ESG products are more expensive. And I wonder about that. And it’s a fair point, we mentioned how this is a tool to help mitigate risk, and in doing so, is there a cost associated to that?

The short answer to is no, there shouldn't be any difference in price or the cost of the fund. And on the topic of risk, there's been multiple academic research that's been done that's looked at historic returns over time, and what you find with sustainable solutions are that they are less volatile than their counterparts. So you're taking on less risk, mainly because you're investing in companies that do think about ESG, and that includes good governance. It includes diversity, it includes paying attention to human rights, and so on, and of course on performance.

So this notion of I want to do something good, but I have to give up performance to achieve it feels like it's so yesterday, and I think we need to get past that.

Now, the most important question of all - how do you get on the path to sustainable investing?

It definitely starts with learning, programs like ForHER are a great example. There is a lot of great content and resources out there for leaning, and that will help you build your foundation. Having that foundation on what socially responsible investing is and how it works is so important.

The second step is identifying what's important to you. Think about the brands that you bring into your home, the companies you choose to give money to over another, if you're able to think about what your values are, in terms of where you're putting your money, I think that is very important. And then try to align your investments to that.

Then, as I mentioned before, speak to a professional, ask them for their support in helping you research investments that align to your values, you can ask them to get impact reports for you to review as well, in addition to the return and risk characteristics. After all, you want to know how you’re making an impact!

With that, I want to thank you so much to listening in, we hope everyone learnt something today, and we look forward to having you join us at our next episode.