

INSIGHTS FROM CFA SOCIETY SINGAPORE

Book review: Essential reading for investors in an ESG-driven, post-Covid world



MARK BHASIN

IN Purpose and Profit: How Business can Lift Up the World, George Serafeim, the Charles M. Williams Professor of Business Administration at the Harvard Business School, provides a roadmap and best practices for businesses to achieve the long-term competitive advantage that can emerge when they prioritise environmental, social and corporate governance (ESG) goals, such as climate change mitigation, diversity and inclusion, and sustainability, alongside the pursuit of profit.

The importance of ESG factors has been accelerated by the Covid-19 pandemic, making this book essential reading for all investors.

Once considered "soft" and outside the scope of what a serious investor should be thinking about, ESG issues are now not only important in society, but also critical in business. Today, it is incumbent on asset managers to incorporate all long-term drivers of value, including ESG factors, as part of their fiduciary duty to investors.

Over the past decade, Serafeim

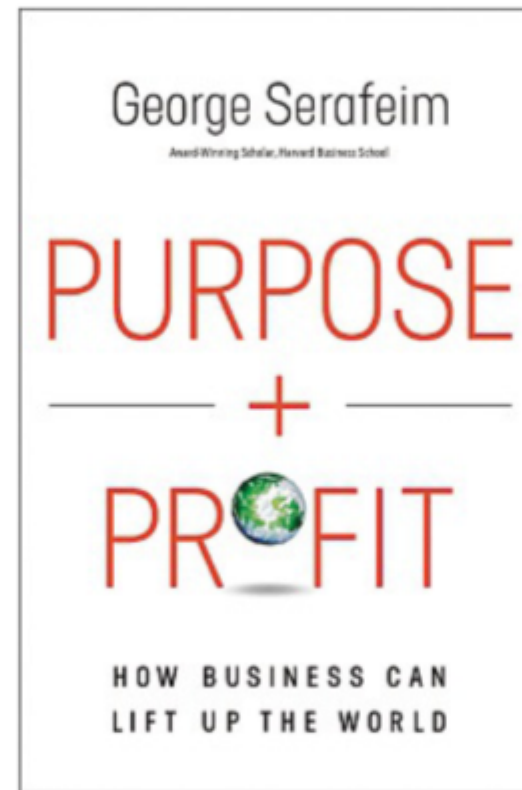
has found that purpose-driven firms that improve performance on material ESG issues outperform their competitors by more than 3 per cent annually in terms of stock returns, based on a sample of more than 2,300 companies.

In addition, based on a sample of 3,078 global companies, the author found that firms that responded to the Covid-19 pandemic with significant efforts to protect customers, employees, and suppliers outperformed their peers by about 2.2 per cent in the one-month covering the March 2020 stock market collapse.

Over the past five decades, since Milton Friedman argued in 1970 that the "business of business is business" and his agency theory was widely accepted, there has been an evolution on the importance of ESG issues. The stakeholder theory, which emerged in the 1980s, provided support for the ESG movement.

Serafeim found that in the 90s, firms with strong ESG performance received more pessimistic analyst recommendations than peer companies, because their sustainability initiatives were considered a waste of shareholder resources.

By the end of 2008, however, this correlation was zero, and by the mid-2010s, firms with strong ESG performance attracted more positive analyst recommendations than other companies. The UN



Purpose-driven firms that improve performance on material ESG issues outperform their competitors, writes author George Serafeim. PHOTO: HARPERCOLLINS

Principles for Responsible Investment (PRI) started in 2005. By 2020, assets under management (AUM) by PRI signatories surpassed US\$100 trillion. This evolution included financial education. CFA Institute started to incorporate ESG topics into its curriculum in 2018, and more recently created the CFA Institute Certificate in ESG Investing programme.

ESG investing started with negative screening, which proved to have minimal positive impact. Serafeim said that companies need to



ESG issues are no longer seen as "soft" and outside the scope of considerations for a serious investor. Asset managers have a fiduciary duty to consider ESG factors as part of long-term drivers of value. PHOTO: PIXABAY

understand which ESG issues are financially material in their industry and how to focus on them.

Firms that improve their performance on non-material ESG issues in their industry exhibited little performance differential from their competitors. Financially-material ESG issues for commercial banks include access to finance for underserved populations, customer data privacy, incorporation of environmental risks in loans originated, and strong anti-corruption practices.

For agricultural product companies, material ESG issues include greenhouse gas emissions, water management, the physical safety of employees, and crop-related risks emerging from climate change. Focusing on ESG issues

that matter to a particular industry can make the difference between success and failure.

I found Serafeim's most insightful example to be the US\$1.6 trillion Japanese Government Pension Investment Fund. Since this fund owns the "universe", it has sought to make the universe more sustainable rather than attempt to outperform the universe. Since pension funds have long time horizons, they need the earth to be viable 100 years from now to be able to pay out their obligations.

As "stewards of the commons", the largest investors are important for sustainability, because they hold numerous positions across industries that face a significant number of material threats.

The final chapter is the most im-

portant one for the "Impact Generation", members of which seek alignment between values and work. Because alignment is not static, it might be appropriate to take a position at a currently misaligned company, provided one has the agency to bring about change, rather than a currently aligned company.

It is the slope of alignment, rather than the current level of alignment, that determines the potential reward. The decision comes down to patience or one's own personal discount rate.

Mark K. Bhasin, CFA, is senior vice-president of Basis Investment Group and adjunct associate professor at New York University's Stern School of Business