Making money and doing good - the rise of sustainable and impact investing

There is no doubt that interest in responsible investments is growing. Not only in Australia but globally, investors are increasingly interested in how a company makes its money not simply how much it makes.

Whilst some investors may focus on the longer-term viability of a company and its behaviour, others may hold particular values they want their investments to mirror. How these two strategies play out in the investments context can be different.

Just making money is no longer enough

Even at the highest level, investors are shifting from only looking at short-term returns to a broader focus on long-term value creation, including the impact a company is having on those around them.

In his 2017 letter to the CEOs of the companies his firm invests in – Blackrock CEO, Larry Fink, highlighted this exact issue noting that “To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate”.

More and more investors are asking CEOs to focus not only on creating shareholder value, but also on long-term vision for the company, and, by extension, the impact it will have on society.

This is not a new idea

Today, many investment managers use environmental, social and corporate governance (known collectively as ESG) knowledge and data. It can help to inform the analysis of risk, innovation, operating performance, competitive and strategic positioning, and quality of management, corporate culture and governance and to enhance financial valuation, portfolio construction, engagement and voting practices.

Examples may include a company’s interactions with the environment, such as water and air pollution, social factors like employee diversity or safety standards, along with the company’s governance structure, such as how the board is composed and compensation structures. This approach seeks to add value or manage risks through broader, more comprehensive investment analysis, decision-making and engagement with companies.

This approach is providing measurable results

Investor-led initiatives have resulted in change at some of the world’s biggest companies. For example last year, investors successfully influenced oil and gas company, Exxon, to be more open about the effects of climate change on its business, by improving is disclosure of climate-related risk.

There are opportunities for everyone

For retail investors, navigating the world of responsible investment can be complex, terms like ethical, sustainable and impact investing are often used interchangeably by investors seeking to ensure that their money is invested in companies or funds that mirror their values and beliefs. In reality, these terms each related to a specific type of responsible investing – depending on what the investment is trying to achieve.

Arguably, the most well-known responsible investment strategy amongst retail investors is ethical investing. This strategy’s primary purpose is to exclude certain industry sectors, companies, practices or even, at times, and countries that meet specific criteria from a fund or portfolio, based largely on the client’s preference not to be invested in these activities. Traditional ethical investment strategies seek to avoid issues like tobacco, weapons, gambling, and pornography, however, investors are increasingly interested in strategies that avoid sectors linked to climate change or human rights abuses.

Sustainable investing, in contrast, is a type of responsible investing that considers ESG issues in an investment, alongside standard financial measures when assessing a company's performance. This might include how a company approaches employee relations, executive remuneration and anti-money laundering legislation, how it manages strategic issues such as climate change, or how it manages corruption.

You may also have heard about the rapidly developing field of impact investing. Impact investments preference the social or environmental purpose of an investment over or alongside its financial results. While this is a developing concept, and there is still discussion around the definition, many investors agree that intentionality of the investment is important. That is, that an impact investment should be aligned to creating a positive social or environmental impact, it cannot simply be a bi-product of business-as-usual behaviours.

What can retail investors do today?

While specific impact investments may be difficult to access for many investors, more traditional investments can still be used to make an impact. We know that that there are often factors outside of the standard measures of business and financial performance that can influence the viability of a company from an investing perspective. Considering responsible investment strategies, allocating a portion of your funds to a dedicated sustainable or ethical option, or even personally investing in those companies known for involvement in social or environmental projects are all possibilities to consider.

Source: BT