360-degree view: Sustainable investments on the test

ESG investing is one of the big trending topics in the financial and also specifically the asset management industry. But when does a company really function according to ESG standards and what are the challenges regarding the exact definitions of ESG investments in the asset management industry? Abdulaziz A. Alnaim, Founder and Managing Director at Mayar Capital, outlines the pros and cons of sustainable strategies for investors and managers alike, and talks about the individual boundaries and meanings of ethical action that are particularly fundamental to Majar Capital's business strategy.

Over the course of the last 18 months, we have all been trying to find new ways to live and work as we adapt to the conditions of the COVID-19 pandemic. However, one thing which has remained a constant during that time is the asset management industry's focus on Environmental, Social and Governance investing (ESG).
The reasons are clear. Individual savers are now increasingly aware of the impact their investors can make. Mayar believe that the climate crisis is the greatest long-term threat to humanity. We owe it to our children and grandchildren to act quickly and decisively.

In equity investing, the theory is on solid ground. Increasing amounts of capital allocated to companies which demonstrate best in class ESG business practice will see their cost of capital reduced. In turn, this incentivises other companies to operate with consideration to ESG issues, in a race to the top on standards. ESG investing can also help spark innovation that

reduces carbon emissions (and therefore costs!).
Investors who remain sceptical of the ethical drivers of ESG investing could instead view these issues through the lens of risk management. Companies which rely on a business model that pays scant regard to the environment, stakeholders all along the value chain or internal governance standards may find themselves scrutinised by their own consumers or even legislators. Sustainability of future revenue streams and the wider environment are interlinked.

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Despite the deep theoretical foundation of ESG investing, in practice defining the term exactly is providing a challenge to the asset management industry and for companies. However well intentioned, attempts to introduce frameworks around reporting and externally available ESG indicators have met with criticism. By creating specific areas of importance, rather than incentivising genuine change, it can have the reverse effect. Companies may begin concentrate on emphasising their ESG credentials by conforming to the reporting standards, leading to justified charges of 'Greenwashing'.

Regulators are navigating a difficult course in being able to monitor self-proclaimed ESG Funds. This is particularly relevant for providers offering both an ESG and a non-ESG strategy. Have those managers truly bought into ESG or is it cynical opportunism?
Since inception in 2011, Mayar has always fully integrated ESG factor into the investment process. This is in keeping with our belief that it is important to be ethical. However, we accept that where the lines are drawn between what is ethical and what is not will always be a personal decision.

This means not becoming over-reliant on labels. ESG can and will mean different things to different people. For example, should one avoid extractive industries entirely or can investors help companies transition to a new, cleaner economy? Mayar made the decision to avoid extractive industries through a combination of both environmental and ethical concerns but each individual will have to come to that conclusion independently.
Investing in ethical businesses that are managed by ethical people is not only the right thing to do, but it also reduces risk. Constant vigilance is required. W often say that "there is always more than one cockroach in the kitchen". Deterioration in ESG factors could be the tip of the iceberg and indicative of broader problems within a business.

In the end, if you choose a fund manager that is consistent with your own ethical principles then as long as the factsheets and voting record remain consistent, that initial due diligence should pay off over the long-term.

Like many things in investing (and in life!), business ethics will have grey areas that are subjective and require your judgment. It is tempting to use that as an excuse not to try and draw the line but we disagree. We think that we should all try our hardest to find a place that where we are comfortable. You'll make mistakes from time to time but you'll learn from them and get better. In this way, we can all play our role in saving for a better future.

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