Business in the Community
The Prince's Responsible Business Network

FACTSHEET

GET THE BASICS RIGHT: AN INTRODUCTION TO RESPONSIBLE INVESTMENT*

Introduction

Over the last decade, responsible investment has become a central topic in the investment world, with more investors asking questions about where their money is going. With media attention on the climate emergency, the plastic waste crisis and the COVID-19 pandemic, the appetite for sustainable investments has been growing at an even more rapid pace.

Recent figures show that European sustainable funds recorded close to €100 billion of net new money at the end of 2020 as investors flocked to put their money in ESG funds amid the COVID-19 pandemic.[i] Meanwhile, global ESG investments have nearly doubled over the past four years to encompass more than $40 trillion in assets, with some experts predicting that ESG investments could make up 60% of the market by 2025.[ii]

Research also shows that ESG funds are outperforming traditional investments over ten years, which is further accelerating the appetite for sustainable investment.[iii] Historically, there has been resistance to integrating ESG into investment decision-making, on the basis that it went against fiduciary duty. There is now a growing body of evidence that integrating ESG considerations into fiduciary duties is of critical importance.[iv] This is encouraging for those of us who see responsible investment as a key lever to accelerate the pace and scale of business action to meet the Global Goals and Build Back Responsibly.

With this increased focus on sustainability, investors are looking more closely at the sustainability, or ESG, performance of their portfolios. Consequently, companies are thinking more about how they tell their sustainability stories to investors and are increasingly turning to their sustainability teams to help them communicate.

At Business in the Community (BITC), we have found through various interviews with our members, that many sustainability practitioners feel overwhelmed when dealing with this, sometimes due to lack of experience in investment, and sometimes due to the sheer number of surveys they receive. This guide highlights what we think are the most important things that sustainability practitioners need to know about responsible investment.

**Disclaimer: This content is for informational purposes only, you should not construe any such information or other material as investment, financial, or other advice.*

HRH The Prince of Wales
Royal Founding Patron

"RESPONSIBLE INVESTMENT IS ESSENTIAL FOR CHANNELLING CAPITAL TO TACKLE ENVIRONMENTAL AND SOCIAL CHALLENGES, INCLUDING THE CLIMATE CRISIS AND COVID-19. THE RECENT ALIGNMENT OF CLIMATE POLICIES, INCREASED CORPORATE COMMITMENTS ON NET ZERO AND STRONG INVESTOR ENGAGEMENT ON SUSTAINABLE DEVELOPMENT HAVE PERMANENTLY PROPELLED ESG INVESTING TO BECOME BUSINESS AS USUAL."

Anne Marie Verstraeten, UK Country Head, BNP Paribas

WHAT IS RESPONSIBLE INVESTMENT?

The Principles for Responsible Investment (PRI) defines responsible investment as 'a strategy and practice to incorporate environmental, social and governance (ESG) factors in investment decisions and active ownership'.[v]

There are 2 main ways to invest responsibly:

ESG Integration

This is when investors consider ESG issues when building their portfolio. This could be done by screening for companies that do not align with their values or integrating ESG issues into investment analysis and decisions alongside traditional performance factors. 'ESG Leaders' positively invest in high ESG performing companies rather than excluding specific sectors.

Active Ownership

This is when investors encourage the companies they are already invested in to develop more sustainable business practices. They do this by engaging with the companies to discuss their ESG strategy and risk management or formally expressing approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.

HOW IS IT DIFFERENT TO ETHICAL/ SOCIALLY CONSCIOUS/IMPACT INVESTMENT?

These are terms that are often used interchangeably with responsible investment, but responsible investment is much broader than many of them. The main difference is that these other terms make ethical goals a priority, but responsible investment still focuses on financial return. Some of these other types of investment are described below:

Ethical or Socially Responsible Investment

Both ethical and socially responsible investment refer to the practice of using one's ethical principles as the primary filter for the selection of securities – investing informed by the investor's values. The two terms are often used interchangeably. These investors typically avoid investments from so called 'sin' stocks – companies involved with stigmatized activities, such as gambling, alcohol, tobacco, or weapons. socially responsible funds typically have one overarching set of guidelines that are used to select the portfolio, whereas ethical investing brings about a more personalised result.

Impact Investment

Impact investing aims to generate specific beneficial social or environmental effects in addition to financial gains. An impact investment strategy actively seeks to make a positive impact by investing, for example, in businesses that benefit the community or in clean-technology enterprises that benefit the environment and will usually have some measurable impact.

"WE ARE LOOKING FOR COMPANIES TO FOCUS ON TELLING THEIR STORY AND NOT SIMPLY TICK ESG BOXES. WE WANT TO HEAR HOW BUSINESSES PLAN TO BE SUSTAINABLE IN THE FUTURE IN THE FACE OF UNPRECEDENTED CLIMATE AND TECHNOLOGY DISRUPTION; TO UNDERSTAND THE PERCEIVED OPPORTUNITIES AND RISKS THAT NEED

TO BE NAVIGATED TO HOLISTICALLY CATER FOR THE NEEDS AND INTERESTS OF ALL RELEVANT STAKEHOLDERS."
Saker Nusseibeh, CEO, Federated Hermes

WHAT ARE THE KEY CHALLENGES?

Data

One of the key challenges that you may face is the issue of data, which manifests itself in many ways. Investors use a wide range of ratings agencies and indices to make their investment decisions, which more often than not means that you will be asked to fill out a wide range of surveys and provide data to many different organisations. This means being asked the same thing in different ways, thus having to cut the data differently to meet the requirements of each rating or index.

Your team may not have the capacity to fill in so many surveys or may not know where the investors are sourcing the data from and therefore which surveys to prioritise. Further on in this document you can find links to key initiatives and performance assessment tools to help you align with standards and existing initiatives. BITC's Responsible Business Tracker® can also help you to gather all this information in one place and better understand your sustainability, or ESG offering, which can make it easier to share your data with investors and index data managers.

Misinformation

Similar to the issue of data highlighted above, misinformation is another challenge you may face. As highlighted above, your team may not have the capacity to fill out so many surveys, but many ratings agencies will take it upon themselves to fill out the survey on behalf of your company using publicly available information. The problem with this is that not everything your organisation is doing may be available online, some things may be in progress or just started. Also, the people filling out these surveys on behalf of your company are most likely doing the same for many other companies, so it is highly likely that they are only skim reading through what is available online, and/or misunderstanding your organisation's business model, which may contribute to the way your data is collected.

To combat this, you can work on ensuring you have a comprehensive narrative within your reporting. Be proactive in your communications and external reporting and link up your investor relations team with your sustainability team and senior stakeholders across the business so that everyone speaks the same language.

Jargon

Sustainability professionals are often not well versed in the investment world and vice versa, therefore you may struggle with understanding the jargon and context of some of these conversations and communicating your data back to either your own investor relations team, or to other external stakeholders such as rating agencies or investors themselves. This is a common challenge we found at BITC when interviewing some of our members about their responsible investment strategies. Below you can find some of the most common terms to familiarise yourself with.

"THE MULTITUDE OF ESG RATING ORGANISATIONS AND INDICES CAN BE OVERWHELMING FOR COMPANIES. AT IHG HOTELS & RESORTS, WE TOOK THE TIME TO ENGAGE WITH OUR KEY STAKEHOLDERS TO UNDERSTAND THE DATA, DISCLOSURES AND BENCHMARKS THAT ARE DECISION-USEFUL TO THEM. WE EVALUATED THEIR FEEDBACK, AND PRIORITISED THE DISCLOSURES THAT MATTER MOST, WHILST ALSO ENSURING THAT WE RESPOND AND COLLABORATE WITH A CORE GROUP OF ESG RATING AGENCIES AND INDICES."
Catherine Dolton, Vice President, Global Corporate Responsibility, IHG

WHAT ARE SOME HELPFUL WAYS TO ENGAGE WITH INVESTORS?

The best and most efficient way to prioritise which ratings and surveys to pay attention to is by engaging with your investors to see what it is they're looking for. If your organisation has an investor relations team, they would be your first point of contact to liaise with your investors and understand what is important to them. To build this relationship, the sustainability and investor relations teams at GSK decided to sit together, encouraging the two teams to work more closely together.

But you can also talk directly to your investors, through means such as a sustainability conference, which is what BITC member Unilever did to engage with its investors.

"AS A SUSTAINABILITY PRACTITIONER, IT'S BRILLIANT TO SEE THE SUSTAINABILITY AGENDA BECOMING MUCH MORE MAINSTREAM AMONG THE INVESTMENT COMMUNITY. THIS CREATES OPPORTUNITIES FOR US TO WORK WITH OUR INVESTOR RELATIONS TEAM TO ENGAGE INVESTORS ON THE CLEAR BUSINESS CASE FOR SUSTAINABILITY AND DEMONSTRATE HOW WE BRING THIS TO LIFE IN OUR OWN OPERATIONS AND BEYOND. CENTRAL TO THIS DIALOGUE IS THE RELATIONSHIP BETWEEN SUSTAINABILITY AND BUSINESS GROWTH – WITHOUT THIS IT IS DIFFICULT TO SPEAK THE SAME LANGUAGE. ALONGSIDE INTEGRATING SUSTAINABILITY INTO INVESTOR COMMUNICATIONS, WE HAVE ALSO WORKED TOGETHER ON DEDICATED SUSTAINABILITY ENGAGEMENT WITH INVESTORS, INCLUDING A SUSTAINABILITY EVENT AND A SERIES OF WEBCASTS WHICH ENABLE US TO PROVIDE DEEP-DIVES INTO SPECIFIC SUSTAINABILITY ISSUES, SUCH AS CLIMATE ACTION AND PALM OIL INDUSTRY TRANSFORMATION."

Rebecca Marmot, Chief Sustainability Officer, Unilever

WHAT ARE THE KEY TERMS I NEED TO BE FAMILIAR WITH?

ESG

ESG stands for Environment, Social and Governance, which are a set of criteria used by responsible investors to evaluate a company's operations. Environmental criteria look at the environmental impact of the company, such as carbon emissions, water usage and biodiversity. Social criteria look at how the company interacts with its employees, the communities it operates in, its customers and its suppliers. Governance criteria look at things such as its leadership, executive pay and shareholder rights. There is some debate around the correct definitions of ESG, particularly as each rating, survey, or index tends to use its own definition. This is something that the EU Taxonomy Report and WEF White Paper both attempt to address. You can also use BITC's Responsible Business Map™ to understand the factors we use to define ESG, or Responsible Business.

Asset Owner vs Asset Manager

Asset owners and asset managers are both types of investors. Asset owners are institutions or people who own the underlying assets including pension plans, insurance companies, official institutions, banks, foundations and high net-worth individual investors. Sometimes, asset owners entrust the management of those assets to an asset manager. Asset management companies include BlackRock, Federated Hermes, L&G and Columbia Threadneedle.

Asset Classes

An asset class is a group of investments with similar characteristics that adhere to the same rules and regulations. There were traditionally 3 main types: stocks, bonds and cash (or cash equivalents), however, nowadays real estate and commodities are examples of other sought-after assets. Investors use asset classes as a way to diversify their investment portfolio, as they have varying amounts of risks and returns – essentially diversification reduces risk and may increase the probability of making a return.

Stocks

Stocks give an investor partial ownership, or equity, in a company. The more shares of a company that are bought, the more of the company the investor owns. This means that if the company performs well, the investor will profit, and if it doesn't perform well, then likewise the investor may lose out, as the value of the shares that have been bought may fall below what they were purchased for. The most common reason that companies issue shares is to raise cash to be used for future growth.

Bonds

Bonds are a loan from an investor to a company (corporate or private bonds) or government (sovereign bonds). There is no equity or ownership involved. The company or government is in debt to investors through bonds and will pay the investor a fixed amount of interest for the length of time the bond has been issued for. Once that time period is over (i.e., the bond has reached full maturity), the company or government will pay the investor back in full. Bonds can be issued to finance specific projects, such as those related to the Global Goals or to support COVID-19.

Green Bonds

Green bonds are bonds that are issued with the intention to encourage sustainability and to finance environmental projects, such as those relating to climate change. Government-issued green bonds tend to come with tax incentives, such as tax exemption and tax credits, which can make them more attractive to investors than other equivalents. Companies can issue their own green bonds tied to specific environmental projects within their business.

Sustainability-linked Bonds

Sustainability-linked bonds are linked to ESG key performance indicators (KPIs), such as science-based targets that companies commit to achieve. If the company fails to achieve these commitments, it must pay additional payments to the bondholder on top of the usual interest payments associated with bonds. Unlike green bonds, the funds raised from sustainability-linked bonds are not tied to specific projects and tend to be for general corporate purposes. For example, Tesco PLC was the first retailer to launch a bond of €750m aligned to an agreed Sustainability Performance Target (SPT) of reducing Scope 1 and 2 Group Greenhouse Gas (GHG) Emissions by 60% by 2025 against Tesco's 2015 Baseline[vi].

Active vs Passive Investment

Active investment is a hands-on approach and requires someone to act in the role of portfolio manager, doing deep quantitative and qualitative analysis on the stock market and making decisions on buying or selling stock in response to short-term changes. Passive investment usually involves buying an index fund which is based on a major index, like S&P500 or FTSE100. The index fund will automatically buy and sell stock from companies that are entering or leaving the indices each year. Passive investment tends to work well for most investors, and studies have shown that passive investment results in higher returns. However, while some responsible investors do invest in index funds linked to sustainability indices, such as DJSI or FSTE for Good, there is debate on the compatibility of passive investment and sustainability, as 'comprehensive sustainability integration involves many active decisions, it requires active portfolio management, active risk management and active performance evaluation techniques'.[vii]

Screening for ESG

Screening uses a set of criteria, such as ESG, to determine whether a company should be included in a particular investment portfolio. Positive screening includes a company if they meet that set of criteria (e.g., targeting companies with the lowest carbon emissions), and negative screening excludes a company if they do not meet the criteria (e.g., excluding companies with the highest carbon emissions). Investors may also use sustainability indices as screening criteria, as well as the overall offering of a company, e.g., choosing not to invest in certain industries such as alcohol, tobacco and weapons.

Divestment

This is when investors choose to sell their stocks and shares in companies. This could be due to financial reasons, or because the company is related to controversial social or political issues. An example of this is investors choosing to divest from the fossil fuel industry due to its connection to climate change. However, divestment from controversial companies is not always seen as the best way to create change. Many investors choose instead to create change in companies through active ownership and engagement, for example, encouraging fossil fuel companies to innovate in renewable energy.

Proxy Voting

This is when a single person or firm casts a vote on behalf of a company shareholder. This may be because the shareholder cannot be present at that shareholder meeting, or because the shareholder chooses not to vote on that particular issue, either because they are not interested in that matter or feel they do not have enough knowledge or experience to vote and therefore passes their vote on to someone who understands the issue better.

Integrated Reporting

Integrated reporting attempts to address the issue of having a commercial report separated from a sustainability report by bringing the information that is usually shared in annual reporting, such as strategy, governance and performance, together with the wider commercial, social, and environmental context within which the business operates. By taking an integrated approach to reporting, companies can think about the way they do business and how they create both long and short-term stakeholder value. Thinking in this way can help companies to clearly articulate their story in a way that is relevant to all stakeholders.

Carbon Pricing

A carbon price is a cost applied to carbon emissions to encourage polluters to reduce the amount of greenhouse gases they emit. It is seen by many economists as the most effective way to reduce emissions. Taking into account an appropriate carbon price is key for investors to evaluate investment opportunities. Research conducted by Route2 for BITC in 2020 showed that the true social cost of carbon is at least $80 per tonne of CO_2, but more likely to be in the region of $360 per tonne.[viii] Recent forecasts from the Bank of England suggest that a price of $100 per tonne of CO_2 might be reached by 2030, and warn businesses to assess the risks associated with this and disclose with investors.[ix]

Fiduciary Duty

A fiduciary is a person with a legal obligation to act in the best interests of another. In investment, this is anybody with legal responsibility for someone else's money, e.g., a portfolio manager or investment advisor, who has a duty to act in the best interests of their client. Traditionally, this was thought to be by investing their money in whatever would bring the highest financial returns, however in recent times this thinking has evolved. The PRI suggest that failure to consider all long-term investment value drivers, including ESG issues, is a failure of fiduciary duty.[x]

WHAT ORGANISATIONS, INITIATIVES AND INDICES SHOULD I BE AWARE OF?

BITC's Responsible Business Tracker®

A comprehensive performance assessment tool, for businesses looking to take responsibility seriously, developed through consultation with 200+ businesses, NGOs, government and international partners.
www.bitc.org.uk/the-responsible-business-tracker

CDP

A not-for-profit charity running the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts.
www.cdp.net/en

Dow Jones Sustainability Index (DJSI)
The Dow Jones Sustainability Index family tracks the stock performance of the world's leading companies in terms of economic, environmental and social criteria.
www.spglobal.com/esg/csa/indices/index

EU Taxonomy
A tool to help investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy.
www.knowledge4policy.ec.europa.eu/publication/sustainable-finance-teg-final-report-eu-taxonomy_en

FTSE4Good
An Index Series designed to measure the performance of companies demonstrating strong ESG practices, to be used as a financial product, for research and for benchmarking.
www.ftserussell.com/products/indices/ftse4good

Green Mark
An internationally recognised environmental accreditation and route to ISO 14001 which provides evidence of a company's commitment to environmental sustainability.
https://greenmark.co.uk

Global Reporting Initiative
An international independent standards organisation that helps businesses, governments and other organisations understand and communicate their impacts on issues such as climate change, human rights and corruption.
www.globalreporting.org

Impact Investing Institute
An independent, non-profit organisation which aims to accelerate the growth and improve the effectiveness of the impact investing market.
www.impactinvest.org.uk

London Stock Exchange Group
A British-based stock exchange and financial information company that owns the London Stock Exchange, FTSE Russell and has initiatives such as Green Mark.
www.lseg.com

MSCI
An investment research firm that provides stock indices, portfolio risk and performance analytics, and governance tools to investors. It also provides ESG ratings by measuring a company's resilience to long-term, financially relevant ESG risks.
www.msci.com/our-solutions/esg-investing/esg-ratings

Sustainability Accounting Standards Board (SASB)
SASB Standards enable businesses around the world to identify, manage and communicate financially-material sustainability information to their investors.
www.sasb.org/standards

Sustainalytics
A leading independent global provider of ESG and corporate governance research and ratings to investors.
www.sustainalytics.com/

Taskforce on Climate-Related Financial Disclosures
The TCFD has developed a framework to help public companies and other organisations more effectively disclose climate-related risks and opportunities through their existing reporting processes.
www.fsb-tcfd.org

Principles for Responsible Investment (PRI)
Pursued by a United Nations-supported international network of investors working together, the six aspirational principles are often referenced as ‘the Principles’.
www.unpri.org

World Economic Forum: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation
This report proposes a common, core set of metrics and recommended disclosures that companies could use to align their mainstream reporting.

www.weforum.org/whitepapers/toward-common-metrics-and-consistent-reporting-of-sustainable-value-creation

World Benchmarking Alliance

The WBA develops a series of benchmarks assessing 2,000 of the world's most influential companies, ranking and measuring them on their contributions to the SDGs and makes this information freely available to everyone. www.worldbenchmarkingalliance.org

WHERE CAN I GO FOR MORE ADVICE?

- BITC's Advisory team works with organisations of all sizes and across all sectors and geographies, to support them in improving their approach to addressing ESG issues. We can help you understand your current state and priorities, take a strategic approach to managing ESG issues, improve your measurement and communication of activities and take action to make positive change in the environment and society.
- Speak to your Relationship Manager about participating in the next intake of the Responsible Business Tracker®. The Tracker is a comprehensive performance assessment tool, for businesses looking to take responsibility seriously, developed through consultation with 200+ businesses, NGOs, government and international partners. The Tracker® is not only available for free to all BITC members but can be used by any business to assess performance and progress against BITC's Responsible Business Map, built on the UN's Sustainable Development Goals (SDGs).

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You might also like:

- To find out more about our work on Global Goals
- To investigate our Advisory Services
- Join us at one of our upcoming Events

Talk to one of our expert team today to learn how membership of BITC can help take you further on your responsible business journey and drive lasting global change.

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