ESG Investing, Changing the Business World for the Better

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Abstract

The twenty-first century has marked the growth of the triple bottom line: people, planet, and profits. What was initially a catchphrase used by the most environmentally conscious firms, the triple bottom line has become a priority for firms around the globe. Rather than solely focusing on short-term profitability, the business world is looking to long-term wealth generation strategies that empower stakeholders. The emphasis on firms to balance wealth generation with environmental preservation has culminated in the prominence of ESG investing. Our research explains the widespread impact of ESG investing on the economy, the environment, company CEOs, company stakeholders, and society, at large. Rather than being viewed as a mandatory box to be checked off, modern business is beginning to leverage ESG investing to generate substantial wealth. Below, our research explores how the business world shifted their perspective and sees ESG investing as a lever for lasting financial growth and the health of society and the environment. While literature supports the notion that ESG investing has produced sizable returns for investors, our research also identifies potential confounding variables and gaps in the literature to ensure ESG investing is not being given undue credit.

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Investing Opportunities

ESG investing has an opportunity to impact the world in considerable scale. In 2015, the United Nations agreed upon 17 Sustainable Development Goals aimed at encouraging businesses to advance ESG initiatives and incite important change for people, planet, and profits by 2030. The goals include targeting issues including poverty, education, clean energy, climate action, responsible consumption/production, and more. Achieving these goals isn't only associated with doing "good," but doing "well" too as "achieving the Global Goals opens up US$12 trillion of market opportunities."

In the years since the release of the UN SDGS, ESG investing has grown as businesses and investors recognize the incredible opportunities. In 2020, the availability of sustainable funds grew by 30% from the year before, increasing the number of funds to nearly 400. As a result, $51.1 billion of net new money stemmed from ESG investors. The director of sustainable investing research at Morningstar attributes this increase to the ability of investors to observe the direct impacts of their investments on sustainability concerns. This indicates that by further highlighting the impacts of ESG investing, we could increase the number of investors focused on ESG investing.

Environmental Impact

ESG investments are driving positive change for the environment. This is exemplified by the relationship between greenhouse gas emissions -- a driver of global warming and climate change -- and ESG investments. Emissions are negatively correlated with ESG investments; "from 2014 to 2018, sustainable investments grew from 18% to 26%... [while] the average carbon intensity of Nasdaq, AMEX and NYSE companies decreased about 30%." Additionally, when investors anticipate governmental regulation or technological change -- which increases their willingness to invest in sustainable, long-term initiatives -- emissions decline 2.2 and 3.6 times faster. The reduction of emissions can be attributed to the power wielded by ESG investors and the pressure they put on companies to follow sustainable goals. When the proportion of wealth held by green investors doubles, the carbon intensity falls by 4.9% per year. "Green" investors force companies to internalize the impact of environmental impacts on their financial valuation, increasing their cost of capital. Continuing the trend of ESG investing in green initiatives has the promise to make the mass change needed to correct the environment.

Social Impact

The growing popularity of ESG investing has fostered a new wave of capitalism, with tangible impacts on CEOs, shareholders, and society at large. As explained by a recent *Harvard Business Review* article, capitalism used to revolve around maximizing shareholder returns. Under Milton Friedman's economic philosophy, CEOs were responsible for profits and high stock prices, not societal and environmental well-being. The aforementioned reform of capitalism is represented by a 3-D definition, in which CEOs are encouraged to take a more holistic approach to value creation--prioritizing all stakeholders, employees, and consumers. A driving force behind this modern-day capitalism is BlackRock CEO, Larry Fink. Rather than focusing on short-term quarterly revenue growth, Fink endeavors to find long-lasting, innovative solutions to permanently operate as a driver of corporate social responsibility. With the rise of ESG investing, this has prompted prominent CEOs from companies such as Walmart, Coca-Cola, and Wells Fargo to follow in the footsteps of Fink.

In addition to affecting today's CEOs, the rise of ESG investing impacts millions of consumers who "vote" with their dollars every day. Socially and environmentally conscious companies are listening to their shoppers now more than ever, as they understand their investors and customers are not solely fixed on high ROI. Over $50 billion were invested in ESG funds this year, compared to $21 billion in 2019, as today's millennials now have the disposable income to invest their money. Corporations are adjusting to this heightened demand for ESG investing, and they know that their target market demands true socially responsible business--not deception greenwashing. Society has a genuine impact on how corporations develop their CSR plans, and this tangible impact has only become stronger over the last 3 years. This impacts who large corporations partner with, acquire, and get their raw materials from. Rightfully so, all pieces of a corporation's supply chain are viewed under a microscope to ensure their ESG footprint is significantly and transparently communicated to all relevant stakeholders.

Economic Impact

Until recently, ESG has been a priority of just a few firms, but now, the dynamic has changed since the value of ESG has been realized through more and more experimentation and research on the subject area. Scholars have produced more than 2,000 empirical studies on the topic of ESG and financial performance since the 1970s, with 90% of these individual studies finding a nonnegative relationship between ESG and corporate financial performance. The majority of studies report positive relationships between ESG and financial performance, suggesting the business case for ESG is well-supported by financial outcomes. In all, the recent academic and financial analysis-based consensus is that ESG and financial performance are related and especially likely to result in positive financial and operational outcomes for organizations that adhere to ESG standards. Further, research expands the case for ESG in capital investments, as ESG information is proven to mean better investment decision-making and outcomes overall. In all, ESG investing and implications for operations of a firm are supported in research and will continue to be explored as these cases are adopted and proven in real corporate environments.

With increased discussion and support of corporate adoption of ESG for operational and financial outcomes, there is lots of speculation as to what the future implications of ESG standards and reporting and performance will look like. One particular area of interest in the future of ESG and economic implications deals with ESG reporting. Because there are no widely accepted reporting standards established, there is lots of discussion around where these baseline definitions of materiality and disclosures will stem from. Many anticipate that policy groups and regional and domestic laws related to ESG to set examples. There is also the potential for sector and universal disclosure systems being generated by organizations like the International Financial Reporting Standards. Additional areas of speculation center around what industries will excel at ESG performance and reporting, and also who will be the individual changemakers and drivers within firms to adopt ESG. In all, policy, education, and advocatism will be important influences on the future of ESG in the coming years and especially on the economic implications of ESG adoption and investing.

Implications & Gaps in Research

ESG investing has certainly increased in popularity in the last decade, and has seemed to bring about positive change. However, not all of this success can be attributed solely to ESG investing.

ESG investing has been linked to reduced carbon emissions, and strong financial performance including higher return for investors. But ESG investing is primarily found in companies that have other strong financial metrics such as high return on equity, low leverage, high profitability, and good management. It is all very possible that these other strong financial metrics drive the higher returns, and not ESG investing as a whole, or the people's willingness to vote with their dollars by supporting companies invested in sustainability. Companies who perform strongly on most financial measures are able to invest in ESG, and in turn see the environmental and economic benefits of ESG investing. Regardless of whether ESG investing is the cause or byproduct of a good company, its existence and the willingness of consumers and companies to accept its role in business will help sustainable goals for years to come.

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