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Amy L. Harvey
Murray State University, amylharvey0707@gmail.com

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ESG Investing: Past, Present, Future, and Why You Should Care

Amy L. Harvey

Murray State University

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Abstract

This paper discusses ESG (Environmental, Social, and Corporate Governance) investing, also known as socially responsible investing, green investing, and ethical investing. This paper will inform the reader on the past, present, and future of ESG investing. It will dive deeper into each category and discuss the correlation between the issues and investing principles. Different business philosophies will be compared along with corporate responsibility. The pros and cons of ESG rating systems will be discussed and reviewed. This paper will answer if ESG investing is profitable for the business and help determine the impact it has on our planet.

ESG investing: The Past, the Present, the Future, and Why You Should Care

Environmental, social, and governance (ESG) investing is known by many names, but it is a way of investing that promotes businesses to make decisions based on their long-term impact on the environment, social responsibility, and governance policies instead of just considering short-term profits. I will discuss the topics and issues that make up ESG investing, along with discussing different business philosophies, when ESG investing began, how it evolved, where it is going, and why businesses should care.

ESG investing differs from impact investing, sustainable investing, and socially responsible investing (SRI) by identifying itself within three major categories: environmental, social, and corporate governance. ESG investing also continues to focus on returns. Socially responsible investing can become more focused and exclusionary. SRI is focused on social impact and financial return. It focuses on current issues, and therefore the investments may lose money if the issue falls out of step with society. SRI includes if the company is acting socially responsible and if it is socially just; therefore it also includes climate change and environmental impact. To be sustainable means to be able to continue without running out. Sustainability is "the property of being environmentally sustainable; the degree to which a process or enterprise can be maintained or continued while avoiding the long-term depletion of natural resources" (Sustainability, 2021). Therefore, sustainable investing encompasses investments that focus on sustainable companies that do good for the environment. This term is interchangeable with green investing. Impact investing is defined as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return" ("What you need to know", 2021). All of these terms are closely related, yet differ from each other. In this

paper, ESG will be used as the all-encompassing term, but may be interchanged with the other terms for variety and specificity.

The philosophy behind this type of investing has its roots in religion. The beginnings of ESG investing can be claimed to go back hundreds of years when different religious sects decided not to buy certain products that did not go along with their beliefs. Methodists, Jewish people, and Muslims are all said to screen the products they are willing to purchase with most prohibiting alcohol, tobacco, weapons, and gambling (the sin stocks), along with certain meats and food products. Methodists did not want their members to invest in anything that would promote social harm. Muslims were encouraged to not invest in any products or services that were prohibited by Islam. The sin stocks were shunned and therefore gave rise to exclusionary stocks or social screens. "The Quakers and Methodist leader John Wesley had long advocated that investors should avoid business practices or companies that might be socially harmful and the first screened investment fund was created in 1928 'when an ecclesiastical group in Boston created the Pioneer Fund'" (Trelstad, 2016, p. 5). The Pioneer Fund still exists today.

By the 1960s with the civil rights movement at its peak and the Vietnam War raging, investors began to place more emphasis on social equality and boycotting weapons. The first Earth Day was in 1970, and activism became more environmentally aware. By now there was a mixture of socially responsible investing that included religion, environmental concerns, racial equality, and social justice. Also, the 70s gave rise to affordable housing initiatives and more community-based investing. During the era of apartheid, many investors did not want anything to do with South Africa. As the movement to disband the racist apartheid system continued, many companies and individuals took their money out of South Africa. Joan Bavaria, who founded Franklin Research & Development, which later became Trillium Investments, wrote in

2007 "that the goals of the Socially Responsible Investment community in the 1980s were generally those of caretaker, protecting human and natural resources from harm and avoiding exploitation for profit" (Trelstad, 2016, p. 6). This helped the socially responsible investing movement become global. Global issues affecting ESG include rising global temperatures, blood diamonds, and international human rights issues.

The 1990s brought forth its first ESG mutual fund, the Domini Social Index. By 1994, there were 26 funds available, and by 2006 there were 60 funds available. Today there were 23 more funds offered in the first half of 2020 alone. There are major global initiatives including the Global Reporting Initiative, the United Nations Sustainable Development Goals, UN Principles for Responsible Investment, the Global Impact Investing Network, and the Paris Agreement that are pushing the movement forward. There are also companies like BlackRock that are making ESG investing more mainstream.

Corporate Social Responsibility (CSR) has come a long way since Friedman stated in 1962 "that the only social responsibility of a business is to increase profits and maximize returns to its shareholders by virtue of whose investment the business continues to exist" (Ramasamy et al., 2020, pp.1959-1960). CSR is directly related to the Triple Bottom Line (TBL), which briefly means a business has not only one bottom line but three: profit, people, and the planet. TBL will be discussed more later in this paper. "CSR is a self-regulated business model that aims to contribute to societal goals of a philanthropic, activist, or charitable nature by engaging in ethically orientated practices"(Gilal & et al, 2020, p. 2276). More and more businesses are developing their own CSR initiatives or having consulting firms assist. They are also informing their customer base of their actions through marketing and by being more transparent.

There are many reasons a company would want to form a CSR initiative. One, if not the most obvious reason, is pressure from consumers and other corporations/external standards. Companies are judged or perceived to be good or bad depending on their actions and ratings are given through organizations such as the United Nations Global Compact and the Global Reporting Initiative. CSR is a way for a business to maintain accountability and proclaim what they stand for. CSR can take many forms including environmental awareness, diversity in the boardroom and higher positions within the corporation, donating to charities, and/or labor issues. CSR is a way for a company to brand itself. It can create a connection between the consumer and the company. Consumers like to be related to a company that has a positive social impact and will spend more if they believe that the company is actively participating in CSR initiatives that will benefit society as a whole. In the journal article, *Corporate Social Responsibility and brand passion among consumers: Theory and Evidence,* the authors say, "a growing body of marketing research has reported that customers will have positive attitudes towards companies practicing CSR activities" (Glial & et al., 2020, p. 2276).

In 2010, the International Organization for Standardization (ISO) provided guidance for businesses and organizations on what CSR is and how to implement their beliefs into action. "ISO 26000 is increasingly viewed as a way of assessing an organization's commitment to sustainability and its overall performance" ("ISO 26000", 2020). The ISO is a non-governmental agency that began in 1946 made up of 165 members that represent their countries. These guidelines were developed over five years and because they were developed with many different members from many different countries, these guidelines are considered to be an international consensus.

It is hard to discuss CSR without discussing the triple bottom line. The TBL is a way to look at a business's success without just looking at the balance sheet and the income statement. It not only looks at financial returns, but also considers how they were achieved. When considering people and the planet when discussing profit, it changes the outlook. It matters how the product was made and who helped get it to that final stage where a customer purchases it. In this way, CSR and TBL are intertwined. "A triple bottom line encourages companies to create their own corporate social responsibility strategy" (Films Media Group, 2019). John Elkington is stated to have come up with the phrase 'triple bottom line' in 1994. He was a British management consultant and thought businesses should be measured on more than just profits. If an organization can be a legal entity why not make it responsible for its actions? "The Triple Bottom Line presents a clear understanding of what is counted as corporate social responsibility and it makes the concept easy to understand" (Ksiezak and Fischbach, 2017, p. 107).
Let's consider each pillar of the triple bottom line individually, starting with profits.

Triple Bottom Line

Profits

Profits are the easiest for most to understand. A business cannot continue without making a profit. Profit is the money left over after all expenses and taxes are paid when speaking financially. Profit can also be defined as how an area profits from your presence. So, it is not only how much profit you make but what you do with it that matters. Understandably, a company must use some of its money to invest, expand, and take care of its stakeholders, but under this model, a company must also consider its CSR. Philanthropy, giving back to the community, and increasing the salaries of its employees all can be considered here. By increasing salaries, this company increases taxes paid in that area and therefore is helping the

whole community. When the company uses its profit for some of the above-mentioned ideas, it is for a positive impact. The company needs to be mindful not to use these profits to increase its own pockets and provide 'golden parachutes' for its high-ranking employees. More money leads to greed. We have all seen the movies where the Wall Street investor gets a lot of money and loses everything that matters. Money can make people make poor decisions. A company wants to try and do everything it can to prevent mishandling of profit and to not create an air of distrust or corruption.

People

People make up customers, employees, and the community in which the business operates. The way a company treats these three types of people is crucial to a business that believes in the TBL. First, its customers need to trust what the company says and does. Customers have power. The informed customer has the power to expand or reduce your profit. They can encourage others to buy your products, or they can encourage others to boycott your products. The informed customer expects more from the company. The employee deserves to make a fair wage based on their skills and to have a safe work environment. They deserve to not be discriminated against for age, sex, sexual orientation, color, race, pronouns, or anything else. "Diversity management allows for creating such an environment within the company that makes possible to use the potential of unique competences of workforce" (Ksiezak and Fischbach, 2017, p. 103). The community has been mentioned a little in the profit section, but it is also considered here with how the business participates in the community. The business can be a sponsor for other organizations, like clubs or sports teams. By backing the local community activities, the business does not only help get its own name out in the public but puts forth a goodwill effort to help and support the community as a whole.

Planet

The planet is where we all dwell: the company, the people, and the materials needed to make the products. If the planet does not do well, none of us do. When the industrial revolution began in the United States back in 1760, we did not know all that we know now. We used child labor and we did not have evacuation plans, fire extinguishers nearby, mandatory hourly wages, or workers' rights of any kind back then, but we learned and grew. We realized that it was the business's responsibility to take care of the workers, to make sure they were safe and did not die at work due to them wanting to make a profit. This is a continuation of that realization. We are smarter now. We are more educated about the chemicals used to make certain products and how we are to dispose of them for everyone's safety. We have learned over the years the responsibilities businesses have to people and places. It has not always been easy to make businesses clean up their act because it is costly to them and cuts into their profits, but it is for the greater good. We now know so much more than we did back in 1760. We know that a responsible business should not dump the chemicals they use into the water nearby because it affects the living organisms and seeps into the ground and runs off into someone's drinking water. We now know that carbon dioxide is the cause of greenhouse gases and erodes our ozone layer and pollutes our air. Companies need to differentiate profits from destroying the planet and realize that profits can come from protecting the environment that we share. If a company begins by simply making sure the lights are turned off before leaving for the shift, it will save on energy expenses and help the planet at the same time. That is a very simple statement but a true statement. Small changes can make a huge difference.

These three areas or pillars are interconnected. Profits can be increased by taking care of the planet. As discussed in Bob Willard's book, *The New Sustainability Advantage: Seven*

Business Case Benefits of a Triple Bottom Line, "The time has come to dispel the notion that being green is bad for business. If saving the planet is not reason enough, there's another incentive for companies to contribute to sustainable development – it boosts profits" (2012, p. 4). Some companies that have this business strategy include Marks and Spencer, Starbucks, Ben & Jerry's, and Tom's. They may not call it the triple bottom line, but the sentiment is the same.

Environmental, Social, and Governance Issues

Environmental issues

When dissecting the E in ESG investing, it is good to review when and why it began. The climate change movement is said to have begun in the United States in the mid-60s when a U.S. policy advisor wrote a report on greenhouse gases. President Richard Nixon declared the first Earth Day in April of 1970. The Environmental Protection Agency (EPA) was also created in 1970, and along with it, its legislation regarding clean air and water. Also, by the 1970s there had been multiple environmental organizations formed, including Greenpeace and the Environmental Defense Fund. The 1980s brought rising temperatures and the anti-nuclear movement. The Intergovernmental Panel on Climate Change (IPCC) was formed in 1988 by the United Nations, "created to provide policymakers with regular scientific assessments on climate change, its implications and potential future risks, as well as to put forward adaptation and mitigation options" ("The Intergovernmental Panel", n.d.). Environmental awareness was rising both in the United States and in the world. The Rio Earth Summit and the Kyoto Protocol were both held in the 1990s. The Kyoto Protocol's purpose was to get developed countries to decrease their carbon emissions and reduce greenhouse gases.

It is hard today to discuss climate change and the climate change movement without mentioning Greta Thunberg. Greta is a teenage girl from Sweden who decided to skip school

and sit outside the Swedish Parliament and fight for climate change. This young girl has been so matter-of-fact with her message that it has resonated around the world. She has inspired another wave of climate activism and has made an action case. She has brought the issue of climate change to another generation. Action from school-age children has brought the issue to the front; she is asking now for action from governments, agencies, and individuals. As Nulman said in their, *Brief History of Climate Change Policy & Activism*, “The problem of climate change is global in nature, and any attempt to mitigate it will require an international effort” (Nulman, 2015, p. 20).

Some examples of environmental issues to be considered when investing include carbon emissions, air and water pollution, deforestation, waste management, and energy efficiency. “Human activities are responsible for almost all of the increase in greenhouse gases in the atmosphere over the last 150 years” (“Sources of greenhouse gas”, 2020). By decreasing our fossil fuel use we can cut back on the greenhouse gases in our atmosphere. Greenhouse gas gets trapped in our atmosphere and increases the temperature of the planet. We use fossil fuels for transportation, electricity, and heat. Air pollution is a direct result of our industries' emissions, transportation, waste, wildfires, and landfills, and the burning of fossil fuels. Air pollution or smog is when particles are stuck in the air, depriving humans, animals, and plants of the oxygen they need. Water pollution is partially caused by runoff from farmlands using pesticides, from golf courses treating the grounds, and from factories. Chemicals collecting and running downstream through and to our drinking water eventually flow into the oceans. Water pollution is also caused by sewage waste, river dumping, marine dumping, and oil pollution (“Sources of water pollution”, n.d.). Marine and river dumping is the intentional dumping of waste materials and/or chemicals into our waterways. Oil pollution is caused by the numerous accidents on

rivers and oceans each day. According to the World Wildlife Organization, "One dump truck full of plastic waste enters our ocean every minute" ("Ocean and Marine", 2021). Our oceans absorb most of the increased temperature and that, along with the pollution, is threatening our sea life and has impacted our weather patterns. This is evident by the rising ocean temperatures and the fact that ocean life is moving north.

Deforestation is when a forest is cut down for its lumber, land, and/or other resources and not replanted. "Tropical deforestation accounts for almost one-fifth of greenhouse gas emissions and threatens the world's most diverse ecosystems" (Burgess et. al, 2012, p. 1707). Deforestation affects the biodiversity of the world. The tropical rainforests hold the majority of living organisms, and when the forests are destroyed so are the lifeforms living there. The trees take up carbon dioxide and help reduce our carbon output. The process of clearing land for logs or land use alone increases our greenhouse gases, but when we destroy and burn the land, whether intentional or in wildfires, all that carbon dioxide is released back into the atmosphere. Pimm explained this issue concisely:

> Although forests may regrow after being cleared and then abandoned, this is not always the case, especially if the remaining forests are highly fragmented. Such habitat fragmentation isolates populations of plant and animal species from each other, making it difficult to reproduce without genetic bottlenecks, and the fragments may be too small to support large or territorial animals. Furthermore, deforested lands that are planted with commercially important trees lack biodiversity and do not serve as habitats for native plants and animals, many of which are endangered species (2020).

By setting aside nature preserves, national and state parks, wildlife areas, and sanctuaries, we are combating some of the effects of deforestation. This is a difficult challenge. The forest is

the basis for some countries' or areas' economies, and the answer is not clear, but moderation and respect for the land and what it offers is a beginning. Short-term profits and a way of life cannot outweigh the long-term effects of what the forests offer us and the planet as a whole.

Waste management takes into account an industry's ability to manage its waste as a business. Waste includes the chemicals, boxes, plastics, electricity, water, and food waste used in the industry. Being conscious of a company's waste can not only be environmentally sound but also can be very profitable for a business. According to Willard, "companies in the United States dispose of 7.6 billion tons of industrial waste each year" (2012, p. 70). Disposing of this much waste is costly. If a company can cut back on this amount, it will save money and increase revenue. A company can cut this cost in a variety of ways. They can cut waste costs at the beginning of making a product by being more resourceful with their raw materials. Companies can aid in the recycling of past products and reduce their consumption of materials by reassessing their packaging into smaller formats or more sustainable materials. This will all cut back on the waste as the end product is finished. They can also sell their waste to other companies. Consider a company that disposes of a product that another company can utilize; if they work together, they can create 'industrial ecology' (Willard, 2012). The company has now made an expense into a revenue stream and became more environmentally conscious. Many companies are working on becoming zero-waste by a certain year. Amazon, Procter & Gamble, Subaru, Toyota, Sierra Nevada, and others have all pledged to go zero-waste and are making strides to achieve their goal. Their efforts could change and influence other companies to follow suit. An example of how a company can go zero-waste is the following:

> In 2010, Procter & Gamble's manufacturing facility in Auburn, ME, became the company's first in North America to achieve zero-waste-to-landfill status by recycling

> or reusing more than 60% of the overall waste produced and incinerating the rest for energy production. The company's Global Asset Recovery Purchases (GARP) team found a beneficial use for the nearly 40% of factory waste that could not be recycled or reused. The excess materials were incinerated and used to power the facility; any excess power was sold back to the local utility. The GARP team calculated that the program diverted over 10,000 tons of waste from the landfill and saved the company tens of millions of dollars in cost recovery over the year. Auburn in the ninth P&G plant to earn the distinction of zero-waste-to-landfill, which P&G says fits its goal of having zero waste going to landfills globally and instead of being beneficially reused in its value stream (Willard, 2012, p. 71).

The era of people and businesses just making products without the worry of caring about the afterlife of a product is coming to an end. The focus on banning single-use plastics is making its way to the forefront. Single-use plastics are almost as frowned upon as someone smoking a cigarette these days.

A final example of environmental issues is energy efficiency. Most of the time this is the first thing that comes to mind when anyone discusses being environmentally aware. It is the obvious starting point. By decreasing a company's energy consumption, they will help their bottom line. This is an easy way to save money, and there are government incentives for a company when they decrease their energy use. "In the United States, buildings account for 72% of electricity consumption, 39% of energy use, and 38% of all carbon dioxide emissions" (Willard, 2012, p. 52). There are several ways to cut back on energy usage. A company can simply be mindful of its unnecessary energy consumption and make sure lights are turned off in offices and factories when not in use. They can also make sure to turn off their computers and

power down equipment when able. Companies can also use and/or supplement their energy use with natural, renewable sources including wind and solar energy. Buildings can be built greener in the beginning, and with this forward-thinking, they will cut down on their energy use from the start. There are a myriad of ways a company can become more energy-efficient, and this will not only help decrease their carbon emissions but also help their bottom line directly by cutting back on their expenses. "This strategy runs the gamut from low-tech (like insulating the water heater) to the ultra-high-tech, as in new computer chips that can run on less electricity" (Brill, et al., 2000, p. 102).

Social Issues

The "S" in ESG investing refers to social responsibility. We have discussed earlier socially responsible investing (SRI). SRI encompasses the social issues that are to be listed herein, but also takes climate change into account. The social issues that are considered with ESG are many, and they continue to change and evolve. These are harder to gauge for an investor and rely mostly on laws and company disclosure. Social issues to consider when investing your values include gender and diversity, labor standards, human rights, health and wellness, community issues, and conflict zones. These issues range from short-term to long-term issues, and they ebb and flow depending on current events, including who and why anyone is at war, but they all matter.

Gender and diversity are major issues, taking into account women's issues, LGBTQ+ issues, racial inequity, and disability rights. This year the importance of these social issues has risen to the top. Gender, race, and ability inequities have surfaced during this pandemic. In one instance, many women have stopped working to look after the school-aged children who are unable to attend classes due to the pandemic. Wage gaps have always existed, but the pandemic

has raised many questions about the work that women do, whether it is paid or unpaid. "Globally, 75% of unpaid work is done by women, who spend between three and six hours per day on it compared to men's average of thirty minutes to two hours" (Perez, 2019, p. 70). All of these issues affect income equality, access to healthcare, and the need for justice reform. It is a multi-faceted issue that is systemic, intricate, and will be challenging to untangle.

Labor standards refer to topics such as wages, workplace conditions, and child labor laws. In the United States, we have multiple agencies that protect the workers and the consumers while in the workforce. Minimum wage is still an issue today and the wage gap between men and women and women of color is also a staggering issue. Perez found that "white men are rewarded at a higher rate than equally performing women and ethnic minorities, with one study of a financial corporation uncovering a 25% difference in performance-based bonuses between women and men in the same job" (2019, pp. 93-94).

When considering labor standards globally, an investor must consider the possibility of sweatshops, young children working long hours, bad workplace conditions, and inadequate facilities. American companies have encountered these problems in their supply chain and have been caught on the wrong end of the social spectrum, losing them consumers and profits. Agriculture is an industry where fair labor practices and standards are important and can affect your everyday life.

"Health and wellness" have great depth to them. They combats food deserts and the lack of nutritious food in low-income areas. They also consider obesity, tobacco, alcohol, non-genetically modified (non-GMO) foods, organic, and locally grown foods. Health and wellness seep over into the environmental issues when discussing organic, non-GMO, and locally sourced foods. During the Covid-19 pandemic, there has been more reliance on food banks. When

considering this social issue, an investor should be mindful, especially when investing in the food or agricultural industry.

Community issues revolve around many aspects including affordable housing and investing in local minorities or women-owned businesses. "Community Investing offers solutions to many twenty-first century challenges, from inner-city decay to the decline of the rainforests" (Brill, et al., 2000, p. 114). Focusing on community-based social issues is much like the saying "act locally, think globally." Investments in this area can lead to exciting economic development that helps out on a local scale but has far-reaching potential for societal change and improvement.

Conflict zones include war zones, terrorist activities, etc. When doing business in these areas there are guidelines issued by the United Nation's Principles of Responsible Investing (UN PRI). "The primary responsibility for peace, security, and development rests with government but the private sector can make a meaningful contribution to stability and security in conflict-affected and high-risk areas." ("Responsible Business Conflict-affected", 2012).

Governance Issues

Corporate governance issues are important to investors. A company's corporate governance dictates company values, directions, beliefs, and disclosures. "Good corporate governance ensures transparency and accountability and can prevent corporate scandals, fraud and issues pertaining to corporate liability" (Price 2019). Corporate governance issues range from board nominations and diversity, executive pay, corruption, company transparency, and cybersecurity. Executive pay is a pressing issue to investors. Board diversity is a prominent issue that is not just a corporate governance issue but also could be considered a social issue. The topics associated with corporate governance can sway investors positively or negatively.

Corporate governance is indicative of the company's directions and in this day and age of transparency if a corporation seems to be performing in a shady way or not disclosing information that affects shareholders.

The words "executive pay" have bad connotations for some people. The bitter taste comes from years of CEOs getting paid seven figures for making a company fail or for having an outrageous salary when their employees hardly make a living wage. Executive pay should have oversight. The dollar amount itself should reflect the work and profits of the company and should be transparent. According to Aguilar, "the development of the golden parachute has often meant that, in practice, executives have been rewarded handsomely for failure" (2014). However, people should be rewarded for hard work and for successfully expanding a company. The board of directors is responsible for most decisions, compensation, hiring, among other responsibilities. The board is supposed to be the liaison between the corporation and the shareholder. They are there to protect the shareholder's interest. Boards that put emphasis on corporate governance and select/elect the right persons for the job have better governance outcomes. Per Sarhan, et al., "better governed firms (with more diversified boards) are less likely to overpay their executives" (2019).

This leads to the importance of board diversity. Diversity and inclusion on any board leads to improved perspectives, more ideas, and increased collective intelligence. Boards should reflect the shareholders they represent. Diversity comes in many forms: socioeconomic, race, gender, ethnicity, physical ability, and religion. Some would say that placing women and minorities on the board is a symbol or just puts a token person in place that can be influenced to go along with what everyone else decides. However, as also stated in Sahran, et al. "in well governed firms, the extra monitoring provided by diversified boards may lead to negative effects

on corporate performance" (2019). This indicates that they are not just symbols or tokens, but that their presence has an effect on a company's performance. "Thus, the additional monitoring function performed by female directors is of more value in firms with strong CG mechanisms" (Sahran, et al., 2019). This means that firms with weak corporate governance may try to cover issues with increased board diversity, but stronger corporate governance firms find more worth in a female director. Qureshi, et al. (2019), state "the firms with a female presence on their board have a significantly higher (ESG) disclosure score compared with the firms without a female presence on their board" (p. 1213). Furthermore, "appointing female directors can improve firm legitimacy and provides firms with more capital inflows, investment opportunities, government support, and community acceptance" (Sahran et al., 2019). The fact is that most of corporate America are white men. Nasdaq is trying to change that. They made a proposal to the United States Securities and Exchange Commission this past December that "would require all companies listed on the exchange to publicly disclose consistent, transparent diversity statices about their board of directors" (Chapman, 2020). Nasdaq goes on to further propose that companies have at least two minorities on their board. The company as of now will not be taken off by Nasdaq if they do not comply if they publicly disclose why they do not have a diversified board.

Transparency, accountability, measured performance, and disclosure are all closely related. Accountability requires some form of measured performance, evaluation, or review of one's job duties and responsibilities. To be accountable, a corporation must be transparent. Being transparent leads to disclosure.

Cybersecurity is another corporate governance issue in this age of technology. The SEC "describes the "grave threat" cybersecurity risks pose to investors and capital markets" (Goldin

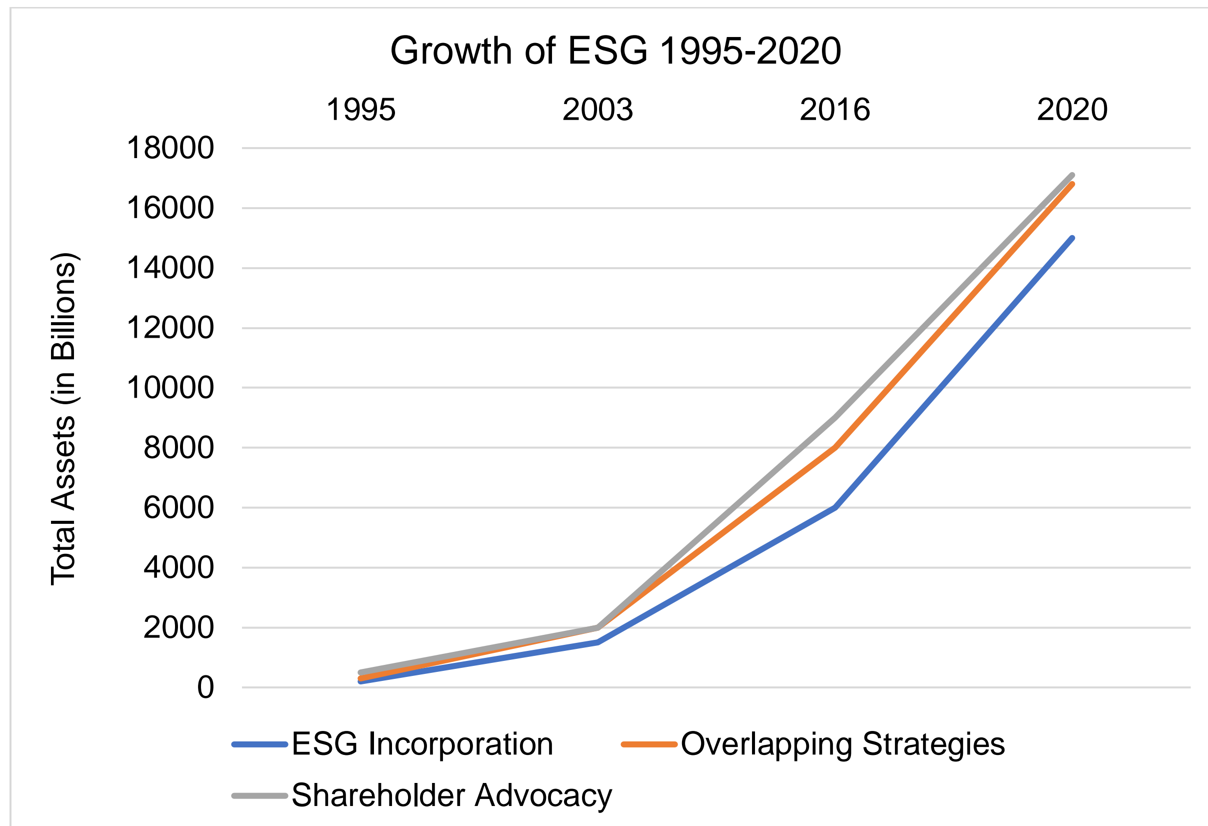
et al., 2018, p. 6). Cybersecurity risks can be related to company financials, company operations, and/or legal issues. To disclose this information allows the investor to be more informed and helps decrease the risk of insider trading.

The above-mentioned environmental, social, and corporate governance issues and how to deal with them can be taken in two ways when considering investing. Companies that do not place environmental, social, and corporate governance concerns very high on their priority list still may be interested in these areas due to the cost-saving aspect that it lends to the business. Other companies may place these issues higher up on their priorities and make these issues more of company culture. This is moral values versus economic values. It does not matter which one a company chooses to be if they put forth these measures their company ESG rating will reflect their actions. All companies are economically value-based but not all are morally value-based. When investing an investor should be aware and understand the difference. A morally value-based investor may choose not to invest in a company that sells guns, but another investor that is more economic value-based may.

To further help the reader understand the ESG factors that go into investing and how they relate to actual dollars invested and what category they are defined to is listed in the following charts and graphs. Figure 1 gives an overall look at the growth of ESG investing since the mid-90s and it references the total number of dollars invested in ESG strategies in the United States. In 2020, there were $51.4 trillion total dollars invested in the US market that was managed professionally. Of that amount 17.1 trillion dollars were invested in ESG, ESG investing has had an increase of 42 percent since 2018 alone (USSIF, 2020).

Figure 1

Growth of ESG 1995-2020

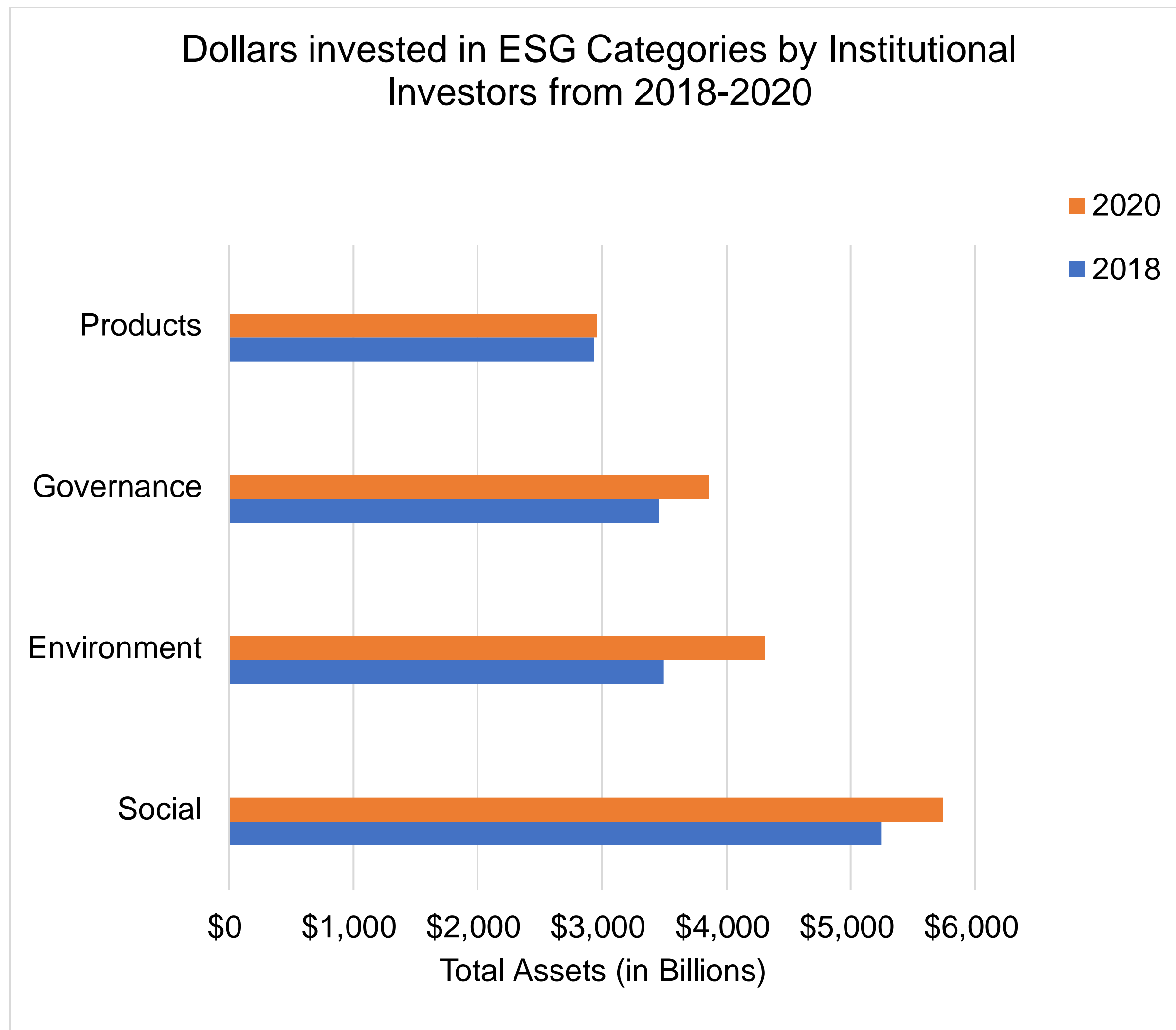


Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Figure 2 illustrates the dollar amount invested into ESG categories by institutional investors. Institutional investors invest funds on your behalf, think 401(k), 403 (b), and pension funds. They buy large portions of stocks and bonds for companies and institutions. Social issues are among the highest category with institutional investors. It is important to note that institutional investors do not use their own money.

Figure 2

Dollars Invested in ESG Categories by Institutional Investors from 2018-2020



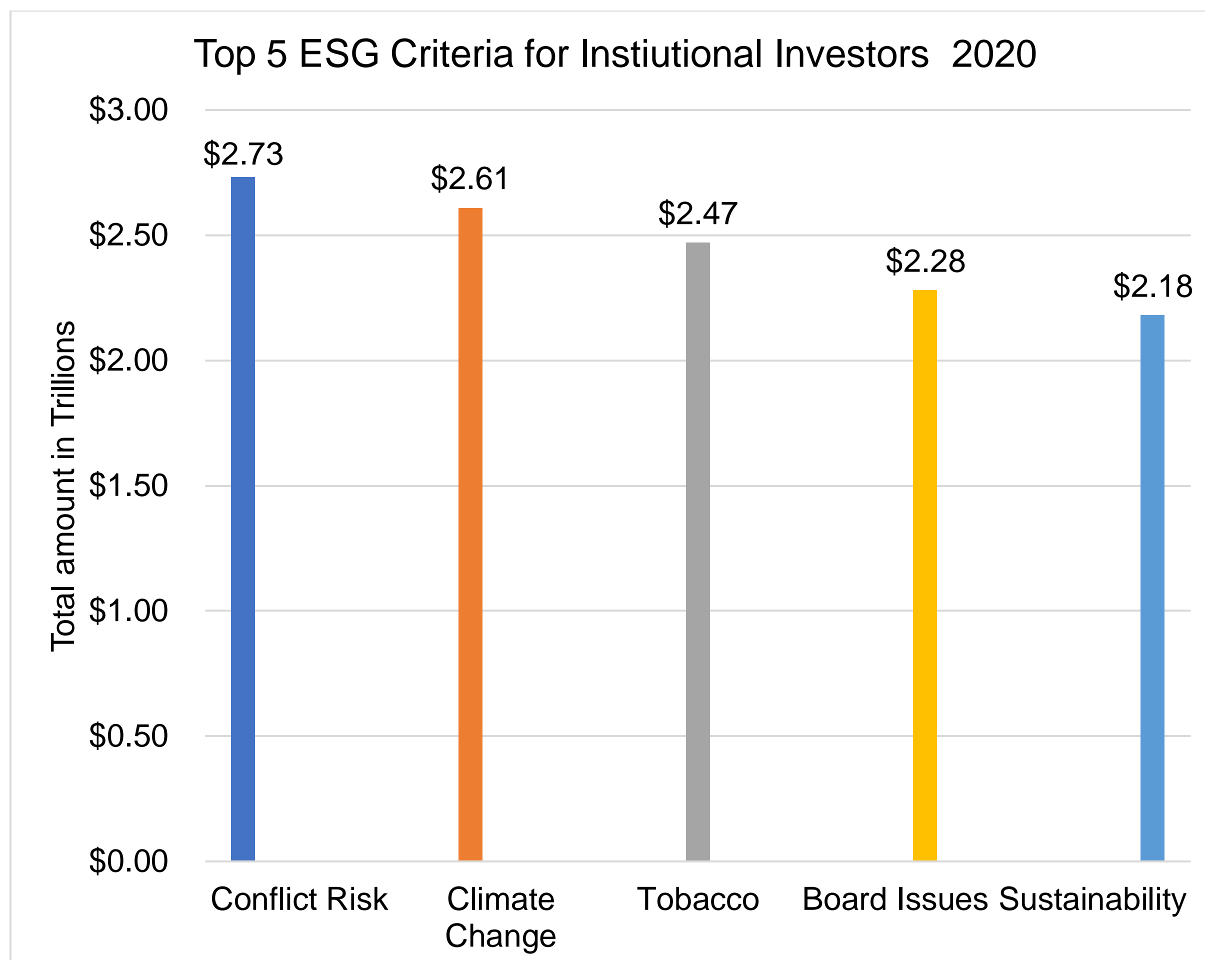
Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Figure 3 illustrates the top specific ESG criteria for Institutional investors for 2020. It goes deeper in Figure 2 and separates ESG issues into subcategories. Investment policies related to conflict risk and (terrorist or repressive regimes) showed the most growth but when compared

to 2018, it had a negative eight percent decrease (USSIF, 2020). Sustainability had a 95% increase from 2018.

Figure 3

Top 5 ESG Criteria for Institutional Investors 2020



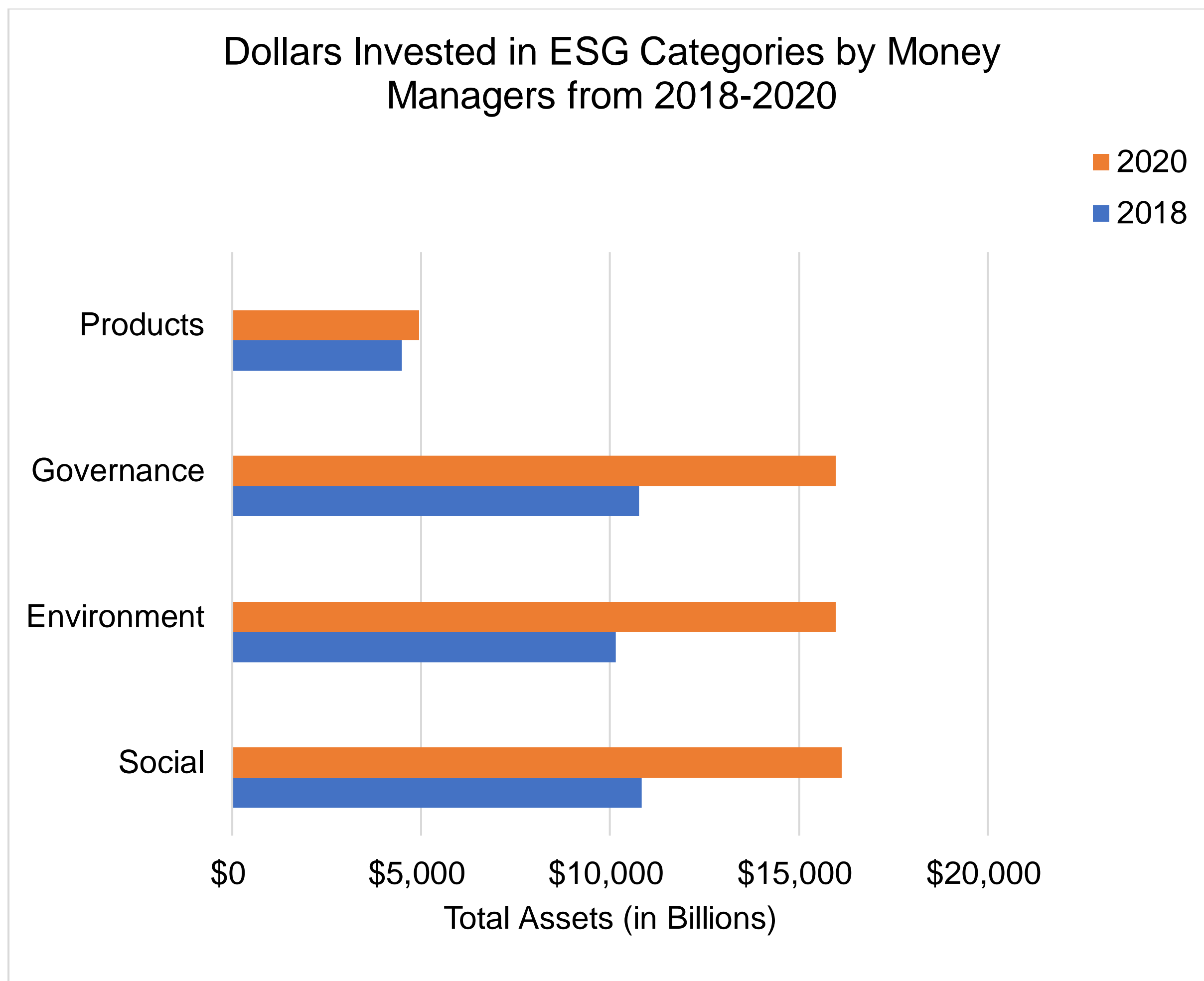
Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Figure 4 represents dollars invested in ESG categories by Money Managers from 2018-2020. Money managers are persons or firms that invest on behalf of an individual. Per Figure 4,

environmental, social, and governance are all pretty closely rated, but social issues were a little more than environmental and governance issues.

Figure 4

Dollars Invested in ESG Categories by Money Managers from 2018-2020



Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Figure 5 illustrates the top 5 ESG criteria for money managers in 2020. Figure 5 separates the ESG categories and depicts the top 5 by asset amount. Climate change is the

number one criterion and continues to grow. Although executive pay had the most growth of 122% from 2018 to 2020, sustainability grew 81%, board issues 66%, and anti-corruption grew by 10% (USSIF, 2020).

Figure 5

Top 5 ESG Criteria for Money Managers 2020

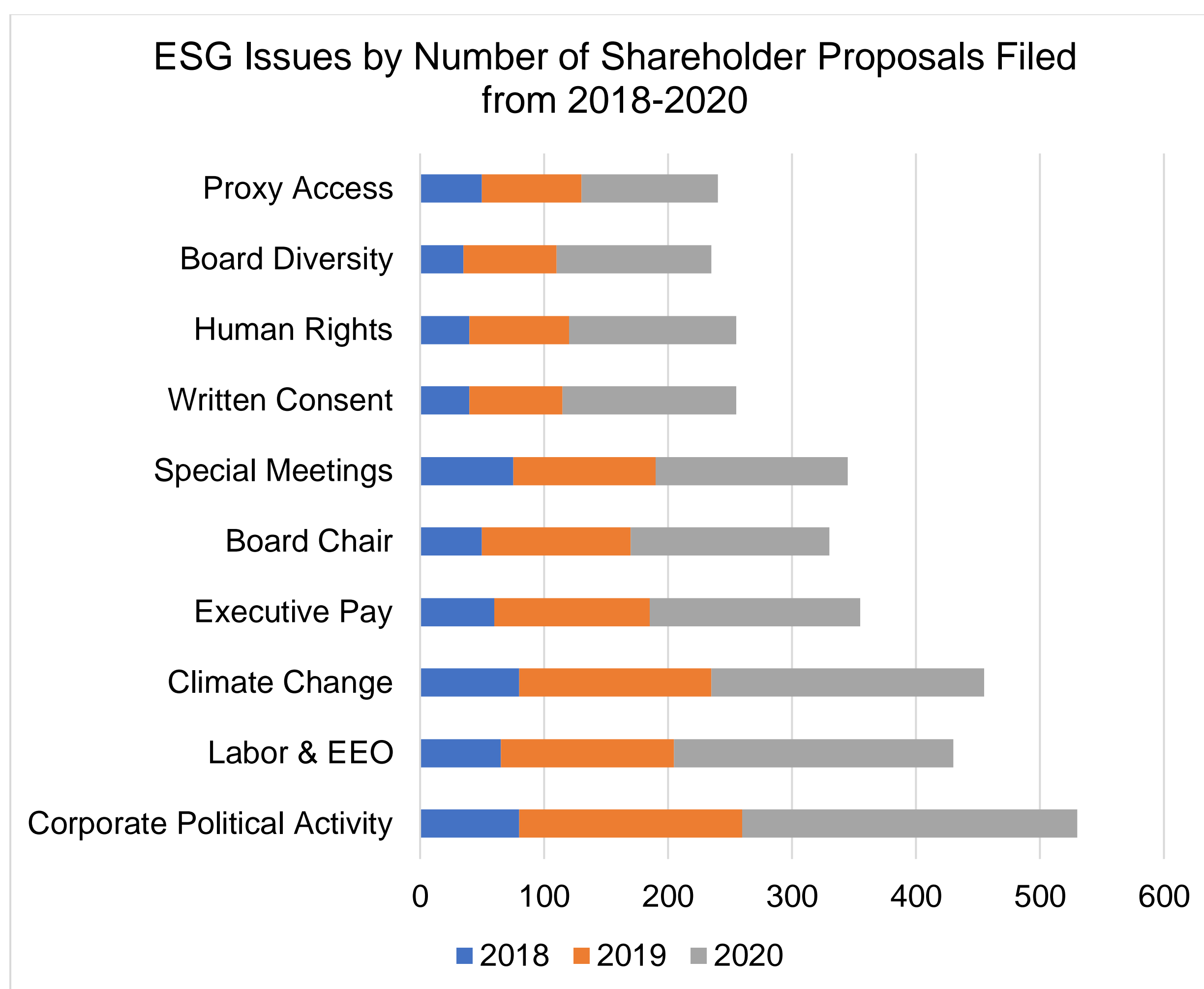
Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Figure 6 illustrates the leading issues raised by shareholders. Figure 6 shows that most proposals filed were related to corporate political activity. "These resolutions focused on company contributions aimed at influencing elections or on corporate lobbying to influence laws

and elections. Many of the targets were companies that have supported lobbying organizations that oppose regulations to curb greenhouse gas emissions" (USSIF, 2020). Fair labor and equal employment opportunity are second, many of the resolutions filed focused on gender pay equity. Climate change is listed as third.

Figure 6

ESG Issues by Number of Shareholder Proposals Filed from 2018-2020



Note. From *Report on US Sustainable and Impact Investing Trends 2020*. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf. 2020.

Organizations

To differentiate between the organizations referenced in this paper and better assist with comprehensive understanding an explanation of each organization follows. The United Nations has a Division of Sustainable Development Goals (DSDG) that is in the United Nations Department of Economic and Social Affairs. The DSDG has developed 17 sustainable development goals. These goals correlate to the 2030 Agenda for Sustainable Development that was adopted by all UN nations in 2015. The 17 sustainable development goals are in order as follows and as listed in *Transforming our world: The 2030 Agenda for Sustainable Development* (UN General Assembly, 2015).

- Goal 1. End poverty in all its forms everywhere
- Goal 2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture
- Goal 3. Ensure healthy lives and promote well-being for all at all ages
- Goal 4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
- Goal 5. Achieve gender equality and empower all women and girls
- Goal 6. Ensure availability and sustainable management of water and sanitation for all
- Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all
- Goal 8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Goal 9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
- Goal 10. Reduce inequality within and among countries

- Goal 11. Make cities and human settlements inclusive, safe, resilient and sustainable
- Goal 12. Ensure sustainable consumption and production patterns
- Goal 13. Take urgent action to combat climate change and its impacts*
- Goal 14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development
- Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
- Goal 16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
- Goal 17. Strengthen the means of implementation and revitalize the global partnership for sustainable development

The UN Principles of Responsible Investment (UN PRI) was founded in 2006 but began in 2005 when the then UN Secretary-General, Kofi Annan invited others to develop the PRI. They launched at the NYSE in April 2006. They are supported by the UN but are not the UN. They are partners with the UN Environment Programme Finance Initiative and the UN Global Compact. The UN PRI has six guiding principles for responsible investing. They are as follows and as listed as of 2017 in *What are the Principles of Responsible Investing?*

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

The UN PRI now has more than 3,000 signatories worldwide.

The Global Reporting Initiative (GRI) was founded in 1997 in Boston after the Exxon Valdez oil spill. GRI has sustainability reporting guidelines for global institutions and businesses. They provide the framework for sustainability reporting and help companies become transparent and be responsible for their impact. They were the first to set global sustainability reporting standards in 2016. They will assist companies in becoming better at reporting and ESG disclosure.

The US SIF or The Forum for Sustainable and Responsible Investment is a member-based US non-profit. It uses GRI guidelines, and its mission is to rapidly shift investment practices towards sustainability. The USSIF are members of the Global Sustainable Investment Alliance (GSIA) and the US Impact Investing Alliance. These two organizations are both member-based but the GSIA is a worldwide organization. The US Impact Investing Alliance is

more of a lobbying firm for the United States. It advocates and supports policies. It tries to move the issue forward towards a more sustainable future.

In Figure 1 we illustrated the growth of ESG from 1995 to 2020. In 2020, ESG funds continued to grow and even excelled during Covid-19.

> Covid-19 has also acted as a turning points of sorts. Not only has the global pandemic underlined the importance of resilient business models, but it's shown that how companies treat all their stakeholders – including employees and customers – can impact the bottom line (Stevens, 2020).

2020 was not just about the pandemic, it also shone a light on racial justice, workplace issues most likely helped propel the increase in socially responsible funds. According to Morningstar, "there were 534 index funds focused on sustainability, overseeing a combined $250 billion" (Steven, 2020). Hale goes further to state:

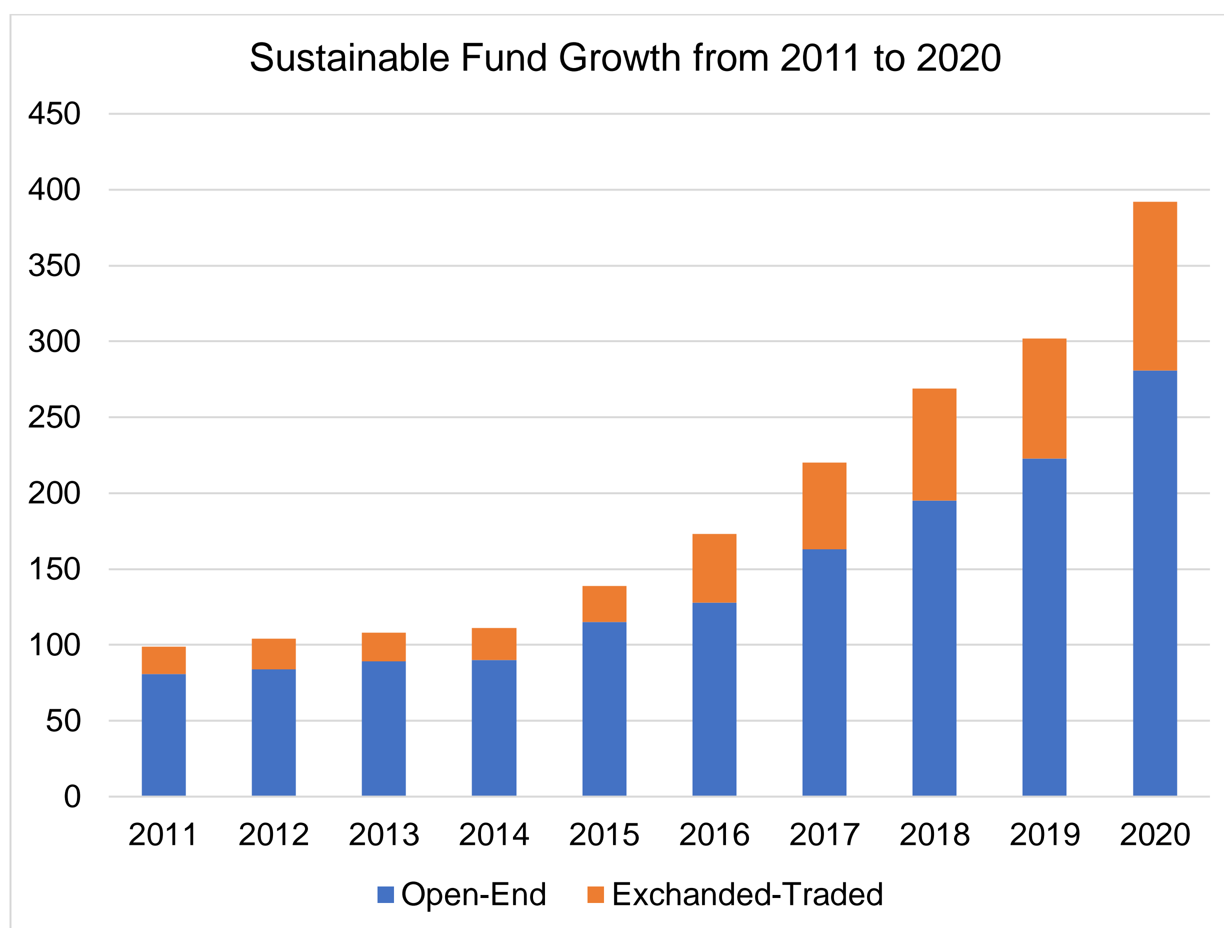
> The turbulent events of 2020 – the global coronavirus pandemic, continued weather extremes, the movement for racial justice in the United States, and the U.S. presidential election- underscored the salience of sustainability concerns to investment managers and strengthened the rationale for end investors to invest in a sustainable way. This climate has fueled the continued growth of the U.S. sustainable fund universe, both in terms of the total number of funds and flows (2020).

Figure 7 depicts the nearly quadrupled amount of sustainable funds in the past ten years. Open-ended funds are mostly mutual funds. Mutual funds are diversified and contain a number of stocks and bonds. They are traded at the end of the day. Exchange-traded funds or ETFs are similar to mutual funds in that it is a diversified group of stocks and bonds, but they can be more specific into a certain sector. They are traded much like individual stocks. There were 392

combined sustainable ETFs and Open-ended funds by the end of 2020 available to the United States with 534 index funds globally. Figure 8 illustrates the total amount of assets invested in sustainable funds from 2009 to the end of 2020. Another way to see the growth of ESG investing is by addressing the new funds launched this year. In 2020, there were 71 new funds started.

Figure 7

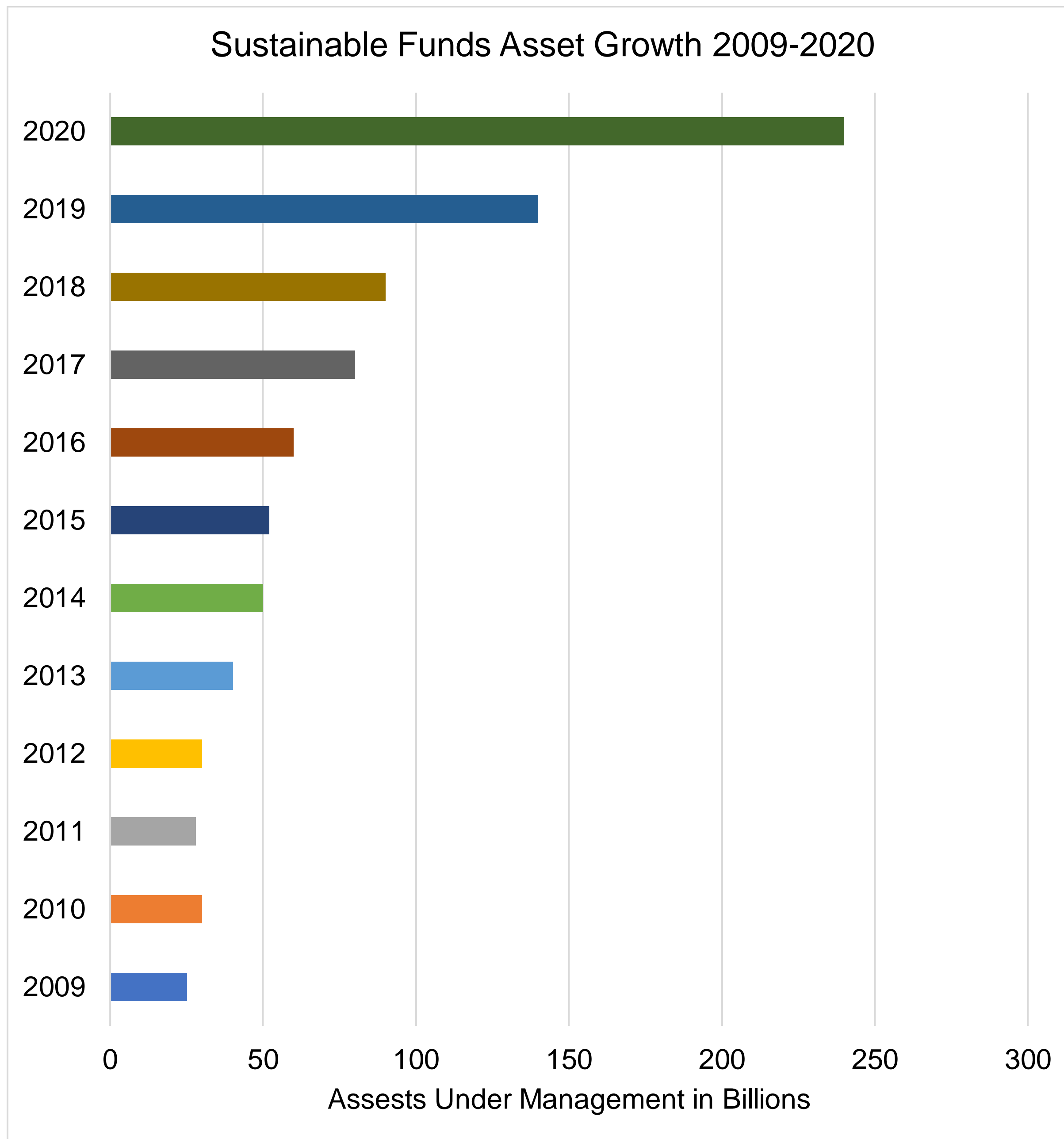
Sustainable Fund Growth from 2011-2020



Note. From *U.S. Sustainable Funds Continued to Break Records in 2020.* https://www.morningstar.com/articles/1026261/us-sustainable-funds-continued-to-break-records-in-2020. Copyright 2021 by Morningstar, Inc.

Figure 8

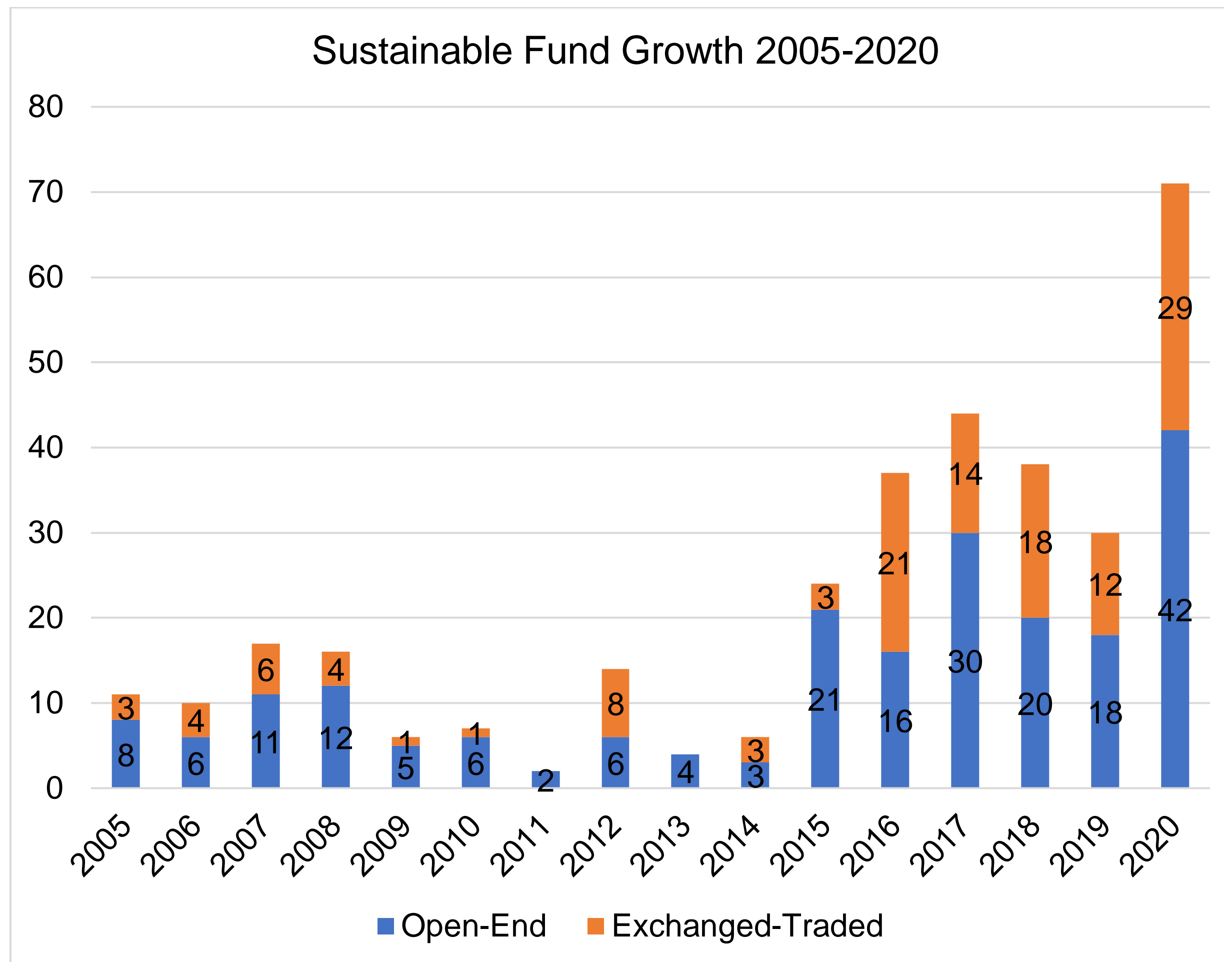
Sustainable Funds Asset Growth 2009-2020



Note. From *U.S. Sustainable Funds Continued to Break Records in 2020.* https://www.morningstar.com/articles/1026261/us-sustainable-funds-continued-to-break-records-in-2020. Copyright 2021 by Morningstar, Inc.

Figure 9

Sustainable Fund Growth 2005-2020



Note. From *U.S. Sustainable Funds Continued to Break Records in 2020.* https://www.morningstar.com/articles/1026261/us-sustainable-funds-continued-to-break-records-in-2020. Copyright 2021 by Morningstar, Inc.

Figure 9 illustrates the new funds that started each year from 2005 to 2020. Each graph represents an area of growth in ESG investing. When taken all together, the reader should see that the number of sustainable funds available grew by four-fold, the total assets invested

increased, and the number of new funds started grew more than ever before. This represents an area of investing that is expanding and is showing no signs of stopping anytime soon.

The continued growth of ESG investments is hard to miss with this information. The future of ESG investing is bright. According to Sullivan and Collins, the ESG funds in the United States will comprise fifty percent of professionally managed funds by 2025 and they estimate that 200 new funds will launch in the next three years (2020). In the Sustainalytics annual outlook report for 2021, they provided “investors with 10 environmental, social, and governance investment themes for 2021 that can positively contribute to advancing the United Nation’s Sustainable Development Goals" (Sustainayltics, 2021). These 10 themes included biological pesticides, precision farming, natural food preservatives, organic feed, certified sustainable products, using fish waste, integrated multi-trophic aquaculture, using recycled plastics, reducing food waste, and recovering waste. These investment themes for 2021 are the future of ESG investing. It combines environmental, social, and governance issues with reporting to minimize ESG risk and to help advance the United Nation’s Sustainable Development Goals. With help from technology, better reporting, and improved rating systems ESG investing themes combined with the United Nation’s Sustainable Development Goals can bring us towards a more sustainable future.

ESG Ratings

It is difficult for an individual investor to know if a company is making a positive or negative impact on the environment, if their board is corrupt, or how their employee wages compare to the CEO's salary. For investors and advisors to find this information out there are multiple reporting agencies that give companies an ESG rating. There are about 30 ESG rating agencies worldwide. There are only a few that are global and others that are more locally

specific. There are no standards for ESG ratings, so some companies use AAA as the best score, while other companies use a numerical scale. Doyle explains, “The wide adoption of ESG ratings is the result of asset managers signing the United Nation’s Principles for Responsible Investment” (2018). As stated earlier in this paper, the UN PRI now has 3,000 signatories. Companies have been rated by their financial performance alone for many, many years, but by incorporating their CSR performance, they are being rated on their overall behavior including environmental, social, and governance actions. “The practice of socially responsible investing (SRI) aims to change the institutional context for firms by allowing investors to employ negative and positive screens that penalize firms which do not abide by CSR norms while benefiting firms that do” (Avetisyan & Hockerts, 2016, p. 317).

There are four major rating agencies that will be discussed further including MSCI, ISS, CSRHub, and Sustainalytics. MSCI stands for Morgan Stanly Capital International and was founded in 1969. *The Consolidation of the ESG Rating Industry as an Enactment of Institutional Retrogression,* by Avetisyan and Hockerts state,

> MSCI entered the ESG market by acquiring RiskMetrics, which enabled it to obtain the knowledge, capabilities, methods and client bases of the two rating agencies that had created and dominated the SRI industry since the 1990s. This is because RiskMetrics, in 2009, had consolidated the US ESG-rating-agency sector by acquiring two industry pioneers: KLD and Innovest (2016, p. 321).

MSCI has ratings from AAA-CCC and rates companies as laggard, average, or a leader in their industry. MSCI has 35 key issues that companies are assessed on depending on their industry. A technology company would be assessed on their privacy policy but not their water management, like a mining company would be. All companies are rated on their corporate

governance and behavior because it pertains to all industries. MSCI uses public data and gives a percentage to each risk. They combine these to give an overall rating. MSCI has a free search on its website. MSCI, like other rating agencies, has its own ESG indexes that go by certain ESG criteria.

Institutional Shareholder Services, ISS, was founded in 1985. The ISS uses 1,000 data factors and a numerical scale of 0-100 with 100 being the best. It has 5 ESG scorecard key elements that are 1) climate, social and governance risk, 2) industry key issues, 3) UN sustainable developmental goals impact on products and services, 4) industry risk profile, and 5) EU taxonomy. The ISS uses the UN SDGs to decide on investments for a more measurable impact. ISS also uses the EU taxonomy as an assessment tool to get information. Schütze et al. state, “By developing a taxonomy for sustainable investments, the EU Commission has created the first standardized criteria for climate-friendly economic activities” (2020).

CSRHub is another rating agency. They use four main categories, community, employees, environment, and governance. Each of the four categories has 3 subcategories. Under community are human rights and supply chain, community development and philanthropy, and product. The employee’s category has compensation and benefits, diversity and labor rights, and training, safety and health. Environment includes energy and climate, environmental policies and reporting, and resource management. Under governance are board, leadership ethics, and transparency and reporting. CSRhub uses data sources that are listed on their website and they put a numerical value to each one of the above-mentioned areas that have been quantified. CSRhub also uses a numerical scale of 0-100, with 100 being the best. CSRhub also has a free search on their website. It gives an industry average and lists basic information for free.

Sustainalytics also measures ESG risk but uses a numerical scale of 0-100, with the lower score equaling the lowest risk. Sustainalytics has two main categories exposure and management. Exposure is the exposed ESG risk to the company determined by the industry. The management category takes into account how well the company is at managing the ESG risk. Together they make up the overall rating. Sustainalytics also gives an industry comparison and has a free search on their website that gives basic information.

ESG ratings have their limitations. Critics of ESG ratings state a few downsides that should be considered when using ESG ratings. According to Doyle, "ratings agencies attempt to apply a one-size-fits-all approach which has created consistently skewed benefits for large and multi-national companies" (2018). Three areas to consider are 1) there is no standardization between agencies, 2) larger firms have increased ratings, and 3) variation of regulations depending on location.

Above, four rating agencies were described and each one had different elements or criteria considered when rating a company. They also each had different rating systems. There is no standardization. During this last half-century rating agencies have consolidated. Some have merged and others have been acquired. This consolidation, according to Avetisyan and Hockerts, "leads to the provision of increasingly standardized and commoditizes sustainability data" (2016, p. 327). Thus, we may not be there yet, but maybe we are on our way to a more standardized and universal set of guidelines to rate companies along ESG criteria.

The second area of concern for using ESG ratings is that larger companies have higher ESG ratings. This statement reflects the thinking that a larger company can afford to have more disclosure than a mid to small-sized company. This means that the larger company might not be more aligned with the ESG criteria than a smaller company but can just afford to disclose what it

does. On the other hand, a larger company might be able to invest more towards their ESG policies. There are many variables regarding this issue. Some ESG rating agencies factor in firm size, while others do not. If this rating depends on disclosure, that is also another form of transparency, which is a good thing. The fact that smaller companies do not disclose this information in no way means that they are not as sustainable, but most rating agencies take the lack of disclosure as a bad sign. No news is not good news where ESG ratings are concerned. Also, larger firms may be more at risk than smaller and mid-sized companies when it comes to ESG criteria. According to Drempetic, Klein, and Zwergel, in *The Influence of Firm Size on the ESG Score: Corporate Sustainability Ratings Under Review*, they "confirm the highly significant relationship between data availability and ESG scores in all sectors" (2019, p. 348). They also confirmed the link between larger firm size and higher ESG rating using Thomson Reuters $ASSET_4ESG$ ratings.

Geography also plays a part in ESG ratings. Laws requiring disclosure are different from country to country and so are environmental and social regulations. European companies get higher rankings than the United States. Earlier in this paper, the European Union's taxonomy was discussed. The EU's taxonomy is a classification system for sustainable investments and is used to help the country meet its environmental goals for 2030. Europeans are well ahead of the game compared to the United States. The EU has adopted other requirements as well, according to Doyle,

> In Europe, the EU requires companies with 500 employees or more to publish a "non-financial statement" as well as additional disclosures around diversity policy. North America has no such requirements for disclosure which is one source for the positive bias toward European companies (2018).

Knowing that there are problems with the ESG rating system should not dismiss them as a whole, but to use them and be aware of their limitations. When using ESG ratings, use more than one rating agency, and be mindful of the location of the firm and the size of the firm.

Even though ESG ratings are far from perfect, they have value to the investor and the company. ESG ratings can affect the company and the stock market. "ESG ratings provide one of the few comparable sources of data on a wide range of CSR-related policies, practices and performances" according to Clementino and Perkins, (2020). Stories regarding a company's corporate social responsibility policies are in the news almost every day.

> Investors and analysts have access to more information than ever on firms' behavior toward environmental, social and corporate governance issues. And whether they like it or not, corporate executives have to take into account CSR concerns, if only to improve financial performance and lower risks" (Capelle-Blancard and Petit, 2017, p. 557).

News regarding CSR policies affect stock market prices, consider the news of an oil spill, a recall on cars, or news that a company hired its first woman CEO. According to Capelle-Blancard and Petit, "firms coping with ESG negative events experience low but significant drop in their market value" (2017, p. 544). On the other hand, positive news rarely shows an increase in stock value. Although, according to Clementino and Perkins,

> ESG ratings can, in certain cases, contribute to the incorporation of new CSR issues into firms' policy, practice and strategy; provoke internal organisational change required to more effectively operationalise business ethics and sustainability; and elevate the strategic importance of addressing ESG issues (2020).

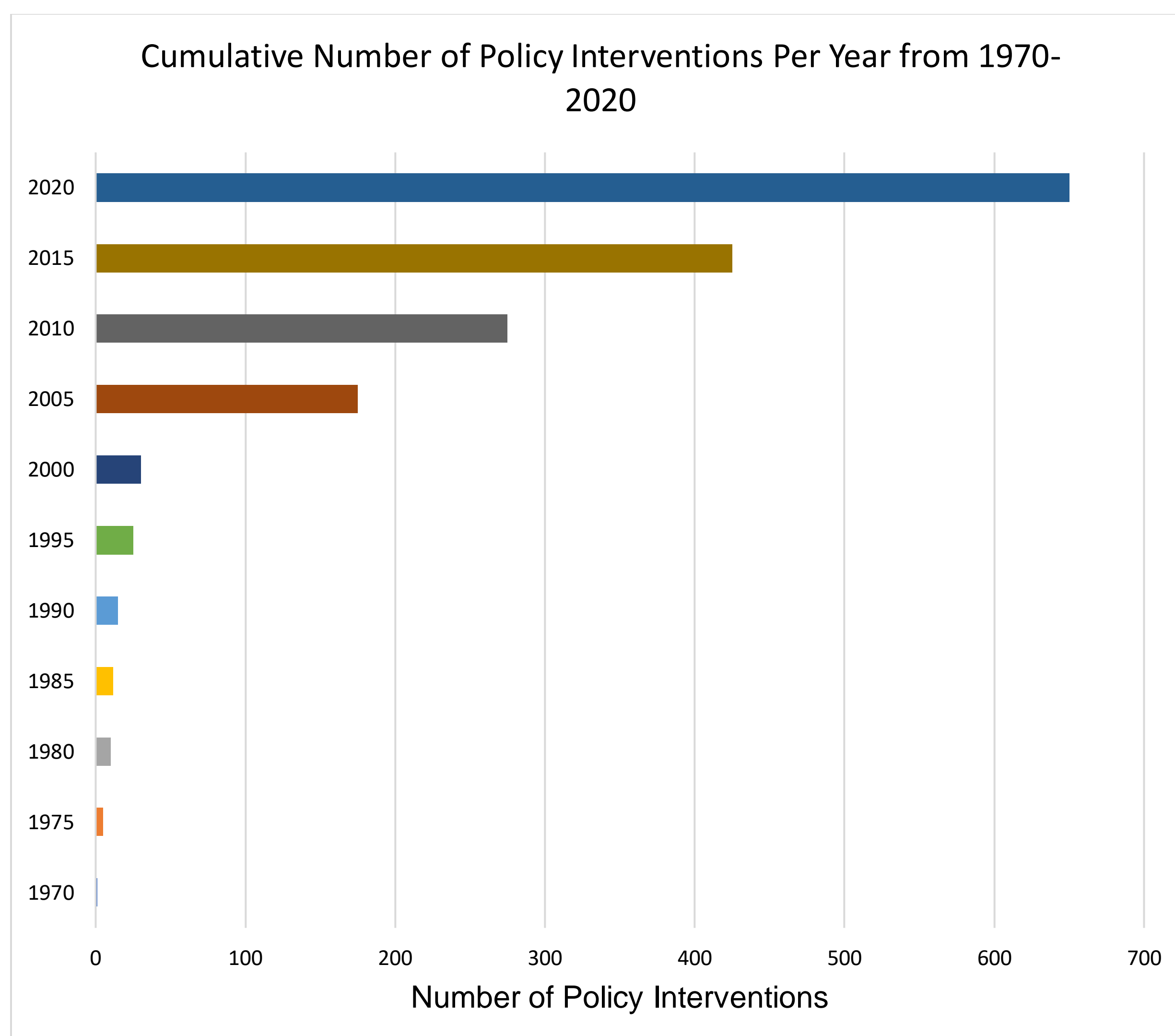
Laws and Regulations

Laws and regulations regarding ESG investing, sustainable finance and investments are growing considerably. According to PRI, there have been "124 new or revised policy instruments in 2020, the highest number so far and 32 more than the previous year" (PRI Regulation Database, 2021). Some issues regarding regulations have been discussed earlier in this paper. EU is leading the change, whereas the United States is lagging in this area. The Securities and Exchange Commission (SEC) is the regulatory lead for ESG regulation in the United States. The SEC has a "hands-off attitude to ESG reporting" (Jebe, 2019). The SEC requires companies to disclose material information. Jebe states that, "The definition of materiality has historically been controlled by the government, which focuses on a narrow concept of materiality confined to economic information" (2019). The SEC was petitioned in 2018 using data from "the Sustainability Accounting Standards Board's (SASB) conclusion that approximately 93% of US capital market value is susceptible to material financial implications from climate change in order to bolster their argument for how ESG issues meet SEC's materiality thresholds" (The rise of ESG, 2019). The federal government may not be taking action on sustainable investing, but the states are setting their own regulations in the United States. Illinois and California have passed state requirements. In September 2019, "Illinois signed the Sustainable Investing Act into law, signaling the next step in state ESG integration requirements" (The rise of ESG, 2019). This law went into effect in January 2020. According to *The Rise of ESG Regulation*, other states have ESG requirements or have them pending including California, Massachusetts, Minnesota, and New Jersey (2019). The SEC may be turning the corner on ESG disclosure. Their website is taking public comment on climate disclosure as of March 15, 2021. The SEC also released a press release on March 4, 2021, announcing, "the

creation of a climate and ESG Task Force in the Division of Enforcement" (SEC, 2021). Per the SEC this is, "Consistent with increasing investor focus and reliance on climate and ESG-related disclosure and investment, the Climate and ESG Task Force will develop initiatives to proactively identify ESG-related misconduct" (2021).

Figure 10

Cumulative Number of Policy Interventions Per Year 1970-2020



Note. Regulation database. From https://www.unpri.org/policy/regulation-database. Copyright January 2021 by PRI.

Greenwashing is becoming more of an investor/consumer-based issue as more people seek out sustainable investments and products and services. Greenwashing is "the practice by which companies claim they are doing more for the environment than they actually are" (Tzavara, 2021). This is a complex issue and that has many types. Greenwashing is defined by Delmas and Burbano, in *The Drivers of Greenwashing* as "the intersection of two firm behaviors: poor environmental performance and positive communication about environmental performance" (2011). They describe the drivers of greenwashing as either external, organizational, or individual as depicted in Figure 11. External drivers are consumer and investor demand for green products or services. Organizational drivers are incentives for companies, organizational communications, and organizational ethics. Individual drivers are factors that influence individual decision-making. An example of greenwashing is Volkswagen lying about their car emissions.

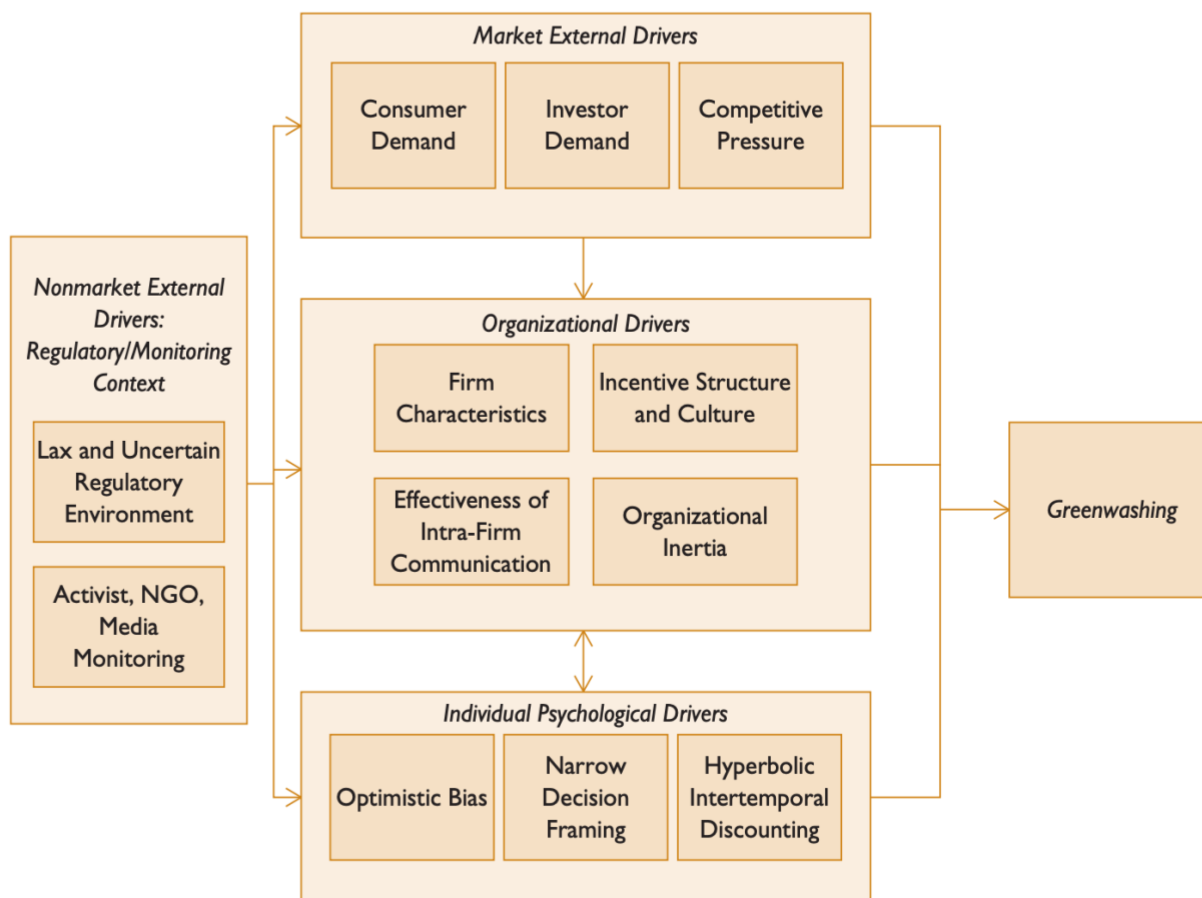
Earlier, it was discussed that ESG ratings have an impact on a company's stock value. According to Capelle-Blancard and Petit, "the impact of negative ESG news on firms' market value is lower for firms which are prone to greenwashing" (2017, p. 549). Lyon and Maxwell, go on to state that part of the reason may be that,

> although companies naturally want to publicize their environmentally friendly actions, they are often surprisingly hesitant to promote their environmental successes or to issue detailed environmental reports. Parts of the reason appears to be that activists react more angrily to firms that lay claim to being virtuous, and then are discovered to have feet of clay, than to firms that never make such claims (2011, p. 4).

The EU is putting regulations in place to eliminate greenwashing. "The regulation intends to raise awareness within the markets about sustainability and reduce the number of unsubstantiated and misleading claims about sustainable attributes of investments" ("The rise of ESG", 2019).

Figure 11

Drivers of Greenwashing



Note. From "Drivers of Greenwashing", by M.A. Delmas & V.C. Burbano, 2011, *California Management Review, 54*(1),64-87 doi:10.1525/cmr.2011.54.1.64. Copyright 2011 by California Management Review.

Screening

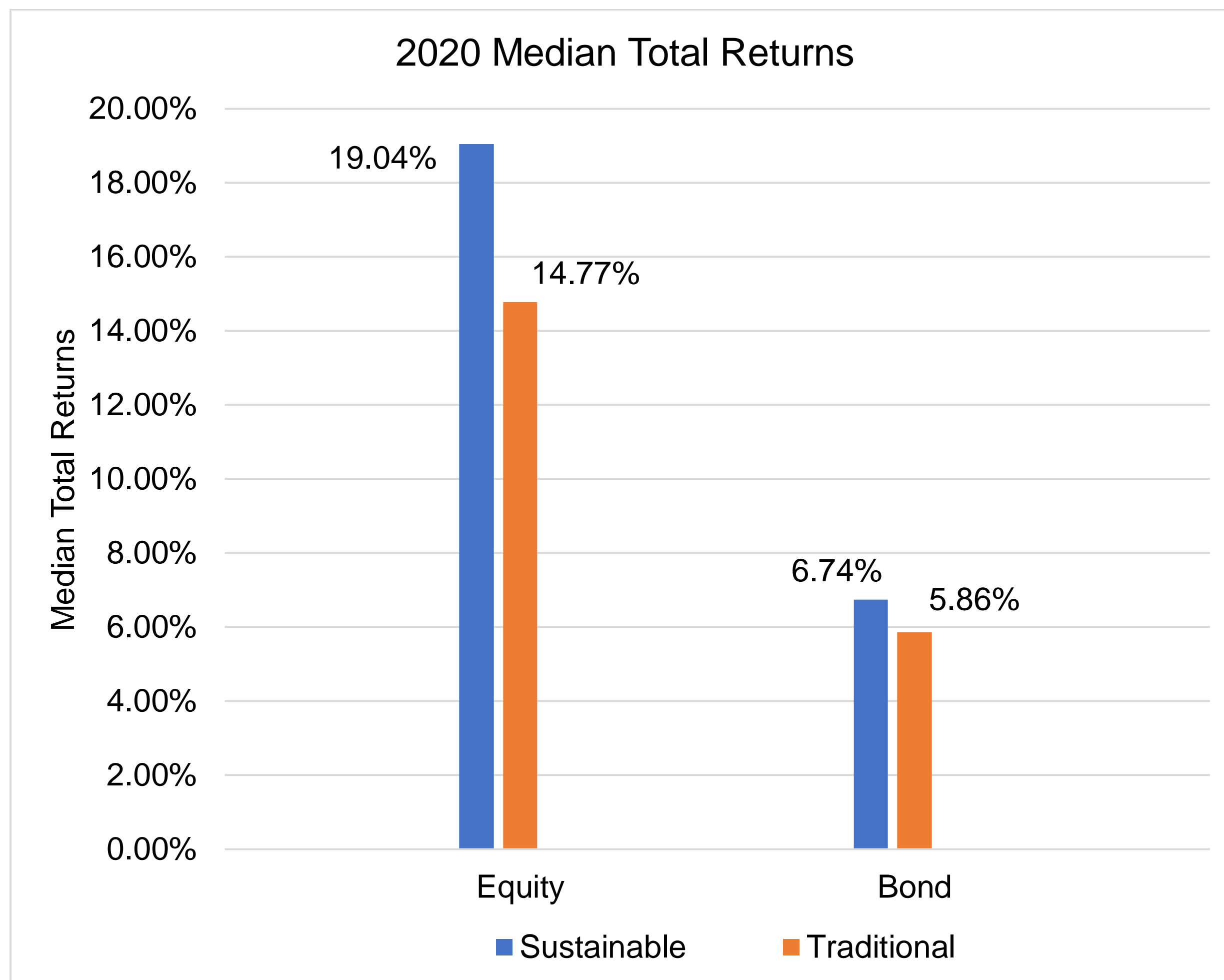
Investment strategies include screening stocks. Screening stocks can be exclusionary or inclusionary. Negative screening and positive screening are also used. Negative or exclusionary screening is initially how the ESG movement began. Faith-based investors chose not to invest in companies that they morally disagreed with. Presently, investors choose to screen out sin stocks, gambling, tobacco, alcohol, and weapons. Under the ESG lens, an investor may also exclude nuclear power, repressive regimes, and discrimination, to name a few. Positive screening or inclusionary screening is when an investor chooses a company for its positive impact whether it be environmental, social, or governance. According to Kempf and Osthoff, "it pays for investors to screen their portfolio with respect to socially responsible criteria and it is worthwhile to use several screens at the same time" (2007, p. 916).

ESG Funds and Financial Performance

It has long been said that because ESG investing excluded industries that the financial return was less. This is no longer the case. In, *The Effect of Socially Responsible Investing on Portfolio Performance*, Kempf and Osthoff, "suggest that past SRI ratings are valuable information for investors. A simple trading strategy based on this publicly available information leads to high abnormal returns" (2007, p. 921). The link between ESG investing and positive financial returns have never been as high as it is now. During the 2020 worldwide pandemic, Covid-19 destroyed stock markets. "In 2020, sustainable funds demonstrated that investing with an emphasis on how a company manages material ESG risks and how it manages key stakeholders can produce good returns in an uncertain economic environment" (Hale, 2021).

Figure 12

2020 Median Total Returns

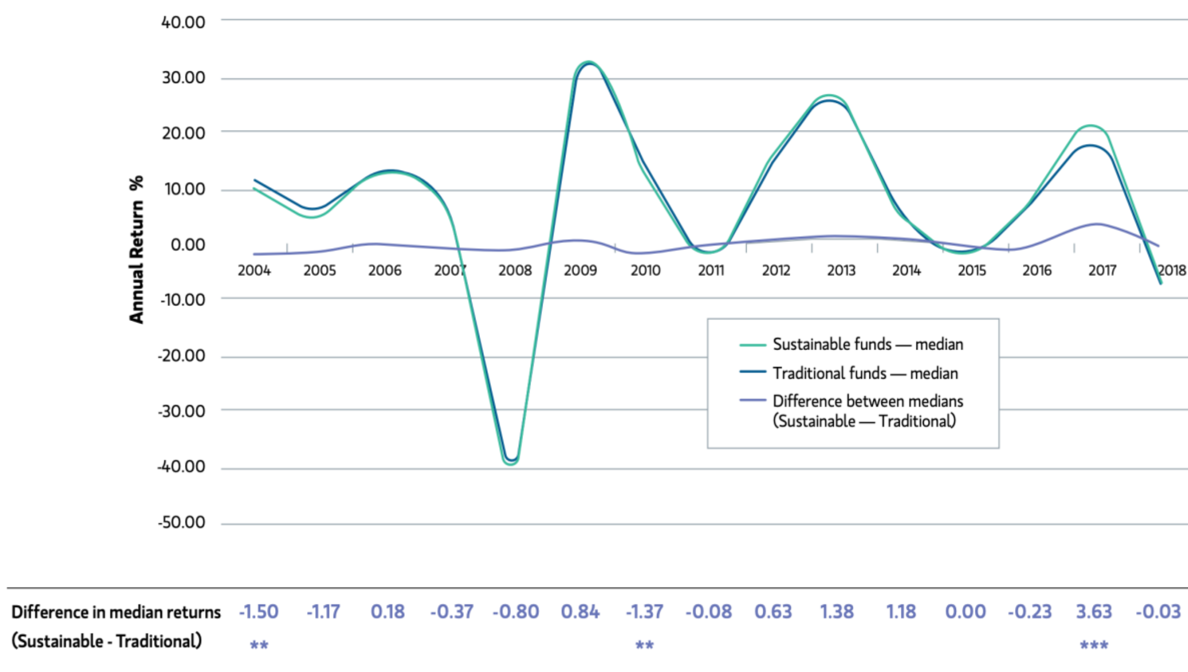


Note. Sustainable Funds Beat Peers in 2020. From https://www.morganstanley.com/ideas/esg-funds-outperform-peers-coronavirus. Copyright 2021 by Morgan Stanley.

Figure 12 depicts that the total median return of sustainable mutual funds and ETFs were 4.3% more than traditional funds in 2020 and that sustainable bonds were 0.9% more than their traditional peers ("Sustainable Funds Beat", 2020).

Figure 13

Median Total Returns of Sustainable and Traditional Funds, 2004-2018



Note. Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds. From https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of _ Sustainable_Funds.pdf. Copyright 2019 by Morgan Stanley & Co.

Figure 13 shows how close to equal sustainable funds and traditional funds were during the time period of 2004-2018. The differences between the two are listed at the bottom of the chart and are rather insignificant. This data coupled with the data in Figure 12 signifies the ability of ESG criteria to manage risk. Sustainable funds not only compete with their traditional counterparts, but they are good at managing risks. In *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds,* by Morgan Stanley Institute for Sustainable Investing, it states,

> The returns of sustainable funds are in line with those of traditional funds, while also offering lower downside risk for investors. What's more, in an uncertain market, sustainable funds may offer a layer of stability for investors looking to reduce volatility (2019, p. 9).

Managing for ESG risk can be profitable.

There have been numerous studies on this topic of financial performance. The basic notion that it lags behind traditional investing has been put to rest for most investors. According to Kiernan, in *Investing in a Sustainable World: Why GREEN Is the New Color of Money on Wall Street,* he states, "companies with superior performance and positions on "sustainability" (i.e., environmental and social) issues achieved, on average, superior financial returns" (2009, p xiii). Although there remain some critics who believe that ESG is just a passing phase. Friede, et al., conclude, "we clearly find evidence for the business case for ESG investing. This finding contrasts with the common perception among investors" (2015, p. 226). Admittingly, there is a need for more studies relating to the many facets of ESG investing that have been discussed in this paper. There is much to be said about how we measure for impact, the need for standardization of ESG ratings, increasing regulations for disclosures, etc. but as this area of investing remains young, investors and consumers can remain hopeful. Trelstad states, "we need better tools to help investment professionals understand the potentially limitless combinations and permutations of financial and impact goals" (2016, p. 13).

Why Should You Care

According to the UN, on March 28, 2019, they reported that there were "only 11 years left to prevent irreversible damage from climate change" (Only 11 years left, 2019). The world population is 7.9 billion people as of 2021. There are only so many resources that the Earth

provides. Having to take care of so many people strains these resources, leaving people impoverished and deprived of clean air and water. In addition, trees are cut down for people to live, for them to keep warm, and eat. That leads to decreased biodiversity and deforestation. These and a number of other issues plague our world today. These problems are not only for individuals but for businesses as well. First of all, if we do not take these issues seriously and continue to do nothing, it will not matter how you invest, because there will be nothing left to invest in. The United Nation's 17 Sustainable Development Goals give companies and countries the framework needed to become sustainable by 2030. Plastun, et al., researched the impact of the SDGS and ESG disclosure regulations. They came to three conclusions:

> 1. The level of ESG disclosure compliance is different in developing countries and emerging countries.
>
> 2. ESG disclosure compliance is higher in developed countries.
>
> 3. ESG disclosure regulation influences the position of the country in SDGI ranking and 50 largest economies. The more country complies with ESG disclosure criteria, the better position in the ranking is. This rule works much better for the case of emerging countries (2020, p. 238).

These results suggest that ESG investing makes an impact towards a more sustainable future. The need for ESG disclosure and increased regulation will help achieve these results.

Investors have both risks and opportunities when addressing these issues. The risk for investors is apparent. The opportunities are limitless. With a global population of 7.9 billion, the untapped potential on how to confront these issues is hopeful. Investors have opportunities to invest in renewable energy, green real estate, eco-tourism, to increase their investment in their community, invest in women and minority run businesses. In *ESG and financial performance:*

aggregated evidence from more than 2000 empirical studies, Friede, Busch, and Bassen state,

> the orientation toward long-term responsible investing should be important for all kinds of rational investors in order to fulfill their fiduciary duties and may better align investors' interests with the broader objectives of society. This requires a detailed and profound understanding of how to integrate ESG criteria into investment processes in order to harvest the full potential of value-enhancing ESG factors (2015, p. 227).

As described in this paper, ESG investing looks as though it is here to stay. ESG investing not only gives a return on investment but also makes an impact. With further regulations and increased awareness, investors can help shape a more sustainable future.

The need to build and develop a better world is more present now than ever. The Covid-19 global pandemic has shown many just how small this planet can be and how necessary it is to work together. Jim Fitterling, Chairman and CEO of Dow, wrote:

> None of us could have predicted all the serious challenges we'd face in 2020: countless natural disasters, a pandemic, economic hardship and continued racial injustice. 2021's onset doesn't naturally end any of them; they are interconnected issues, not isolated problems. To take care of our people and protect our planet, we need to work together. We must collaborate across business, government, NGOs, academia and society to invest in and create shared solutions to mitigate the impacts of climate change, improve public health, strengthen our global economy and foster greater equality and inclusion. We all desire a better, more resilient world; it's only achievable if we come together – civilly, thoughtfully, and wholeheartedly. (Markovitz and Sault, 2021).

The Chairman of Hong Kong Exchanges and Clearing Ltd, Laura M. Cha wrote:

> The pandemic won't disappear with a new calendar year, but there are now encouraging signs of recovery. This year we will need strong leadership from around the globe to build a better world. To create that positive change we need a new playbook, where sustainable business, the adoption of ESG principles and resilient and robust capital markets can provide the cornerstones of our economic recovery and long-term prosperity. The readiness of investors, issuers, regulators and market operators to link financing to ESG data and performance will be key to our future. Capital markets have a major role to play in financing the world's sustainability journey – we already know that, we have all the pieces, we just now need to put them in play for a better and brighter future (Markovitz and Sault, 2021).

This is why you should care.

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