

How ESG Factors Impact A Company's Operations And Investment Decisions

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Responsible Investment and the Meaning of ESG

Responsible investments include incorporating the investment process with corporate governance, environmental and social factors, and financial factors. It can also be termed ethical investing, green investing, socially responsible investment, and triple-bottom-line.

All these names are, however, focused on the same goal of long-term value creation. It is a strategy aimed at generating sustainability and financial value. For responsible real and financial investments, banks should incorporate all forms of factors bound to lead them to profitability. Banking institutions are involved in real investments- investing in property or tangible assets as well as financial investments- investing in bonds; the strategies do not act only on economic value but also on environmental sustainability, justice, and fairness.

Environmental, Social, and Governance Factors in Business

Environmental factors cover environmental issues such as climate change and raw material depletion that affect the choices of investment. In other words, environmental factors analyze how a company is performing as a steward of the natural environment. This criterion examines the environmental risks that affect profitability in terms of investment return and how companies can mitigate the risk (Scott-Quinn & Cano, 2018). For example, a company may face risks related to hazardous waste disposal and environmental regulations that deal with toxic substance emissions and contamination of the natural environment. These issues have pressured investors to adopt sustainability covers. These factors act as externalities that affect revenues and the functioning of the company. For instance, companies investing in nuclear energy are bound to gain more profits as they escape governments' regulations and legal suits and protect the environment by limiting the emission of carbon dioxide.

Social factors evaluate the company's business relationship in regard to its daily operations. These factors show the recruitment policies of the company and the degree of diversity in the workforce. Diversity optimizes agility and innovation by ensuring the company focuses on the importance of having a diverse workforce with different talents and abilities. Subsequently, social factors tie the social responsibilities and human rights concern welfare to the financial capabilities of the organization. For example, ensuring employees' welfare leads to increased profitability, and

appreciating the local communities builds a positive perception of the company. Effective social relations with the public and the company attract a wide range of investors who, in turn, increase the company's profitability. For instance, a company that ensures that its clients

Regarding governance factors, investors are mainly focused on how the company handles important issues and the stockholders' role in decision-making. Additionally, corporate governance entails the use of accurate accounting methods. The governance factors highlight whether there is a conflict of interest between shareholders and the company when choosing board members. For instance, investors will not prefer to invest in a company that does not consider their opinion when electing board members. In relevance to profitability, these factors prevent fraud and ensure transparency in its operations.

ESG Criteria in Corporate and Investment Decisions

In summary, ESG factors impact a company's operations and investment decisions in terms of financials on the basis of cost, revenue, and the cost of finance. Companies that incorporate these ESG factors can take advantage of generating profits in terms of profit margin growth. These factors enable companies to generate profits by ensuring a constant return on investment and effective and efficient operation. These factors also ensure effective management, hence attracting a wide market and increasing the company's price share. Ultimately, the ESG factors enable companies to escape cases of value-destroying reputational risk from issues such as climate change, pollution, working conditions, employee diversity, corruption, and aggressive tax strategies, which affect the company share price, profitability, social perception, and overall decision-making.

Based on ESG factors that dictate the concept of responsible investment, the bank should reject investment proposals from new potential borrowers and existing clients. While maximizing the long-term risks involved in carbon emission utilities, the bank should reconsider its decision to lend to these companies since they depend on carbon-based fuels. Hence, their demand for their output will fall, and in turn, their assets will end up losing value. In consideration of responsible investment, the bank policy should include several investment strategies, which include positive selection, exclusion, Activism engagement, and integration.

Activism ensures that shareholders support the investment proposal. Considering the bank's situation, the investment should be rejected even if the shareholders vote in favor of the investment. In the long term, the investment will have drastic implications on the shareholders' value. The board should advise the shareholders against these investments by laying the financial implications of such entities in the next three to four years, considering the factor that the world is changing towards "green energy." Even though the shareholder's value will be maximized initially, it will have a short-term effect, and shareholders should opt against this kind of investment. Sustainable finance for bankers is a controversial topic based on carbon-heavy assets since they are associated with

advanced climatic change.

Climate Risk, Exclusion Strategies, and Shareholder Responsibility

As stated by Caplen (2018), banks should take climate change seriously and input commitment measures to combat climate change. A positive selection strategy ensures that the investment portfolio chosen adheres to all ESG criteria. The companies in question are opposed to the environmental factors, which can result in the collapse of the businesses. According to Caplen (2018), banks should consider environmental criteria and focus their investments on promoting a high to low-carbon economic transition. These will result in a mutual outcome for both the bankers and society as a whole. In this essence, supporting investment in CO₂ emitting processes, coal and oil miners will negatively impact the company later on by posing risks of environmental degradation. Lending to such polluting companies involves great financial risk and creates a negative reputational risk to the lending company.

The exclusion investment strategy is based on ESG criteria; the bank should remove the companies from consideration based on the environmental factors criteria. This move will benefit the stakeholder's capital by ensuring that their capital is not exposed to risks, which can result in significant losses (Scott-Quinn & Cano, 2018). Through the act of refusing to lend money to such companies, which pose a greater risk to the environment and society, the companies have since transformed, and most of them have started to invest in green energy and more renewables while de-investing from carbon-producing processes.

According to the Boston Common Asset Manager survey, 59 banks do not provide climate-related risks in their investment choices. Based on this assumption, the bank should measure its carbon-related assets and exclude finance utilities, which have 5% carbon-related utilities and emissions (Caplen, 2018). Having a balance sheet that is majorly financed by carbon-dependent entities will result in the Bank having a financial crisis in the near future because the entities that the Bank has leased finances will not be able to cover loan installments. These will have an adverse effect on the shareholder's returns since the bank will be unable to pay dividends due to the shareholders due to lack of funds. In conclusion, it does not meet the social factors criteria or address environmental concerns, and it is against ethical corporate governance. Therefore, the investment is irrelevant based on the ESG factors and should be rejected to protect the shareholder's interest while also upholding the Bank's investment options.

Bibliography

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