PIONEERS NEVER REST ON THEIR LAURELS

It had to be taken, that one photo. On the roof. Her roof. Despite the objections of a photographer afraid of heights Masja Zandbergen, Head of ESG Integration, insisted that she be standing between the solar panels on the photo. Proudly. Because the house – her house – is clear proof that it's possible: to make a difference. If you want to. If you have vision. And if you're willing to invest.

KNOWLEDGE IS NOT SUPPOSED TO BE A POOL OF STANDING WATER

Her climate-neutral home in the north of Rotterdam, built in 2017 on former football training grounds, is a shining example of how everyone can help to build a better, more sustainable future. For example, thanks to heat generated within the Earth, the groundwater – at 80 meters below ground level – stays between 13 and 15 degrees Celsius all year round. It is pumped towards the surface, compressed and circulated through the underfloor heating system. Geothermal heat, solar panels, smart use of natural light, and you're there: a climate-neutral house, with no gas and very little electricity. "You have to dare to invest, but you recoup your costs within a few years. Our energy bill is now extremely low."

And investing – to reap the rewards later – is what it's all about, also in her role at Robeco. But the willingness to invest in sustainability only emerges once people become aware of the need, or the opportunities. And that awareness, Zandbergen notes, has really gone into high gear in recent years. At the start of her career, in 1997, Zandbergen – who didn't like to invest in companies that used child labor or had poor working conditions – was met with resistance from portfolio managers when she talked about sustainability considerations.

Now, analyzing both the risks and opportunities of sustainability has become an essential aspect of every financial analysis. "Everyone is more aware of it, society is changing and you see global unrest about the climate, but also about wage inequality, for instance. Companies realize they are being held responsible by shareholders for their CO_2 emissions, production of single-use plastics, tax morale, and so on."

But increased awareness is not enough. Not by a long shot. "There is still a significant lack of knowledge and understanding in relation to sustainability," says Zandbergen. "And for the asset management industry, we have a long way to go when it comes to effectively implementing sustainability in portfolios. There's much more to it than taking part in a race to be the first to offer a trendy new fund just because it will attract new clients." The industry has to take steps, and that's causing a different kind of conflict. You're competing with your peers, you want to be the best, but at the same time you need everyone to move in the right direction. Because working together is the only way to get change on the agenda. And Robeco is leading the pack, she says.

"Our internal research includes input from RobecoSAM, our Swiss affiliate; our portfolio managers understand the importance of that research. They know how to implement the data, and also why it is crucial in the analysis of future risks and opportunity potential." And that knowledge is not a pool of standing water: it's constantly moving. "Our quantitative researchers have succeeded in developing a 'decarbonized value' methodology. There was a lot of pressure to do so, because clients wanted a value portfolio with a smaller footprint, in other words, lower CO_2 risk. Many traditional value companies are part of old, polluting industries. The researchers have now developed a model that enables them to continue their focus on the value factor, yet substantially reduce their footprint."

But don't think for a second that Zandbergen's resting on her laurels now, because despite the daily progress, much remains to be done. We are still at the very early stages of being able to measure impact. "We've got a long road ahead. I want to keep moving forward. We are building risk models, factor models that incorporate ESG criteria in their calculations. We have developed ESG scores for companies. We hold dialogues with many companies. But at the end of the day, you want to know – be able to measure! – what you have achieved in the real world. And it's there that our impact is difficult to measure, because we don't create or produce anything."

"Will the world be a much safer place if we exclude a company that manufactures controversial weapons? If we exclude, will the investment then be made by investors who care less? And if we lower the carbon footprint of a portfolio, how does this affect the real world?" **There is still little research available to answer these questions**. Clients want fewer risks in their portfolios, including fewer climate risks. From a stewardship perspective, they also want to invest responsibly. For now, non-financial impacts are difficult to measure. With Northern Europe leading the pack, the financial industry is working on finding solutions to measure this non-financial impact. "Some elements can't be included in financial analysis yet," says Zandbergen. "You can include CO_2 risks in your valuations, but this would be a lot easier if there were a unit price for carbon."

Can the financial industry give the world a push in the right direction? Is it, perhaps, even its responsibility to do so, as an owner or manager of large sums of capitals? It's no wonder the industry is in soul-searching mode. And, in a sense, the same applies to Zandbergen. "The question is: where does the responsibility begin and where does it end? If a government decides to build coal plants, should we exclude it? This is one of the many dilemmas the industry is struggling with. And we also have to deal with competitors, NGOs and other players, as well as the question of how certain, big decisions would have an impact on our investment universe."

The palm oil industry presents such a dilemma. Palm oil production poses a threat to the Earth's rainforests. "We have a strict lower threshold: half the production must be sustainable. If companies are nowhere near this limit, we can discuss it until the cows come home, but they'll never get there. We exclude such companies. For other companies, we make it very clear that we expect them to meet this requirement. And in these cases, we can have a real influence." →

In a recent study entitled 'Can Sustainable Investing Save the World?'[1], the authors distinguish between three mechanisms of investor impact: shareholder engagement, capital allocation and indirect impacts. The latter includes stigmatization: naming and shaming. Impact in this study is defined as "change in a specific social or environmental parameter that is caused by an activity." It states that the concept of investor impact is only beginning to take root in the financial industry, and concludes by saying that 'simple' exclusionary or best-in-class strategies are a static approach that ignore the fact that, fundamentally, impact is about change. After reviewing 64 studies, the authors conclude that there is no evidence to support the effectiveness of indirect impact. But there is some evidence to support the fact capital allocation – exiting and entering into investments based on ESG scores – does have a positive influence. The evidence shows that screening approaches affect asset prices, although the extent to which they do so is not consistent. A recent ECB working paper[2] sheds some light on this. It finds that for given levels of economic and financial development, carbon emissions per capita are significantly lower in economies where equity financing is more important relative to bank lending. The paper concludes that stock markets tend to reallocate investments to more carbon-efficient sectors and also facilitate the adoption of cleaner technologies in polluting industries.

In their paper 'Is Exclusion Effective'[3], Robeco's Laurens Swinkels and David Blitz argue the opposite and favor engagement over exclusions as a mechanism for change. And, indeed, the meta study mentioned earlier shows that investors can have the greatest influence on the ESG behavior of companies through engagement. This is consistent with our own findings based on two studies of our engagement database, with data going back to 2005. We found that the companies with which we have engaged successfully have shown significant improvements in ESG scores.

1. Kölbel, J.F., Heeb, F., Falko, P. and Busch, T., 2019. "Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact", MIT Sloan, University of Zurich, Department of Banking and Finance, Center for Sustainable Finance and Private Wealth (CSP), University of Hamburg.
2. De Haas, R. and Popov, A.A., 2019. "Finance and carbon emissions", ECB Working Paper No. 2318. Available at SSRN: https://ssrn.com/abstract=3459987 .
3. Blitz, D. and Swinkels, L., 2010. , 'Is Exclusion Effective?" The Journal of Portfolio Management Ethical Investing 2020, 46 (3) 42-48.

I HAVE AN ANALYTICAL MIND. I WANT TO SEE EVIDENCE. SCIENTIFIC STUDIES.

But sustainability goes far beyond areas such as deforestation and global warming. The social aspects – the S in ESG – also feature daily in the media. And these apply to many more industries and sectors than climate issues do. "In our financial analysis of companies, it is fairly easy to include corporate governance. The social issues are slightly more difficult and often have slightly less impact on financial analysis. Business ethics, decent wages, access to medicines – that type of thing."

So, is it a question of picking your battles? As far as Zandbergen is concerned, you're asking the wrong person. "No," she says emphatically. "We want to tackle everything. Where you place the emphasis just depends on the sector or region. Wage inequality is now increasing in the West, too, with social unrest in various places as a consequence." It is these social issues that touch Zandbergen, mother of two teenagers, the most. It's a theme that also resonates with young people the world over, with social unrest fragmented across the world as a result. Yet it's not them, with their climate change school strikes, who will save the planet overnight.

"Every generation in the past 60 years has taken to the streets. Let's hope that in 30 years, the world will have succeeded in making everything reusable and recyclable, and that we have managed to bring global warming to a halt." Until then, Zandbergen has another concern. "I sometimes wonder whether we are creating a hype when it comes to sustainable investing. Every asset manager is claiming to be sustainable and have sustainability in their DNA these days. That's why I always try to direct our thinking towards concrete results. Are we really contributing to a sustainable future, with everything we're doing?"

She sighs deeply. "I have an analytical mind. I want to see evidence. Scientific studies. Sustainability is on many people's lips. Awareness is growing. But what impact have we made? The EU's new green taxonomy is a good initiative, but will that bring about the change we need? I don't know. I do know that we have to do all we can and as responsibly as possible. And there's so little being taught about sustainable investing, even at universities. We have to reach the point where we can analyze a company and say: 'They make X amount of profit, but have Y negative impact on (for example) biodiversity, and Z impact on climate change. At the moment, though, we can't put a price tag on Y and Z. **But we're working on it**."

Fast forward to 2030, the year in which the UN's 17 SDGs have to be met. "We have to have achieved many of the SDGs by then. Is that possible? Yes. People are often too cynical. The regulators and asset management industry have woken up. We can do it. But we really need to roll up our sleeves, instead of writing 400-page taxonomies. While these help, our work shouldn't stop there."

Another area of research that might help in assessing actual impact is integrated thinking. At Robeco, we systematically integrate material ESG issues into every investment case. We use a very clear framework that is different for each strategy. The process of quantifying external factors is becoming clearer, as our analysts work with sustainability information which often gives better insight into companies' behavior and practices. In the past, we have seen examples of this: for many years the fundamental right of data protection was not deemed to be an issue by the market, until problems started to occur. By taking a long-term external view, our ESG analysis had already addressed this issue as a risk for internet and IT companies and it was taken into account in our cases and valuations by raising the cost of capital in our model. Although the direction was clear, knowing how much to raise the cost of capital is more of an art than a science, and relies on the experience of the analyst.

We still have very little evidence on how much these external factors influence value drivers and thus company valuations. Integrating ESG issues means assessing how long-term ESG trends and external costs – like climate change, loss of biodiversity and rising inequality – lead to changes in business models or have an impact on company valuations. Costs that may seem external at one moment in time may be internalized at another. These developments can, of course, also offer potential competitive advantages or open new markets for companies. The flipside of every ESG risk is that it may constitute an opportunity for another company. One attempt to quantify these external factors is the integrated profit and loss (P&L) methodology. This takes into account not only the financial value created by businesses but also other sources of value created.

A few companies have dared to come up with an integrated P&L. Many assumptions underly their analysis, however it should give companies and eventually investors more insight into the external costs or value they are creating.