ACTIVE VIEWPOINT

MARTIN CURRIE

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

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3 | THE POSITIVE IMPACT OF ESG INTEGRATION

Flows into environmental, social and governance (ESG) themed funds – whether under the 'impact', 'sustainable' or 'responsible' banners – have been very strong in recent years, underscoring a strengthening consensus that these factors really matter in an investment context. But the proliferation of labels may create the impression that asset managers who 'only' integrate ESG – without explicitly marketing their products as such – are somehow less impactful. We take a different view. To us, financial returns and ESG impacts are fundamentally intertwined over the long term and, as a result, we place a significant emphasis on the latter in our research and active-ownership efforts. In other words, while we integrate ESG first and foremost to protect and grow our clients' capital, we believe the attendant signals – and influence on corporate behaviour – contribute directly to a healthier and more sustainable economic and financial system.

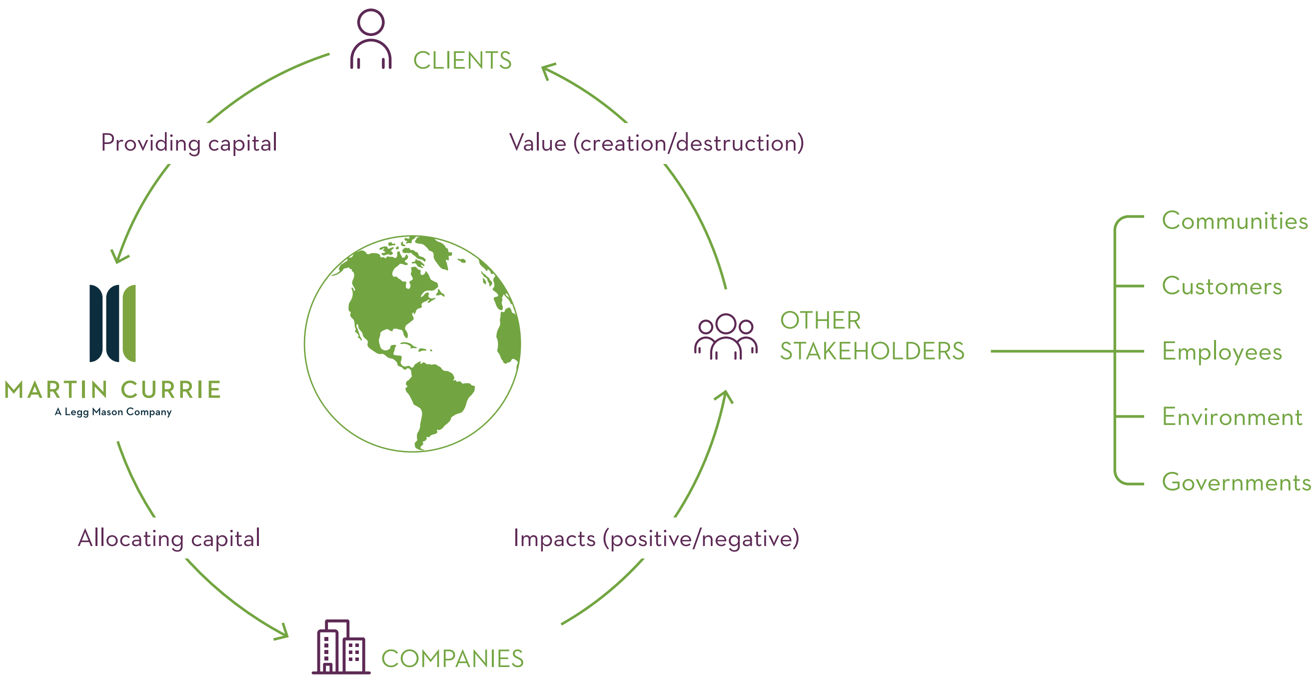
THINKING ABOUT STAKEHOLDERS

Businesses generate a wide range of impacts, both directly through their operations, and indirectly – for instance, through their supply chains. These may be negative or positive, and involve many different stakeholders, including employees, customers, governments and communities. Many of these impacts will not be directly captured by traditional accounting practices and this is a central reason non-financial notions of capital, such as social and natural capital, have entered the mainstream investment vocabulary. What's more, historically, a clear bias towards 'hard' financial information in reporting frameworks, has tended to make ESG impacts more of a footnote in companies' narratives about themselves. Today, such narrow accounts are thankfully becoming rarer, in no small measure due to the efforts of organisations such as the International Integrated Reporting Council (IIRC) – which we are supporters of.

Increasingly, companies are under pressure to tell the 'complete' story of how they create value, which means being transparent about all the resources – and potential externalities – involved. Indeed, major international initiatives, such as the UN Sustainable Development Goals (SDGs), reflect a broad consensus that a greater premium should be placed on sustainability than has traditionally been the case. These highly ambitious goals (of which there are 17 – with an additional 169 sub-targets) may rely heavily on government efforts, but are clearly unattainable without significant private-sector participation. A practical implication for investors is that they need to think more seriously about the signals they are sending, and take a more proactive approach to ensure the businesses they invest in are not misaligned with the imperative of sustainability.

SUSTAINABLE CORPORATE ACTIVITY

So, as an asset manager, where do we fit into the scheme of things? Well, we too have direct and indirect impacts on many stakeholders, through our investment decisions, active ownership and, more broadly, in how we behave as a business. To us, it is a given that corporate activity conducted at the expense of any stakeholder is unsustainable, even if it can take place without a material performance penalty over shorter time horizons. Conversely, businesses that are sensitive to the interests of all parties don't just inoculate themselves against many risks (including those of a regulatory and reputational nature), but should benefit from greater customer loyalty and potential pricing power. We think of it as a virtuous circle, where ESG integration helps us identify – and engage with – companies that are more likely to manage their impacts wisely, in turn strengthening the chances of long-term value creation, which of course loops straight back to our own performance as a business.



CATALYSING CHANGE

Stewardship is a critical part of our investment philosophy. As mentioned in the previous two papers in this series (***The Value of ESG*** and ***Accessing the True Value of ESG***), we do not take an exclusionary (screening out companies) approach, nor are we fixated on 'best-in-class' firms, but are instead interested in a company's direction and pace of travel, even if it is from a lower starting point. This approach is supported by industry research showing companies with strong positive ESG momentum performing better than those that are already highly rated.

Broadly speaking, there are four interconnected aspects of our stewardship:

- **Voting our clients' proxies**
- **Engaging with businesses**
- **Promoting best practice**
- **Respecting our own stakeholders**

A MOST PRECIOUS RESOURCE

Water stress is one of the most emblematic challenges the world faces, exacerbated by climate change and the needs of a growing and increasingly wealthy global population. The agricultural sector is a major protagonist in this story, accounting for some 70% of the world's fresh water consumption. And the evident materiality of this issue (to many stakeholders) is a central reason we joined a two-stage PRI collaborative initiative on water risk in the agricultural supply chain in 2014 – leading the engagements with a number of the companies targeted. The first phase of engagement concluded in 2017, with encouraging results, including 84% of the 32 businesses benchmarked improving their water-related disclosure*. Importantly, besides driving positive company change, this project has provided useful engagement frameworks, as well as helped us better integrate water data into our company analysis and valuations.

*Source: PRI, March 2018.

During our conviction-building process, we are looking to understand the extent to which companies take impacts seriously, and are embedding such considerations both at the strategic and operational level. Besides our voting activity, engagement is an important tool with which we try to nudge companies towards best practice. And, in our view, this is best achieved in a spirit of collaboration and sharing, both with businesses themselves and other investors.

From time to time, we will join up with like-minded investors when trying to spur change at companies, and we continue to participate more widely in efforts to raise standards. Recent joint initiatives we have participated in include antibiotic use in the food sector, water risk in the agricultural supply chain, as well as cybersecurity and tax responsibility – areas where many businesses need to find a more sustainable path, and where we feel a more proactive stance by investors and asset owners is therefore called for.

What about Martin Currie itself? It would indeed be curious if we did not hold ourselves to the same exacting standards that we expect of others. Whether it be our charitable work, the way we treat our own employees or manage the company's carbon footprint, we want to be transparent about what we are up to and why we believe this is in our clients' best interest.

ESG AND LONG-TERM VALUE CREATION

Against a backdrop of shrinking investment horizons, and ever-greater reliance on passive approaches to investing, we believe it is important for fiduciaries to champion long-term value creation and this cannot be done without thinking more broadly about impacts. ESG integration is a critical part of stewardship as we see it, and helps ensure that the businesses we invest in on behalf of our clients operate in a manner that is in harmony with the interests of all stakeholders.

ACTIVE VIEWPOINT is just one part of our range of investment materials. To access further perspectives on our strategies and key investment themes, visit: www.martincurrie.com

FIND OUT MORE

For further information on Martin Currie please visit our website – **www.martincurrie.com**
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IMPORTANT INFORMATION

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