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What Popular Media Gets Wrong About ESG

Too many articles conflate ESG with values-based or impact investing. These things are not the same.

By Chad Spitler, Founder and CEO, Third Economy

Everywhere you look people are talking about ESG. But in nearly every case, critics use the term inaccurately. This makes conversations around ESG needlessly confusing.

The result? Stakeholders often talk past one another. Corporations aren't sure what to prioritize or where to devote resources to advance sustainability initiatives. Even worse, ESG is often hijacked for political ends—even though, as we describe below, ESG is decidedly not political.

Below we explain the differences between values-based investing, impact investing and ESG. Spoiler: ESG is different from these other two in that ESG analysis is a framework, not an investment philosophy, and is about driving returns.

Values-based Investing

Values-based investing refers to a practice in which investors choose opportunities according to *what matters most to them*. For example, an environmental organization wouldn't invest in an oil and gas company, as it would be inconsistent with their values. Alternately, a female-led fund might invest in a business that promotes access to maternal health, based upon the principals' preferences and values.

There are two important caveats when it comes to values-based investing. First, values-based investors might accept comparatively lower returns in exchange for the opportunity to put capital behind their values. Second, values-based investors may not necessarily care about the consequences of their investment. Instead, the sheer act of investing in—or divesting from—an asset is a means by which they express their values.

For example, a group of college students might pressure the university's endowment fund to divest from the for-profit carceral industry. The activists may not care if divestment means lower returns and they also don't necessarily believe that divestment will ultimately translate into concrete prison reform. They simply don't want their university to profit from something they find unethical.

In short, values-based investing is about expressing one's moral or ethical belief systems.

Impact Investing

Impact investing refers to a practice by which investors throw capital behind a company or asset in an effort to affect change. In contrast to values-based investing, impact investing is principally concerned with *consequences*.

For example, one might invest in Tesla if they believe that Tesla is most likely to popularize electric vehicles and thus, decrease GHG emissions. One might also invest in companies that prioritize women in senior leadership roles, if it's likely to influence the hiring of more female leaders in the market at large.

Investors are beginning to realize that every investment has an impact, and the value of integrating an impact assessment into decision-making.

Oftentimes, there is alignment between values-based and impact investing. For example, an environmentalist might avoid investing in fossil fuels from a moral or ethical perspective (*values-based investing*), while identifying impact investments with lower greenhouse gas emissions (*impact investing*).

In summary, impact investing is about consequence.

Investing Using ESG Analysis

Beyond its key difference as a research discipline (not a style or a strategy), ESG is concerned *above all else*, with profit. As our CEO, Chad Spitler, explains in this video, ESG is about money.

Erika Karp, Executive Managing Director and Chief Impact Officer at Pathstone says it best in her Impact Entrepreneur article: ESG analysis "does not imply a value judgment" and the quantitative and qualitative data provided by ESG offers "starting points for further inquiry", to better analyze risk-adjusted returns and inform judgments on future profits.

For example, regulatory pressure and changing consumer preferences could put downward pressure on the valuations of oil and gas companies. In the social realm, more women in leadership roles could lead to outperformance and alpha for investors.

Investors who leverage ESG analysis believe that it will be nearly impossible for corporations to deliver positive long-term returns if they're facing climate instability, including threats like flooding and wildfire to real assets. Corporations will not be able to find consumers or employees in regions where there's climate disruption, or if there are substandard working conditions.

ESG is also about capitalizing on unfolding opportunity. As Larry Fink writes in BlackRock's 2022 CEO Letter, "Every company and every industry will be transformed by the transition to a net zero world. " Investors recognize that ESG factors are likely to spur transformational innovation, creating new products, opening new industries and markets, and generating enormous profit in the long term.

ESG analysis is often conflated with values-based or impact investing because the investment practices can converge in important ways. Impact investors may want to limit carbon emissions because they believe it's a good in itself to promote a thriving climate that will sustain life (and we agree!). But ESG analysis, by contrast, is focused on carbon impact because it recognizes a changing climate brings enormous risk to long-term business success.

In short, ESG is capitalism in action.

Common Terms, Shared Metrics

These terms matter to Third Economy because our mission is to make it easier for corporations and investment managers to achieve their sustainability goals. While ESG is not expressly about promoting a thriving planet, we believe it's possible to achieve durable returns and create a healthy planet and society.

That's why our VIA³ Compass, developed by leading institutional investors and academics, employs these terms deliberately and with precision. We're working to maximize transparency, promote shared understanding, and give all users objective categories to benchmark and measure progress.

Request a free demo of our VIA³ Compass.

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