



# THE MISSING 'E' IN ESG

PERSPECTIVES FROM THE ASSET  
MANAGEMENT INDUSTRY

# REPORT HIGHLIGHTS

- What do we mean by Ethics?
- Taking the pulse of ESG
- Key findings
- What next?

# WHAT IS BUSINESS ETHICS?

IBE defines it as *“the application of ethical values to business behaviour”*

- The values the organization chooses to prioritise
- Different things to different people
- Authenticity and integrity (the ‘say/do’ gap)
- Understanding this needs safeguards and support because ‘life’



*“What we should or shouldn’t do to be consistent with our values”* Alison Taylor,  
Executive Director, Ethical Systems

# BUSINESS ETHICS MYTHS!

What it is not:

- Telling people how to live
- Telling people how to do business
- Adherence to a particular religion or morality - “saints and sinners”
- Purity and perfection
- Unattainable and unrealistic

Everything has an ethical profile, and everything has ethical trade offs.  
Your choices can either be accidental or intentional

# ESG: BROADENING HORIZONS



Company finances are increasingly assessed for business vulnerability to ‘externalities’ in ESG categories:

- Environmental
- Social
- Governance

This aspect of asset manager analysis is here to stay

- Enormous growth in funds investing in these strategies
- A value-added role for active managers
- Allows for breadth of stakeholder perspective
- Regulators encouraging a longer-term perspective

*“If some companies fail to adapt to the just transition to a low carbon economy, they will fail to exist.”* Mark Carney, former Bank of England Governor

*“The mainstreaming of sustainability is the recognition of real risks that might affect future cashflows”* Asset manager

# IS ETHICS RELEVANT?



Asset Managers, seek to analyse business vulnerability to ‘externalities’

- However, do they think about the culture that drives company behaviour before investing?
- Indeed, is it possible to do ESG investing properly without considering the values that shape company decision-making?

We asked leading 28 UK investors about the place of ethics when analysing companies’ ESG credentials:

- Is ethics part of ESG? If so, where? If not, why not?
- What measurements are useful?
- How does it relate to corporate engagement?
- How does asset management stack up?

# ETHICS: THE SILENT 'E'?

Despite resistance to the term, something like ethics does get factored into asset management

1. 'Who do I trust with the money?' - company **values and culture** matter
2. In assessing ESG, asset managers want companies:
  - not to treat ESG targets as a **tick box** exercise
  - not to **game** the system
  - not **greenwashing**
3. Some recommend the ESG agenda is **owned by the board** and **embedded in the culture**
4. As active **stewards** of client capital, investors have a role in governance, oversight and accountability
5. Most asset managers believe their own firms should aspire to high standards

# ANALYSING ETHICAL CULTURE

- Some managers do not believe it is possible or do not know how to do it
- Some asset managers analyse culture - levels of resource, commitment and sophistication differ
  - Both qualitative and quantitative aspects are relevant
  - Trends and lifecycle understanding are more helpful than absolute numbers
- There is no formal training for analysts' assessments, or analytic model for valuations
  - Inefficiencies offer investment opportunities

## Examples of metrics

- Staff turnover: departures from certain areas of the business, or changing trends
- Tech verification: using social media, satellite imagery
- Tracking management promises - the say/do gap
- Diversity – beyond the top team
- Whistleblowing approach & response
- Incentive structures – by design and in comparison
- Response to things going wrong
- What have they shown commitment to – does it map to stated purpose or short-term share price gains?



# KEY FINDINGS

- ESG is profoundly changing the way that companies are assessed and analysed
- Some client and regulatory expectations are proving counterproductive
- Major challenges exist on data, analytic framework, targets, engagement, communication, and their own firms' priorities and culture
- Aspects of investee companies' culture and behaviour may help address these issues
- Asset managers have appetite for greater insights into internal corporate behaviour – but don't call it "Ethics"!

# RECOMMENDATIONS

## Recommendations for Asset Managers

- Ethical culture analysis can help 'quality control' ESG measurements
- Developing methodologies to assess ethical culture offers a source of performance
- Board-led organizational authenticity needs to match to avoid 'greenwashing'

### *Benefits for asset managers*

- Lower risk, greater sustainability
- Untapped source of alpha
- Better long-term results

## Recommendations for companies

- ESG measures need to be part of an authentic narrative – not box ticking
- Explain how cultural values are embedded in decisions and behaviours
- Ethics function could oversee integrity of ESG metrics and provide cultural indicators

### *Benefits for companies*

- Better understanding from shareholders = long-term partnership
- Resources spent doing rather than measuring
- Greater coherence and alignment