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ESG Investing and the Bioeconomy: ESG Investing Through the Financier's Eyes

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Due to a wide range of global challenges including climate change, environmental sustainability, social inequality, and the need for ethical corporate governance, ESG investing and reporting has become the "new normal" for investment firms, corporations, and governments alike. This emphasis gives "cleantech" and "greentech" projects additional financing opportunities, but only if they are able to communicate these ESG values in the correct way and understand the evaluation process.

How can the bioeconomy tap into this new and growing source of global finance? There are four key strategies that need to be developed and documented prior to approaching impact investors for investment.

Global Biofuture Solutions and Biofuels Digest will be exploring this topic with a 4-part series of articles. These articles will help the Digest community to understand the following:

1. What are the differences and similarities between Impact Investing and ESG Investing? How do financial investors use these criteria to make financial decisions?
2. How do environmental, social, and governance criteria apply to my business and how can I understand which international standard to use?
3. How can I create an ESG risk mitigation plan and also incorporate all of my other risks to present a well-rounded risk mitigation plan to investors?
4. How should I properly plan for sufficient time and resources to manage and monitor ESG risks, now and in the future?

We begin the series by exploring how ESG investing came to be, the state of Impact and ESG investing today, who supports ESG investing, and the relevance of Impact and ESG investing to the bioeconomy. Impact Investments, as defined by the Global Impact Investor Network (GIIN), "are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return." Often Impact Investors seek a very targeted social and environmental impact, such as mitigating climate change, reducing de-forestation, improving education, or re-vitalizing an urban area. If Philanthropy is the act of donating wealth to achieve a social or environmental outcome, then Impact Investment is the act of leveraging wealth to achieve social or environmental outcomes, while also achieving a financial return.

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The issue of measuring impact brings us immediately to another investment category: ESG Investing. ESG Investing is similar to Impact Investing in that it seeks to drive beneficial Environmental (E) and Social (S) outcomes, while also promoting good corporate Governance (G). ESG Investing differs from Impact Investing in that it requires companies to issue standardized reports on a broad array of ESG factors, while an Impact Investment might just report on its specific Impact. Hypothetically, a bioeconomy company could make itself attractive to Impact Investors by say promoting climate smart agriculture and reporting on its actions and impacts on agriculture, but to participate in ESG investing it would need to report a specific plan of action for the wide array of ESG metrics.

ESG investing is not a fad; it is a growing trend and is here to stay. Like any new enhancement to the investment landscape, those advisors who embrace ESG investing—and demonstrate their knowledge of the issues and strategies—hold a competitive advantage over those who ignore it and hope that it will fade away.

ESG investing offers an opportunity to capture market inefficiencies, which can potentially enhance returns, lower volatility, and mitigate negative risk exposures such as reputational risk. As ESG reporting and ratings become more robust and companies incorporate sustainable practices throughout their operations, investors are deploying proprietary methodologies to identify market winners and losers in more meticulous, conscious and deeply analytical ways. ESG investing reflects the changing nature of capital markets in which non-financial factors, such as good governance and sustainable supply chain management, are quantifiable drivers of return.

Reminiscent of biofuel sustainability standards, there are a number of ESG standards and ratings agencies, including the Global Reporting Initiative, IRIS+ from the GIIN, MSCI, Sustainability Accounting Standards Board (SASB), and Sustainalytics of Morningstar. The need for ESG reporting standards is clear. As is the case with financial reporting standards, to allow investors to be able to evaluate and compare the ESG performance of potential investments it is necessary for investors to be able to make an apples-to-apples comparison. Currently, the proliferation of standards and their evolving nature makes apples-to-apples comparisons difficult within and across a broad array of economic sectors. For example, what does it mean to compare the ESG performance of an oil major with that of a bank? The ESG community is working to answer such concerns.

ESG investing has really taken off in the last 4 years or so, but it emerged from the considerable history of Corporate Social Responsibility and Socially Responsible Investing. ESG reporting developed from work catalyzed by UN Secretary General Kofi Annan in 2004. The term ESG was coined in 2005 by the influential report "Who Cares Wins" that persuasively argues that embedding environmental, social and governance factors in capital markets makes good business sense and genuinely leads to better outcomes for societies. By 2006 the UN and private sector partners had developed the Principles for Responsible Investment. Today the UN PRI has over 2900 signatories from asset managers and institutional investors, like CalPERS and numerous sovereign wealth funds. This community of investors is driving the widespread use of ESG reporting.

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Today ESG reporting is supported by high-profile private sector leaders like BlackRock CEO Larry Fink and Axel Weber of UBS. Larry Fink's annual letter to CEO's has become a routine call for Impact Investing with strong reporting, particular in the area of climate change risks. Larry Fink is a very strong proponent of the idea that ESG reporting helps companies to de-risk and be more profitable over time. This year Fink wrote, "We [BlackRock] have a responsibility to engage with companies to understand if they are adequately disclosing and managing sustainability-related risks, and to hold them to account through proxy voting if they are not."

Asset managers are still evaluated by their clients by their rate of return. If ESG investments underperformed, then they literally would be a hard sell. But the demand for ESG investments is only growing. Today in the U.S. approximately one-quarter of investment has an ESG component. Likely some of this demand is coming from investor desire for positive ESG impact, but data in support of the business case of "de-risking through sustainability" is growing. McKinsey points out that "Evidence is emerging that a better ESG score translates to about a 10 percent lower cost of capital as the risks that affect your business, in terms of its license to operate, are reduced if you have a strong ESG proposition." In future installments of this article series we will explore the ways that ESG competency and reporting can be used to de-risk investments and project development.

We conclude this installment by pointing out that bioeconomy companies – both mature and growing – need to educated themselves and prepare the right materials and messaging that can position their company or investment for investors interested in either Impact, ESG performance, or both. Bioeconomy companies have always argued that they bring Environmental and Social benefits: Green products that reduce GHG emissions, Jobs (jobs, jobs), and Rural Development. Since the enactment of the RFS in the U.S. and RED in the EU, bioeconomy companies have had to meet these sustainability criteria to qualify to financial and tax incentives and other benefits. What is important now is to understand and embrace a new methodology that can resonate positively both from a risk mitigation perspective as well as providing the impacts and environmental, social, and governance benefits that can change the world in a 360-degree holistic way. Bioeconomy companies must take the initiative and actively position themselves as the solution providers that investors, other companies, and society now expect and are willing to invest into for long-term positive change that we all are working for.

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