The Misconception About ESG

August 2023

Over time, as with most acronyms or catchy labels (like 'Smart Beta'), ESG has come to mean a variety of things to a wide range of investors. From values-driven exclusions, to tilting indices using ESG scores from mainstream providers, to activist-driven strategies. For us, 'ESG integration' is not about expressing values or simply improving portfolio 'ESG scores' relative to a benchmark. At RadiantESG, the consideration of ESG characteristics in our evaluation of companies as potential investments is solely in the service of delivering stronger long-run performance results for our clients—full stop.

In the mid 2000's the most valuable publicly listed company in the world was Exxon Mobil. Very few questions were being asked about anything other than the company's profitability and market share as one of the major players supplying energy to the world. While fossil fuels are an easy example of how public attitudes have evolved, it's far from the only one. More and more, consumers care about worker protections for the people who pick coffee beans, sew sneakers, build cell phones, etc.—and make the effort to research the degree to which companies exploit natural resources or create unnecessary waste in the manufacturing of their products. Investors, for their part, consider not only these changing consumer preferences but also the prospect of regulation, taxation, the upper limits of resource availability, and advances in technology. When it comes to the way firms are run, for example, they have increasingly made it known that they want to see executive compensation aligned with metrics that truly benefit them as shareholders. Looking forward suggests to us that tomorrow's economy – and its winners and losers – will be different. Some of the winners will be the ones that can capture new technologies, new advances in healthcare, and in energy. Some will add to their appeal by treating the environment, their customers, their employees as resources that should be cared for so as to preserve their long-run competitiveness.

The rise of ESG often gets conflated with climate activism, perhaps because the common usage of the acronym places E first—or with greater evidence of climate volatility, it's seen as a separate cultural touchstone. At Radiant, our view is that neither the E, the S or the G is more important than the other—that they are, in fact, deeply connected. We believe that each pillar, and the intersection of the pillars, represents information that allows us to consider influences on a company's future earnings potential, and therefore stock price performance, that supplements purely financial data. So, for us, the question of ESG isn't an ethical or moral consideration, it is a value (not 'values') proposition that seems critical to incorporate if one hopes to have a full understanding of the potential an investment has in delivering strong returns.

Some people could say ESG is about forcing one's own moral or ethical views onto companies and divesting from those who run afoul of those beliefs. As public equity investors, it is very difficult to make the case that we rob companies of capital through divestment. We do, however, advocate for best practices when it comes to E, S, and G among the companies we hold. As much as the anti-ESG crowd would like to paint this as an attempt at social engineering, it is, in fact, in the service of generating higher risk-adjusted returns for our clients in the face of profound change. Companies that do not voluntarily evolve are likely to be backed into a corner by changing regulations or changing consumer preferences – we are simply encouraging company management to be the architect of its own destiny!

At Radiant, we want to build portfolios of companies that other investors will want to own—that incorporate the reality of evolving consumer demand and the acknowledgement among many company management teams that initiatives like DEI and emissions reductions are simply good for the bottom line. We believe stock prices will ultimately reflect these decisions and prove beneficial to investment results.

Change is coming about at an unprecedented pace—some of it may be transitory, but the reality is that much of it is here to stay. Having more data that observes how those changes will drive the attractiveness of a company's value proposition in the long run—which companies will benefit and which will struggle—will continue to be a source of our competitive advantage, and the value we deliver for our clients in the long run.

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