Impact Cubed

PULLING LEVERS: USING THE COST OF CAPITAL TO TACKLE CLIMATE CHANGE

Can investors in publicly listed firms and equity long-short strategies have an impact and help tackle climate change? Despite its increasing popularity, there are still some who argue against sustainable investing.

There are those claiming that encouraging ESG investing is akin to selling snake oil. Tariq Fancy BlackRock's former CIO for sustainable investing recently penned a long essay pushing this point. This argument – that investing is not the vehicle to address problems such as climate change – effectively suggests that if would-be investors really want to have an impact, they should offer their money to charities or organisations directly addressing the issue.

However, Fancy went on to identify the reasons why sustainable investors have an impact in his essay:

"The only really coherent case for ESG investing changing the world is that it raises the cost of capital for 'bad' companies (however you or your fund manager want to define 'bad'), which means they have incrementally less financing to do bad stuff", he wrote.

He also added that this argument rarely receives airtime from asset managers because it does little to sell higher-fee investment products. So, let's give it the consideration it deserves.

There are effectively three levers that people can pull to help speed the transition to a low carbon global economy.

1. The first is via exercising their voting rights, supporting politicians able to back climate-focused agendas and deliver regulations that change corporate performance standards.
2. The second is through their shopping habits – turning down less sustainable goods and purchasing more environmentally friendly products.
3. The last is through their investing – more on which shortly.

Corporates can influence voting habits via donations. Advertising and PR machines can tweak consumer behaviour. But markets are yet to be tamed.

This is where ESG and impact investing comes in. Divesting and shorting companies raises their cost of capital. At the same time, investing in companies lowers their cost of capital. As impact investing gains momentum it costs more for problematic operations – a new coal mine, the construction of a fleet of oil tankers – to be funded. At the same time, it costs less for innovators to finance solutions addressing the planet's climate problems. This is the invisible hand of capitalism at work pulling levers.

The investment lever's probability of success in raising the cost of capital for polluters hinges on passing some tipping point where there are more assets under management in sustainable funds. That is one reason we applaud the growth in flows to sustainable funds.

For investors, urgency is the key to do the right thing - and to do so profitably. Governments stepping in to create new policies and programs will result in the market repricing companies with larger climate risks. At the same time, more people are seeing the investment opportunities associated with the enormity of changes needed which reduces the window of opportunity for investors.

This article was excerpted from our 2018 publication Collective Impact in Public Equity and 2017 publication Towards Sustainable Capitalism, which are available on request by sending an email to info@impact-cubed.com.

ABOUT IMPACT CUBED

Impact Cubed provides ESG analytics and investment solutions for building more sustainable portfolios with greater impact. It combines an award-winning approach to integrating impact into risk and return with technology-enhanced portfolio design and management. The outcome is a seamless approach to customised sustainable investing.

You can find out more about our data and portfolio models at www.impact-cubed.com and if you would like to contact us at info@impact-cubed.com we would be happy to hear from you.

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