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ASKING THE RIGHT QUESTIONS

Integrating ESG into company research requires rigour, nuance and a long-term perspective says Marianne Harper Gow.

ESG is the buzzword of today's investment industry, the three letters encapsulating a complex and challenging range of environmental, social and governance responsibilities. They range from climate change to employee rights and working conditions, data governance and cyber security to supply chain resilience, ownership, corporate culture and remuneration structures.

Context changes definitions. Health and safety, for example, used to be the preserve of heavy industry (injury rates and fatality statistics) but in the context of Covid-19, it is at the top of every company's risk agenda.

But the opportunities associated with being 'good' at ESG far outweigh the risks, particularly over the long term. During the pandemic for example, the spectrum of positive company responses included the proactive and the reactive, ranging from paying suppliers faster to helping laid-off employees with healthcare insurance and career advice. These were measures that, respectively, French cosmetics group L'Oréal and short-term rentals business Airbnb got credit for putting in place when the coronavirus struck. They highlight how ESG issues came further into focus amid the crisis.



Within the context of global challenge it is easy to understand why ESG-focused funds are booming as investors plough money into sectors for the apparent benefit of humanity and the planet.

But how do we distinguish between genuine integration and box-ticking efforts?

It's an important question, because the hamster wheel of the quarterly earnings cycle engenders a short-term mindset. Yet responsible investing should be for the long term and that involves commitment, time and resources.

As an investment house that seeks to invest in companies offering long-term sustainable growth, Baillie Gifford looks to identify companies with management teams and boards that take a thoughtful, positive, progressive and proactive approach to the broad range of ESG matters. The materiality of these can vary significantly between companies, sectors and geographies, and over different timeframes.

Too often we see signs of company 'greenwashing', giving a false impression of environmental soundness, and reliance on easy metrics that allow box-ticking. But data should be viewed in the context of the business, not just be generated for its own sake.

External ESG research providers producing reports looking at dozens of datapoints are not the answer. Worse, that approach can often be misleading. Nor does their research compare like-for-like. Far from it, in fact.

Research last year comparing ESG ratings by academics at the Massachusetts Institute of Technology (MIT)'s Sloan School of Management looked at ESG ratings provided by five ratings agencies. They found that the information decision-makers received from them was uncorrelated, leading to what researchers called 'aggregate confusion', meaning the findings diverged from each other significantly. Baillie Gifford recently carried out its own research, comparing the ESG ratings by MSCI and by Sustainalytics, with similar findings.



Relying on others' data effectively means outsourcing the ESG assessment. That is not what clients and the ultimate owners of capital invested should expect. There is no substitute for doing your homework, working with portfolio managers, and engaging directly with the companies in which you invest.

For this, appropriate resource is required. Doing ESG analysis well is an investment in itself. Companies cannot be thoughtfully analysed on a case-by-case basis if the analyst is responsible for hundreds of companies and reliant on third-party data. In contrast, our ESG analysts are individually attached to different investment teams, so the number of companies is controlled and manageable. They are involved in pre-buy research, they join our investors on research trips, company meetings and in stock evaluation. They gather their own data and piece together information that helps deepen their understanding of the company. It is resource intensive and time consuming, but we regard it as the most effective way to properly integrate ESG issues into our portfolio management process.



Companies sometimes ask us what data we want to see. We turn the question around and ask what their material ESG risks and opportunities are. Where there is a gap, we have an opportunity to engage with the company directly.

And engagement takes time. We need to learn about the company and to build relationships with management and board. When it works, meetings evolve from being transactional to being real relationships, where robust but constructive discussion can focus on challenging issues. This builds longstanding trust.

The relevance of ESG factors is also influenced by a company's cultural and regulatory environment. We opened our Shanghai office last year to engage Chinese companies in their own language and on their home turf. It has also allowed us to deepen our understanding of the culture in which we are investing.

One last issue stands in the way of being a good steward of our clients' capital and a responsible and engaged owner. Proxy voting is an important stewardship activity, but responsibility is surrendered if the shares are lent out, as they are by many managers in stock lending programmes.

We laid out our unvarnished view on the dangers of stock lending in 2018, and agree with Japan’s Government Pension Investment Fund (GPIF), the world’s largest pool of retirement savings, which recently deemed the practice inconsistent with the stewardship responsibilities of a long-term investor. To cut through greenwash, we formulated five questions for clients to ask us and their other managers:

1

How is your ESG research and engagement resource structured?

2

To what extent do ESG analysts collaborate with portfolio managers when:

- Proxy voting?
- Engaging with company management and boards?
- Discussing investment decisions?

3

How does the portfolio reflect the integration of ESG risk and opportunities, in terms of companies selected (or not) or the weighting given to holdings?

4

For proxy voting, are there any anomalies between the percentage of a company held on the record date and the percentage voted at the AGM?

5

To what degree do you use ESG research providers and proxy advisors?

The ability to give full and encouraging answers to these questions, with examples, should give confidence that the baseline ingredients are there for an investment approach that supports long-term, sustainable growth, whatever the global context.

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Marianne joined Baillie Gifford in 2004 and her role has evolved over the past 16 years, along with the Governance and Sustainability function, meaning her experience extends over many areas, including research and analysis, company engagement, voting and client reporting. Her current role involves engaging with institutional investors, regulators and industry bodies across the globe on topics as diverse as climate change, dual class share structures and human capital management. Prior to joining Baillie Gifford, Marianne worked offshore carrying out environmental and geological survey work. She graduated BSc (Hons) in Environmental Science from the University of Aberdeen in 1996 and MBA from the University of Edinburgh in 2002.

She is also a member of the Social Investment Scotland (SIS) Ventures Investment Committee.

