Sustainability is an important investment proposition

Terence Jeyaretnam

Earlier this month I had the opportunity to discuss sustainability in investment with Mr. David Blood, Managing Partner, Generation Investment Management based in London. Prior to co-founding Generation, David served as the co-CEO and CEO of Goldman Sachs Asset Management from 1999 to 2003. The Chairman of Generation is former Vice President of the United States Hon. Al Gore. Mr. Gore is the author of the critically acclaimed book, "Earth in the Balance" and took the lead on environmental issues for the Clinton-Gore White House. Generation, or 'Blood & Gore' as it has sometimes been referred to, has an investment philosophy that integrating sustainability research into a traditional equity framework makes sense in a concentrated equity strategy. Mr. Blood had the following to say:

Jeyaretnam: Firstly, and importantly, why an investment philosophy centred around sustainability?

Blood: Sustainability issues can materially impact a company's ability to generate and sustain profitability and deliver returns to shareholders. By sustainability issues, we mean long-term economic, environmental and social challenges. They include, for example, future political or regulatory risks, quality of human resources management, risks associated with governance structure, the environment, mergers and acquisitions, and stakeholder relations. By broadening the spectrum of information we consider in our investment process to include sustainability research, we have more conviction on a company's management quality, business quality and valuation.

Jeyaretnam: From your investment strategy it is obvious that you believe sustainability research should be incorporated into mainstream investment research. Would such a strategy continue to remain a boutique proposition, or would you expect mainstream financial markets to increasingly adopt a similar approach?

Blood: The interests of shareholders, over time, are best served by companies who maximise their financial performance by strategically managing their economic, social, environmental and ethical performance. After all, these factors can directly affect a company's ability to generate revenues, manage risks, maintain license to operate and sustain competitive advantage. In fact, we believe that sustainable development will be the primary driver of industrial and economic change over the next 50 years.

We hope to prove the business case for this approach, and by extension, help influence the capital markets to integrate sustainability more broadly. We're already seeing evidence of the integration happening in companies. For example, in the corporate sector, GE is designing products to enable their clients to compete in a carbon constrained world. Novo Nordisk is taking a holistic view of combating diabetes not only through treatment but also through prevention. BP is investing $8 billion over five years into alternative energy projects. And the RED campaign – launched recently by Bono along with American Express, Giorgio Armani, Converse and the Gap – is mobilising a commercial response to HIV/AIDS.

The investment community has also started to respond. For example, The Enhanced Analytics Initiative, an international collaboration between asset owners and managers, encourages investment research that considers the impact of extra-financial issues on long-term company performance. The Equator Principles, designed to help financial institutions manage environmental and social risk in project financing, have now been adopted now by 40 institutions which arrange over 75% of the world's project loans. The rise in shareholder activism and the growing debate on fiduciary responsibility, governance legislation, and reporting requirements (such as the Global Reporting Initiative) indicate the mainstream incorporation of sustainability concerns.

Jeyaretnam: From your firm's research, what do you believe are the most significant environmental and social concerns within the equity market investment universe generally? What are the immediate challenges for corporates?

Blood: It depends on the industry and company you are looking at. We strongly believe in focusing on the most material sustainability issues that will impact company performance. For example, in the oil and gas industry, we believe climate change is the most significant driver of change. In the healthcare space, we concentrate on ethical marketing practices and clinical trial construction. And for financial services companies, we focus on human capital management practices and the culture of the firm.

The global context for business is clearly changing. Sustainability issues such as climate change, HIV/AIDS, poverty, corporate ethics, demographics, and stakeholder relations will shape the emerging landscape for business. We believe companies that understand and address the risks and opportunities associated with these trends will be the ones to succeed in the complex world of tomorrow.

Jeyaretnam: What is your advice to members of Engineers Australia in regard to choosing a long-term investment philosophy for their superannuation (pension) funds?

Blood: Investment results for long-only equity strategies are maximised by taking a long-term investment horizon because a majority of a company's value is determined by its long-run performance. Unfortunately, the financial markets (from asset owners and managers to corporate management) have become increasingly short-term. Our economic vitality will be jeopardised if businesses forgo value-creating investments to manage short-term earnings. A short-term perspective can hinder innovation and research and development, diminish investment in human capital, encourage financial gymnastics and discourage leadership.

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