<u>Myopia and the Long View</u>:

<u>Perspectives on Resistance to ESG Integration</u>

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Abstract: The effectiveness of the Responsible Investing strategy of ESG Integration (ESGI) is now well established; there is significant use of this strategy among investment managers and a preponderance of data supporting its success in achieving superior risk-adjusted returns over the long-term. Despite this consensus and evidence, however, skepticism regarding the effectiveness of ESGI persists. Attempts to address this situation by reaching skeptics thus far have not been successful for a variety of reasons, mainly because they have been working from the premise that ignorance and/or limited cognition are the cause. Sociological theory lends some insight into why acceptance of the effectiveness of ESGI and the implications thereof represent a threat to a skeptic's identity. This being the case, a new approach to outreach is called for. The suggestions in this paper call for forgoing any attempts to convince skeptics of the positive environmental and social implications effected by ESGI strategies in favor of appealing to investment managers' competitive nature.

Key Words: adoption, ESG Integration, Key Performance Indicator, Responsible Investing, sociology, skepticism, strategy, sustainability

Introduction:

One who instinctively or habitually doubts, questions, or disagrees with assertions or generally accepted conclusions, is known as a skeptic[1]. Being one myself, I understand and appreciate this instinct, and over the years, it has served me well in many situations and I expect it will continue to do so. Therefore, I also respect this approach. When it comes to the Responsible Investing strategy of ESG Integration (ESGI), however, which enables Investment Managers to better meet their fiduciary responsibilities and facilitates positive social, economic, and environmental impacts across the globe, one would do well to accept the data and evidence in support of its effectiveness and adopt its use.

Despite a large body of supporting evidence, which will be summarily presented and explained, ESGI skeptics persist in their refusal to accept its effectiveness. This refusal may hinder their ability to produce superior risk-adjusted returns, decrease portfolio volatility, remain competitive, and potential to attract new capital. This refusal may also serve to harbor portfolio risk that does not offer a commensurate reward in the form of companies that are not taking global economic trends into the consideration of their future business and operational strategy. Similarly, this refusal serves to exacerbate past and perpetuate continuing "business as usual" corporate behaviors that are a significant cause of negative environmental, economic, and social outcomes. So not only is the failure to adopt ESGI potentially detrimental to portfolio value, continued investment in companies that do not manage environmental, social, and governance (ESG) performance is a positive reinforcement to bad corporate behavior.

Although a course of action that enables Investment Managers to recognize and address the risks and opportunities associated with ESGI comes with an initial expense of time and resources, these costs will, with proper planning and execution yield positive ROI through the aforementioned benefits of ESGI. As such, there is a strong case for adopting ESGI as doing so is in the best interest of the long-term success of an investment manager.

In the following sections of this paper, ESGI will be defined and evidence supporting its effectiveness presented so as to provide substantive and convincing support for its adoption. Next, an overview of typical arguments made against this investing strategy by skeptics will be presented. Responses from a hypothetical advocate of this strategy, which one would expect to convert ESGI skeptics, accompany these arguments. The discussion proceeds with sociological-based explanations of why skeptics may hold their position despite the evidence in favor of ESGI. Rounding out this discussion will be a summary of why approaches employed to date to convince skeptics of its value have been limited in their success. Finally, suggestions using an approach that focuses solely on the financial benefits of ESGI will be given.

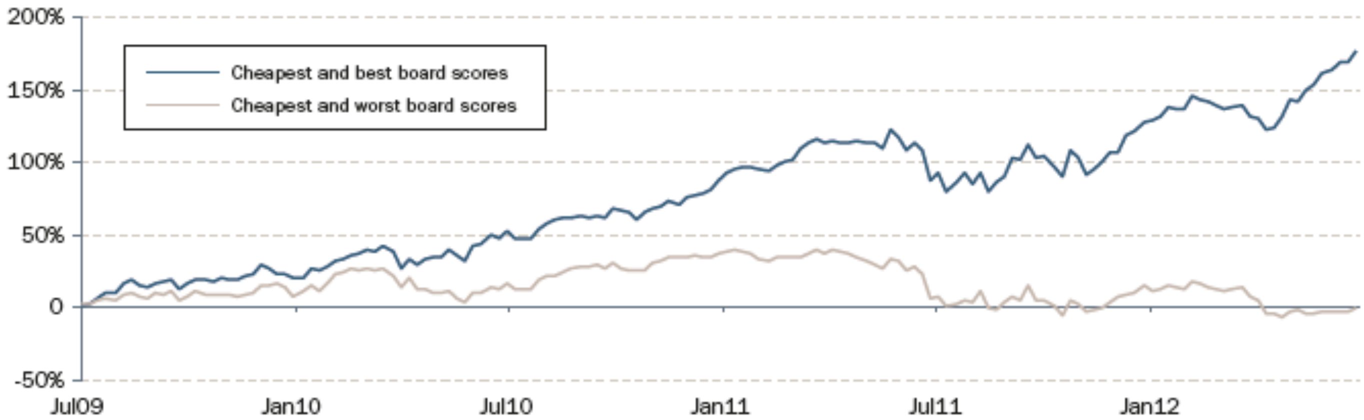
Definition and Use of ESG Integration:

ESG Integration is a Responsible Investing strategy that involves determining sector-specific, material, quantitative and qualitative environmental, social, and governance (ESG) key performance indicators (KPIs). Analysis using these KPIs, help investment analysts identify market leaders and laggards in terms of their ability to capitalize on risk-reduction and efficiency-enhancing opportunities associated with their management. These determinations are possible because ESG performance management in companies provides investment analysts with the opportunity to ascertain more comprehensive operational-level information about a company, thus the possibility to gain myriad insights across the value chain. Furthermore, integrating metrics derived from ESG KPIs with traditional financial analysis provides a more comprehensive assessment of an investment than financial analysis alone is capable, thus enabling better evaluations of investments for long-term potential to outperform the market[2]. This assertion is supported by the fact that integrating ESG KPIs into financial analysis enables investment analysts to tighten assumptions and better assess operational, financial, regulatory, and reputational risks and opportunities, in turn enabling them to build more informed risk profiles and financial models with greater explanatory and predictive power. ESG KPIs can also be used to determine and monitor companies' ability to adapt to changing market conditions; quantify managerial performance beyond financial measures; enable more accurate industry peer comparisons; mitigate and take advantage of, respectively, newly identified ESG-related risks and opportunities, and to keep track of ESG-related incidents that may adversely effect a company's brand and value.

ESGI works as well in theory as it does in practice. An example provided by AXA Investment Managers, which illustrates the use of ESGI as described above in terms of the identification of a KPI and integrating it into financial analysis is provided in Graph I:

Graph I

The affect of board score on share price.



Source: AXA IM, 2012

The graph illustrates that the share price of the companies with the best board scores outperform companies with the worst board scores. Companies with the best board scores returned 40% on an annualized basis, whereas companies with the worst board scores returned -0.3%[3]. Although this may not seem all that insightful, i.e. one would expect poor leadership to result in poor company performance, the fact is that analyses such as these are not undertaken outside of firms that have adopted ESGI, thus investment risks and opportunities are missed. Considering that examples such as these abound across the spectrum of ESG KPIs and the potential implications the results hold on portfolio performance, one would be justified in their initial disbelief that investment managers have not universally adopted ESGI. To be fair, however, there are some practical challenges associated with implementing ESGI, which will be addressed in due course. Before addressing said challenges though, further evidence of the logic behind ESGI is offered through a look at what it takes from a company to manage ESG performance.

A Case for the Relevance of ESGI:

There is a widely accepted notion that the active management of a company's ESG performance is a strong indicator of a generally well-managed operation. The premise is that companies that have programs, processes, and procedures in place to identify and manage ESG-related risks and opportunities are better positioned to outperform their peers across the value chain. This supposition is well founded in that ESG performance management, done properly, integrates the principals and

practices of sustainability at the operational level with a company's overall business strategy. The actions needed to accomplish this type of organizational synchronization require a sophisticated and nuanced understanding of the operational, financial, regulatory, and reputational risks related to global economic issues including but not to: climate change, resource scarcity, human rights and health, labor, poverty, excessive executive pay, poor ethics, limited accountability, and lack of board diversity. On top of this understanding, a significant commitment of organizational resources, courage, and conviction is required from corporate leadership and management in order to envision, devise, plan, and execute the paradigm shift away from a "business as usual" mindset in order to institutionalize these considerations into overall business strategy and management processes. All of which speaks to the high level of leadership and management proficiency required to "make it happen."

These efforts, in turn, enable the identification of opportunities that arise from the aforementioned risks. These opportunities include the implementation of technologies, policies, and behavioral incentives that, very simply speaking, can achieve significant CO2e emissions[4] and water use reductions and improve waste diversion rates. In addition to these environmental outcome improvements, basic opportunities to address societal issues include holding suppliers to internationally recognized environmental, health, and safety standards as well as seeking to develop products and services that address the needs of underserved markets. Opportunities to optimize corporate decision-making capacity include the implementation of governance policies[5], etc. that together or separately; link executive pay to long-term company performance on key environmental, social, and financial metrics; ensure executive boards are independent and reasonably diverse in terms of race and gender; and engender the prudent identification and selection of leadership candidates. Finally, the communication of these types of efforts and the associated successes and challenges to share- and stakeholders as well as the public through appropriate reports, disclosures, and digital media is essential to realizing the full compliment of benefits associated with these opportunities.

The somewhat overwhelming breadth of these opportunities highlights the need for highly qualified and capable leaders, managers, and other human capital to successfully manage ESG performance. As one can see, a defining characteristic of ESG opportunities is their interdisciplinary nature, ranging from energy efficiency to health and safety to board oversight. This nature requires management excellence across a broad range of skills and experience to successfully accomplish the aforementioned feats, therefore adding weight to the positive correlation between active ESG management and superior overall management. Fortunately for companies, there are many sustainability and other professionals who specialize in the areas mentioned. These professionals can build a ROI-positive business case for ESG-related projects and capitalize on them

by bringing the associated programs, policies and procedures to fruition. Additional resources are available in the form of ESG-related subsidies, grants, and other financing instruments, which can ease the upfront cost of implementing such efforts. There are also opportunities to advantageously partner with governments as well as environmental and social advocacy groups to great effect. As such, ESG performance management is possible, is being done, and has proven highly effective.

So as not to create the misperception that sustainability is a potential means for all companies to outperform the market, however, let it be understood that implementing the principals and practices of sustainability only makes sense for companies offering viable product(s) and/or service(s). This being the case, there is no doubt that in addition to determining leaders and laggards, ESGI will crown winners and force the exit of losers. Such outcomes are not to be lamented though as they are a beneficial outcome of equitable[i] competition in market-based economies.

Noting the caveat above, the organizational change required and resources that must be invested to successfully institutionalize sustainability does bring rewards. These rewards come in quantifiable forms[ii] such as increased operating and profit margins; improved access to capital; stronger brand reputation, enhanced employee satisfaction, and workforce and community development. These benefits drive long-term overall outperformance of the market, thus demonstrate the value inherent in managing ESG performance. Case-study[6] evidence substantiating this claim to the tune of billions of US dollars using the Value Driver Model[7] can be found at the United Nations Global Compact website.

Despite this evidence, which supports the relevance and value of ESGI, only a small handful the global assets under management employ an ESGI strategy. Reasons for this lack of recognition of the potential effectiveness of ESGI and adoption of its use are addressed in the following two sections.

The Skeptics' Position and a Hypothetical ESGI Advocate's Response:

Typical challenges by those who have been exposed to the existence and benefits of ESGI have their origins in a lack of understanding of what ESGI is, unreasonable expectations regarding the results achievable through its use, and questioning the veracity and indeed the existence of data that establishes its effectiveness. Without trying to exhaust all of the challenges, the following five ESGI skeptic positions (SP) and ESGI advocate responses (AR) are offered as representative of the arguments from both sides:

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[i] The inequities of current market-based economies and the consequences thereof are discussed at length in Joseph Stiglitz's, "The Price of Inequality: How Today's Divided Society Endangers Our Future."
[ii] There are also less quantifiable, yet, perhaps equally satisfying personal rewards such as the sense of fulfillment one may feel by doing "good" and knowing they are helping to improve standards of living for all citizens of Earth with intergenerational impartiality.

1. **SP**: There are no or very few long-term studies and/or research that verify the effectiveness of ESGI; data is sparse and inconsistent.

1. **AR**: In addition to this objection being misplaced, i.e. there are a plenty of examples of the wide-spread use of unproven investment strategies[8], e.g. collateralized debt obligations, it is also simply untrue. Instead of citing a multitude of studies[iii] to establish the effectiveness of ESGI strategies, however, readers are referred to two studies of studies, which achieve the same purpose through a thorough examination of multiple academic and investment management firm conducted studies.

The first study, "Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors[9]," was conducted by The Asset Management Working Group of the United Nations Environment Programme Finance Initiative and Mercer. Of the five studies it reviewed that employed a pure ESGI strategy, 80% had a positive correlation with outperformance of the market.

The second study, "Sustainable Investing: Establishing Long-Term Value and Performance," was conducted by DB Climate Change Advisors of the Deutsche Bank Group. Two key findings of their review of 100 academic studies of sustainable investing around the world, 56 research papers, two literature reviews, and 4 meta studies were, 1. "89% of the studies examined show that companies with high ratings for ESG factors exhibit market-based outperformance[10]," and 2. "100% of the academic studies agree that companies with high ratings for CSR and ESG factors have a lower cost of capital in terms of debt (loans and bonds) and equity."

Further evidence of the effectiveness of ESGI is offered through the multitude of well-known and respected Investment Managers, which collectively represent hundreds of billions of AuM, that have implemented ESGI in the operation of their Mutual Funds and other financial products, e.g. Calvert Investments, Parnassus Investments, HERMES, Deutsch Bank, Robeco SAM, PNB Paribas, etc. Similarly, major pension funds and endowments, which also represent hundreds of billions in AuM, have implemented ESGI such as Harvard Management Company, Ontario Teachers Pension Plan (OTTP), APG, PGGM, HESTA, and CalPERS, to cite just a handful. Private Equity firms have also begun integrating ESG criteria into investment decisions. Some

[iii] A compendium of such studies can be found here: http://www.sristudies.org/

notable firms include TPG Capital Advisors, LLC, Apollo Global Management, LLC, The Blackstone Group, and The Carlyle Group.

Regarding issues with ESG data, one must concede there has been, up until a few years ago, challenges regarding data availability, consistency, reliability, and verifiability. These issues are mainly related to the nature in which companies report ESG data as well as legal concerns regarding the content of corporate sustainability reports. In some cases, these issues render the data difficult to work with in general and for the inexperienced can lead to the misidentification of leaders as laggards and vice versa[iv]. Similarly, there is an absence of a standard framework and methodology for scoring companies based on ESG performance, which can lead to misconceptions regarding which ESG KPIs are relevant and material and which are not, the latter being irrelevant to ESGI[11]. It is worthy to note, however, that this situation did not prevent the aforementioned investment managers from "identifying the signals among the noise[v]," thereby achieving favorable results with ESGI.

Although the scoring issue remains, within the last few years the data issues have vastly improved. In fact, there is an industry dedicated to providing quality ESG data precisely to enable ESGI and other responsible investing strategies. Companies in this industry include several successful outfits such as Sustainalytics, TRUCOST, Asset4, MSCI, CSRHUB[vi], Bloomberg ESG, RepRisk, and FACTSET as well as smaller boutique firms that often bundle consulting services with their available data. ESG data can also be obtained during analyst calls, and other means of direct communication with companies provided one knows the types of questions to ask. Fortunately, there is some training and education available in this regard as well as many consultants who would be pleased to provide their services.

In addition to these resources, there is an abundance of thought leadership, networking opportunities, information services, and other types of support available through organizations that exist to advance investment practices that consider ESG criteria, e.g. United Nations-supported Principals for Responsible

[iv] This issue serves to reinforce the previously mentioned importance of company's reporting, etc. on their ESG performance.
[v] This phrase is a commonly used catchall for ESG data issues.
[vi] CSRHUB aggregates and normalizes the data and information from a wide range of ESG data-sources in an effort to eliminate the uncertainty resulting from the previously mentioned absence of a standard framework and methodology for scoring companies based on ESG performance.

Investment (UN PRI), European Sustainable Investment Forum (EuroSIF), US Forum for Sustainable and Responsible Investment (US SIF), and many others.

2. **SP**: Considering ESG KPIs into investment decision-making contravenes my legally binding fiduciary responsibility.

2. **AR**: This is a good opportunity to differentiate ESGI from other Responsible Investing (RI) strategies. It is true that some RI strategies subordinate financial returns to positive social and environmental impact[vii] and/or actively eliminate companies from one's potential investment universe. An example of the latter is Screening, which eliminates companies based on whether or not its business activities and sources of revenue are in keeping with investors' ethics and morals. The standard set of screened so-called "sin stocks" include companies directly or indirectly involved in any way with pornography, tobacco, firearms, alcohol, or gambling. Many investors wholeheartedly object to such strategies as they see such restrictions as necessarily limiting potential returns. ESG Integration, on the other hand, is not restricted in this manner as there is no predetermined proscription of one's investment universe as explained in the previous section, Definition and Use of ESG Integration.

To be clear, using an ESGI strategy a company like InBev (a sin stock) could be included in an investment portfolio provided it scored well in an ESG assessment. Thus, clarity on ESGI methodology is essential to understanding its effectiveness as an investment strategy.

With this differentiation explained, it is easy to see how ESGI, in fact, does not prevent an Investment Manager from fulfilling a fiduciary role. In fact, ESGI enhances one's ability to assess potential ROI by providing a more comprehensive evaluation of the investment, thereby improving fiduciaries' ability to act in the best financial interest of their principal. Therefore, this objection is largely the result of an outdated conception of the ESGI investing strategy and an incomplete conception of fiduciary responsibility.

3. **SP**: ESG is a compliance issue, why bother if companies are legally bound to manage these operational aspects of their business?

[vii] Technically, this is known as Impact Investing, which is separate and distinct from Responsible Investing.

3. **AR**: Many companies are out of regulatory compliance and generating above-average returns. From an ESGI perspective, however, this scenario may indicate deeper environmental, health, and safety (EHS) issues among others, i.e. a risk signal to be analyzed. If these issues are not addressed, an ESG Analyst would surmise, they could contribute to a reduction in the value of a stock over time. Another scenario, illustrated by BP's Deepwater Horizon debacle, is when these issues cause a catastrophic event that decimates a stock's value.

There are, thankfully, ESG KPIs that measure such risks, which have been shown to be reliable indicators of poorly performing management, e.g. number of employee accidents/barrel of oil produced. A consistently poor rating on this ratio could be a sign that management is cutting corners on EHS to increase profits. When these types of metrics are meaningfully integrated into financial analysis as previously described, they can significantly reduce, if not eliminate, the occurrence of such portfolio devaluation scenarios[viii].

Furthermore, compliance is about meeting a minimum standard. Highly successful businesses go far beyond this measure. Managing ESG performance is about *creating value* through innovation, technology, behavior change, and other improvements in order to use inputs and produce outputs more efficiently so as to increase financial performance, strengthen brands, and improve employee satisfaction. Companies that can achieve this type of operational excellence are better poised to outperform the market relative to their industry.

4. **SP**: Implementing an ESGI strategy is resource intensive; employee training and/or new hires will be required, data will have to be purchased, consultants may need to brought on, etc.

4. **AR**: Although all these concerns are valid, and the associated actions may indeed be required, there have been no claims that implementing ESGI is easy or does not require an upfront and ongoing investment of human and financial capital, only that it is effective in generating superior, risk adjusted returns.

An alternative, less resource-intensive approach to take when presented with a potential market advantage such as being able to claim the use of ESGI is asking, what is the current and future demand for ESGI? And based on the answer, asking do the benefits of implementing ESGI sufficiently outweigh the costs?

[viii] Domini Social Investments, which manages mutual funds with a combined AuM of US $1.3 billion, was well aware of BP's regulatory compliance issues though the use of ESGI. Based on this information, Domini sold all BP shares prior to the failure of Deep Water Horizon, thereby avoiding a significant loss in the value of the fund.

Regarding current demand for ESGI, US SIF reports[12] that client demand is the top reason Investment Managers are adopting ESGI. It is, perhaps, more important though to find out what is on the horizon of current demand. In seeking to answer this question, one would discover four key facts:

1. An estimated US $41 trillion wealth-transfer is expected to occur from Baby Boomers to Generations X and Y (GX&Y) over the next 40 years[13].
2. 36% of respondents to a World Economic Forum (WEF) study[14] of 5,000 Millennials, aka Generation Y, across 18 countries ranked 'to improve society' as the *primary purpose of business.*
3. GX&Y value price over brand, are not known for brand loyalty, and are not averse to switching costs[15].
4. GX&Y's use of the internet to inform themselves and to take part in their chosen causes differs markedly from that of Baby Boomers[16].

Given these findings, it is reasonable to conclude that, "the emerging generation of investors is likely to seek achievement of social objectives in addition to financial returns[17]." It is equally reasonable to conclude that in order for Investment Managers to be able to take advantage of the expected wealth-transfer opportunity, they will need to accommodate the differences between the investor profiles of GX&Y and Baby Boomers by rethinking their investment strategy to include ESGI.

Regarding the question of whether or not the benefits of implementing ESGI sufficiently outweigh the costs; first, one must realize that it is not necessary to institutionalize ESGI from the outset. One can proceed from there by initiating a pilot project employing ESGI as a means to determine the viability of the strategy and its worth to their firm. The results could then be used to compare with traditionally managed assets and a decision made as to whether or not to proceed further, keeping in mind, of course, the US $14.76 trillion[ix] pool of capital that may require the demonstration of an implemented ESGI strategy.

ESGI skeptics would also do well to remember the previously identified contingent of Investment Managers successfully using ESGI and consider them as competitors with an advantage. One may further consider that despite large-scale resistance there is a trend towards the use of ESGI among Investment Managers being

[ix] This figure, 36% of US $41 trillion, is used to qualify the opportunity in accordance with the portion of GX&Y investors likely seeking to connect social outcomes of business entities with investment returns.

partially driven by the burgeoning demand among retail investors previously cited, i.e. UN PRI signatories have grown to 1,248 members, representing US $34 trillion in AuM[18], in the last eight years. There is also a host of ESG-related disclosure, reporting, and public listing practices and policies on the horizon that may affect companies' performance.

As these initiatives are still in their early stages, having an ESGI program in place is still a means to differentiate[x] one's firm from competitors, thus a potential source of competitive advantage. If realized, these two factors can serve to enable the supply of emerging demand for responsible investment products and the demonstration of regulatory compliance, which amounts to increased potential, relative to competitors, to quickly realize positive ROI through acquiring new clients and attracting additional capital from existing clients.

5. **SP:** Show me how to achieve alpha using ESGI. The sub-text being, if I can't get alpha using ESGI, I am not interested.

5. **AR**: This is a particularly vexing objection because it assumes that achieving alpha is the standard that must be met in order to qualify as a viable investment strategy, a notion, which of course is absurd as there are many investing strategies that fall short of this standard. There are, however, Investment Managers who claim to be achieving alpha using ESGI. Andre Bertolotti, chief investment officer at Quotient Investors is one. He has achieved alpha of 4.88 percentage points over the last three years compared with the Russell 1,000[19]. Extolling the effectiveness of ESGI he flatly states, "Without ESG, my portfolio would look like that of many other managers... But when you bring ESG into the picture, I end up buying a different set of stocks.[20]" This example is not to say that alpha is guaranteed using ESGI, as Investment Managers would have to 'figure it out,' so to speak, for themselves. As previously stated, there is training, education, and consulting services available in this regard.

Despite these resources, it would be fair for Investment Managers who, through considerable effort, have refined their investment strategy over the years to balk at the effort necessary to "figure it out." I.e., re-thinking a successful investment strategy may not be worth the effort. The results of a cost-benefit analysis to determine if the effort is worth the potential return would depend largely on individual circumstances. That said, considering the response to **SP 4** above, those who fail to adapt to the next generation's investment goals and

[x] This is especially the case if one's data and/or service providers are well-known industry standards rather than a non-proprietary in-house solution.

expectations regarding the provision of financial services run the risk of rapidly losing Baby Boomers' capital, which funds the assets they manage now[21].

As one can see, the challenges are not well founded and the responses amply address the embedded criticisms and concerns. Nevertheless, these challenges have typically led to the dismissal of ESGI. Their position is analogous to Climate Change deniers' in that despite being presented with a preponderance of scientific as well as readily observable evidence, they refuse to accept its reality. Although one may expect the responses, communicated effectively and in accordance with one's audience, to clear up skeptics' misunderstandings, properly reset their expectations, and convert skeptics they have little chance of doing so. This is because they begin from the false premise that ignorance and/or limited cognition is the root cause of ESGI skepticism.

Explaining the Skeptics' Position:

Before addressing potential reasons behind the ESGI skeptic position, it is important to note that a significant portion of potential adopters of ESGI have not been exposed to the existence of ESGI, nor for a variety of reasons will they, or their clients be for that matter, in the relatively near future. As adopting ESGI is not on their to-do list, they will do little if anything towards adoption; the significance of this situation being its representation of a separate, ongoing challenge to achieving more widespread adoption of ESGI that will remain as such until an effective means of reaching these folks is devised and implemented. Suggestions for how to help accomplish these tasks are discussed in the final section of this paper.

Although there are a variety of explanations for why skeptics may hold their position, simple ignorance and/or limited cognition on their part does not seem to have sufficient explanatory power. Moreover, if it were the case one would expect that some further education in line with previous responses would be sufficient to convert skeptics. Sadly, this is not the case. As such, given the persistent skepticism of those who have been exposed to the existence and benefits of ESGI strategies, a new explanation is needed. Employing sociological theory, the following five examples offer some insight into skeptics' possible motivation and thinking regarding their rejection of ESGI.

1. Cultural Cognition theory posits that as scientific knowledge and numeracy increases, i.e. the "smarter" one is, among those with a worldview that, "ties authority to conspicuous social rankings and eschews collective interference with the decisions of individuals possessing such authority," i.e. the more one espouses the benefits of a hierarchical social order, the more likely one is to question the data and information with which they are presented[22]. Although this position makes some degree of intuitive sense, *vis a vis* the previously identified

evidence in support of ESGI, such a skeptic would do well to allow for the possibility that they don't "know it all" and to find out and consider *all* of the facts, not just the one's that serve their purpose of denial.

2. Motivated Avoidance theory posits that when faced with a complicated, complex, and troubling issue, some individuals' instinct is to give up and not learn more about it, i.e. they do not endeavor to come to an informed conclusion based on non-biased information[23]. Thus, their skepticism arises from their ignorance being "informed" by the disagreement surrounding the issue and any misinformation they are exposed to in their everyday life. Disagreement and misinformation such as; the prevailing position of one's firm regarding ESGI; information broadcast and written by the ubiquitous and seemingly innocuous news media; as well as the many biased, agenda-advancing entities with the means to distribute their message[xi].

3. Some hold that there is money being made in the form of grants, subsidies, and donations by climate scientists, governments, and not for profit entities that accept the reality of the ESG issues facing society as a result of business operations. Therefore, being financially motivated, their "alarmist" claims, are specious.

4. Under the general heading of fear, when some individuals are presented with threatening information their instinct is to deny the truth of the information and/or its applicability to them. Similarly, humans are notorious – in the field of economics – for underestimating the risks associated with likely events and overestimating the risks of unlikely events. Thus, in both cases, imminent danger is effectively denied. The danger in this case being that they are wrong about the effectiveness of ESGI.

5. Building upon the sociological concepts of confirmation bias, wherein one "give[s] greater heed to evidence and arguments that bolster [their] beliefs" and disconfirmation bias, wherein one "expend[s] disproportionate energy trying to debunk or refute views and arguments [they] find uncongenial," is the rationalization explanation. This theory states that when one is presented with information that questions deeply held beliefs and/or that one's way of life could be fundamentally threatening to society, they reject the validity of the source of the information[24]. Thus, the information itself cannot be correct.

[xi] This ability is very easily enabled via digital technology for any entity with Internet access and a modicum of organization.

Failed Attempts at Converting Skeptics:

Given these explanations, it is easy to understand why the attempts to date to convince ESGI skeptics have been of very limited success. To wit, the fear mongering and plays at sympathy proffered[xii] by those to the left of the political spectrum, the information overload typical of academic efforts, and even simpler, data-based claims basically assume that ignorance and/or limited cognition is the root cause of ESGI skepticism. Potentially exacerbating these efforts are the terms and phrases used to communicate the concepts of ESGI, e.g. sustainable, responsible, environmental, ethical, which for skeptics carry negative connotations[25]. Just hearing or reading these and similar terms, is an immediate cause for concern regarding and even dismissal of the worth of ESGI. The well-intentioned thinking behind these attempts was that if the information is properly explained and the data and methodology verified and substantiated, it would be accepted and follow-up actions taken accordingly.

With the five previously stated theories in mind it is clear that the factors of ignorance and/or limited cognition are likely a relatively minor contributor to reluctance to adopt ESGI *vis a vis* clear and compelling reasons to do so. Another, more powerful, factor that attempts to convert ESGI skeptics have not considered as an explanation is the basic human instinct to preserve one's identity.

One aspect of identity being preserved, through denial, is one's level of intelligence and self-worth as manifested in career performance. That is, if one admits that ESGI is effective, they are likely to conclude that through inaction they could very well have left significant sums of money on the proverbial table. Admitting to oneself that one has not been doing the best for their employer, clients, etc., after years of claiming to have been doing so, could be very uncomfortable and possibly embarrassing. Mental health professionals refer to this type of internal conflict as cognitive dissonance, i.e. the discomfort one feels as a result of attempting to simultaneously maintain two conflicting cognitions. In this case, 'I have done my best' and 'I dismissed, without sufficient reason, information that would have improved my performance.' This discomfort often leads to decisions based primarily on emotion or more precisely, the moderation of emotions fueled by anxiety. Denial of the effectiveness of ESGI would serve to avoid the anxiety and preserve and reaffirm one's sense of career accomplishment.

Another aspect of identity being preserved, through the same defense mechanisms, is one's self-image as a "good person." For if one admits that ESGI is effective they will also soon come to more explicitly realize the negative consequences of business operations not managing ESG performance, which have significantly contributed to the environmental and social

[xii] Which is not to claim that the assertions made regarding, e.g. habitat loss due to sea-level rise, the health effects of pollution, etc. are not true and relevant, rather, that they are not effective towards inducing behavior change among individuals for which these negative consequences have no immediate bearing or significance.

issues and threats facing both businesses and the public as previously discussed. With this realization will come another, perhaps more troubling, realization, i.e. as a result of not considering ESG criteria in their investment decision-making processes, they have made an outsized contribution to these issues. As such, they have through their occupation, albeit unwittingly, further jeopardized the health and future wellbeing of their spouse, children, other family members and friends, themselves, and indeed the rest of the world; a notion certainly capable of inducing a fair bit of anxiety. Again, denial of the effectiveness of ESGI would serve to avoid the anxiety and preserve and reaffirm one's self-image as a "good person."

A New Approach:

The combination of obstacles stated in the previous sections severely diminishes if not eliminates the power of an attempt to appeal to skeptics' sense of logic and reason with a sensible argument backed up by empirical evidence. That is, providing text and data-laden pre- and proscriptions for investors to follow, as has been employed by ESGI advocates to date, has not proven to be an effective strategy. This being the case, a new approach is needed to increase the adoption of ESGI. As such, in an attempt to circumvent the threat posed to skeptics' identity, their distaste for terms and concepts commonly used in the context of ESGI, and the disregard for the environmental and social benefits ESGI can effect, the following suggestions for ways to increase the adoption of ESGI are offered. They seek to appeal to the competitive nature of Investment Managers to the exclusion of trying to raise awareness and increase understanding of the implicit environmental and social benefits of ESGI.

1. Similar to the XPrize[26], a competition could be designed and issued to demonstrate the achievement of alpha through the use of ESGI. Similarly, more prizes like the Moskowitz Prize for Socially Responsible Investing[27] could be made available to students.

2. Under the heading of training and education; sustainability and ESGI coursework could be added to the curriculum of appropriate graduate and undergraduate business classes and more ESG-focused extra-curricular opportunities such as the PRI Young Scholars Finance Academy[28] offered by oikos could also be made available. Similarly, more ESGI training opportunities could be made available to Investment Managers. One such online and very affordable opportunity is provided by the Responsible Investment Academy[29], which is supported by Bloomberg, RobecoSam, CFA Institute, and Financial Services Council. More personal and expensive training is provided by highly qualified academics and former financial services professionals on a limited basis through RFK Compass[30]. Taking this idea a step further, a Responsible Investor professional accreditation could be formed; possibly as sub-designation to a

Certified Financial Analyst (CFA). In fact, this possibility was recently reported[xiii] on by The Guardian[31] and was a topic of discussion at a recent meeting of the Vancouver CFA Society.[32]

3. In order to raise retail investor awareness of ESGI, Morningstar, CNBC, and other mainstream finance-focused sources of information could dedicate coverage to the strategy. Beyond raising awareness to generating and driving retail investor demand for sustainable investment products, a directory of sustainably managed investment products could be built. The directory could be searchable by an appropriate mix of traditional and ESGI associated criteria and the results displayed accordingly including a link to the provider.

4. Investment Management firms could align compensation incentives with the successful use of ESGI integration.

5. Eligibility for banking and investment subsidies could be restricted to firms that have a predetermined minimum percentage of their AuM using ESGI.

6. Standard reports issued by indexes and exchanges could be benchmarked against a comparable index of assets determined as sustainably managed, for example, MSCI ESG World or Dow Jones Sustainability World indices. These reports could then be distributed through social media applications and financial news sources.

Although this suggestion may sound far fetched, studies[xiv] have shown that one of the most effective methods to induce behavior change is to regularly deliver messaging that employs easily understandable, "every day" language and graphics to convey a gentle command that also relates a benefit into a single "takeaway" or lesson. Essential to the effective consumption of the message is the full consideration of one's audience in terms of the language employed, the incentive described, the delivery method, and who or what is delivering the message. Finally, it is noteworthy that some degree of trial and error may be necessary to realize the maximum potential behavioral change through this method.

[xiii] CFA managing director and co-head of education John Bowman's response, one of considerable resistance to the idea of thoroughly incorporating ESGI into the curriculum CFA training, displayed a conspicuous lack of strategic vision and accountability, indicating a clear governance issue.
[xiv] One such study, to which the author was privy while interning at the New York City Mayor's Office of Long-Term Planning and Sustainability, was sponsored by GreeNYC; i.e. the public outreach arm of the agency.

As it happens, the most powerful among the four benefits proven to be the most motivational is financial, the other three are, in order of relative power, health, environmental, and social cache[xv]. Using this insight, the previously mentioned factors and others could easily be incorporated into basic comparisons using tables and/or charts configured in such as way as to raise awareness among Investment Managers of the effectiveness of ESGI in generating superior risk adjusted returns. The takeaway being something in keeping with the notions of increasing clients' returns, earning a larger bonus, attracting more capital, etc. Regarding the latter, for messages delivered in the digital realm, functionality could be included in the message to, "connect" with investors interested in "green" funds now!

To be clear, given the seeming intractability of the skeptic position regarding the adoption of ESGI, these suggestions are intended to help induce institutional and individual behavior change consistent with the adoption of ESGI. Advantages of these suggestions include being; consistent with Investment Managers' desire to realize superior long-term risk-adjusted returns; relatively easy and inexpensive to implement; and save for suggestion 5, not fraught with political and regulatory barriers to overcome in order to be implemented. Only with multiple "solutions," however, will universal adoption of ESGI be achieved. With this understood and given the myriad sustainability-related challenges being faced by society, a concerted effort must be made to realize the potential for investors to simultaneously address the aforementioned risks and meet fiduciary responsibilities by leveraging their capital resources and influence to invest in and otherwise advocate for sustainably run companies. This can be achieved through the use ESGI. Doing so will help to ensure the future viability of the social, environmental, and economic spheres of society, increase public awareness of the necessity for sustainable processes and systems, and meet the ever-growing demand for new ideas, products, and services that employ sustainable solutions. In the absence of such an effort, bad behavior by companies will continue to be positively reinforced by investments that do not employ ESGI.

Robert's LinkedIn profile is here: http://www.linkedin.com/profile/view?id=47866594&trk=nav_responsive_tab_profile

[xv] This benefit is to be understood as an opportunity for one making the behavior change to boast about their commitment to the environment. NB: this benefit/incentive primarily applies to environmentally conscious, relatively affluent members of society.

End Notes:

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