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Does ESG investing really have an influence on companies?

Research questions integrated and score-based strategy on the risk of mixed message sent to companies

What motivates equity ESG investment strategies is the ability to influence the behaviour of companies through the portfolio decisions that they lead to. To this end, it is often argued that an investor who is dissatisfied with a company's ESG behaviour, and who wishes to remedy the situation, needs to stay on as its shareholder and engage with it. Indeed it is believed that if the investor divests from the company, its influence over the company will cease. Moreover, the act of divesting is often presented as a passive approach that has no bearing on the company's management, a capitulation rather than a form of action.

In a new publication entitled "ESG engagement and divestment: mutually exclusive or mutually reinforcing?" Scientific Beta argues that both divestment and engagement are actions that promote change and illustrates the empirical results of academic studies that both approaches can be effective.

This paper also demonstrates that these two strategies are entirely compatible: the rise of collaborative engagement campaigns, in which current and potential shareholders combine their forces, are testimony to the fact that divestment does not put an end to an investor's possibility to engage with a company. Divestment and engagement are hence not mutually exclusive and reinforcing.

Those who deem ESG divesting strategies incompatible with engagement sometimes see integrated ESG mixing strategies as a good match with ESG engagement. Unfortunately, this type of approach, which means that the weight of a stock is a result of both its financial and ESG characteristics, can lead to investment policies that are totally inconsistent with the stated objectives of the strategy. As an illustration, Scientific Beta shows in this paper that as far as Low Carbon strategies are concerned, the score-tilted or optimisation-based approaches can certainly lead to a strong reduction in the portfolio's overall carbon score while at the same time increasing the investments in the most carbon-intense companies.

In contrast to ESG mixing strategies, top-down ESG strategies that use straightforward ESG filtering to do this, i.e. removing the worst ESG performers from the investable universe, concentrates the divestment on the ESG laggards and sends clear-cut signals to all companies and stakeholders. In combination with ESG engagement, in particular through collaborative ESG campaigns, ESG filtering lays the ground for an effective ESG investing policy.

The Scientific Beta white paper can be accessed through the link below:

ESG Engagement and Divestment: Mutually Exclusive or Mutually Reinforcing? May 2020, Scientific Beta Publication

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About Scientific Beta

Scientific Beta aims to be the first provider of a smart beta indices platform to help investors understand and invest in advanced beta equity strategies. Established by EDHEC-Risk Institute, one of the top academic institutions in the field of fundamental and applied research for the investment industry, Scientific Beta shares the same concern for scientific rigour and veracity, which it applies to all the services that it offers investors and asset managers. On January 31, 2020, Singapore Exchange (SGX) acquired a majority stake in Scientific Beta. SGX will maintain the strong collaboration with EDHEC Business School, and principles of independent, empirical-based academic research, that have benefited Scientific Beta's development to date.

The Scientific Beta offering covers three major services:

- **Scientific Beta Indices**
  Scientific Beta Indices are smart beta indices that aim to be the reference for the investment and analysis of alternative beta strategies. Scientific Beta Indices reflect the state-of-the-art in the construction of different alternative beta strategies and allow for a flexible choice among a wide range of options at each stage of their construction process. This choice enables users of the platform to construct their own benchmark, thus controlling the risks of investing in this new type of beta (Smart Beta 2.0).

  Within the framework of Smart Beta 2.0 offerings, Scientific Beta provides access to smart factor indices, which give exposure to risk factors that are well rewarded over the long term while at the same time diversifying away unrewarded specific risks. By combining these smart factor indices, one can design very high performance passive investment solutions.

- **Scientific Beta Analytics**
  Scientific Beta Analytics are detailed analytics and exhaustive information on its smart beta indices to allow investors to evaluate the advanced beta strategies in terms of risk and performance. The analytics capabilities include risk and performance assessments, factor and sector attribution, and relative risk assessment. Scientific Beta Analytics also allow the liquidity, turnover and diversification quality of the indices offered to be analysed. In the same way, analytics provide an evaluation of the probability of out-of-sample outperformance of the various strategies present on the platform.

- **Scientific Beta Fully-Customised Benchmarks and Smart Beta Solutions** is a service proposed by Scientific Beta, and its partners, in the context of an advisory relationship for the construction and implementation of benchmarks specially designed to meet the specific objectives and constraints of investors and asset managers. This service notably offers the possibility of determining specific combinations of factors, considering optimal combinations of smart beta strategies, defining a stock universe specific to the investor, and taking account of specific risk constraints during the benchmark construction process.

With a concern to provide worldwide client servicing, Scientific Beta is present in Boston, London, Nice, Singapore and Tokyo. As of December 31, 2019, the Scientific Beta indices corresponded to USD 59.2bn in assets under replication. Scientific Beta has a dedicated team of 52 people who cover not only client support from Nice, Singapore and Boston, but also the development, production and promotion of its index offering. Scientific Beta signed the United Nations-supported Principles for Responsible Investment (PRI) on September 27, 2016.

On November 27, 2018, Scientific Beta was presented with the Risk Award for Indexing Firm of the Year 2019 by the prestigious professional publication Risk Magazine. On October 31, 2019, Scientific Beta received the Professional Pensions Investment Award for “Equity Factor Index Provider of the Year 2019.”

Risk Awards 2019 Winner
Scientific Beta
Indexing firm of the year

PROFESSIONAL PENSIONS
INVESTMENT AWARDS 2019
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