Socially Responsible Investing: Debunking the Myths

Just a half-century ago, Nobel-winning economist Milton Friedman championed the concept of maximizing shareholder wealth: "There is one and only one social responsibility of business: to engage in activities designed to increase its profits." Today, the tides have turned.

With growing unrest due to economic, social and environmental concerns, a movement towards "moral capitalism" has emerged. Prior to the pandemic, the Business Roundtable, a consortium of CEOs from 181 of the largest corporations, declared a shift in corporate attitude and a new social consciousness in serving all stakeholders including employees, communities and the environment.

Investing is also experiencing a shift in purpose. Socially responsible investing (SRI) continues to grow in popularity as investors recognize the opportunity to invest in companies that are making positive changes in the world. SRI involves including environmental, social and governance (ESG) factors in investment selection and management. Environmental issues include climate change and resource depletion; social factors involve human rights, people management and consumer protection; and governance refers to the responsibility and accountability of company management.

Canadian assets under management using ESG factors are in excess of $2 trillion.[1] As SRI continues to grow, so do certain perceptions. Here are four common myths, debunked.

SRI strategies underperform conventional strategies. It has been argued that investing with SRI strategies reduces the number of investment opportunities, thereby lowering an investor's potential returns. However, companies that wisely manage ESG risks and opportunities may actually show improvements to certain financial metrics, potentially enhancing profitability and/or share prices. There is evidence to suggest that correlations exist between strong sustainability practices and company performance.[2] One of the reasons may be because corporations that apply ESG factors across their organizations can reduce various business risks.

SRI mainly involves screening out "sin" stocks. In the past, many SRI methodologies focused on exclusion-based investing, with the purpose of avoiding companies that were considered to be in sin industries like tobacco, gambling, or alcohol. However, as SRI has grown in popularity, there has been a distinct move towards screening investments using inclusionary factors, such as focusing on those companies who are better at managing sustainability-related issues.

SRI is limited to equity investments. While SRI was initially focused on equity investing, over recent years there has been a growing movement in SRI across all asset classes. For example, in the fixed income market, municipal "green bonds" have grown in popularity. These bonds are used to finance climate and environmentally-friendly projects, such as clean-tech. In 2019, global green bond issuance rose by 51 percent (as compared to 2018), raising over US$250 billion.[3]

While Canada remains a small player in the global green bond market, it is expected that positive investor interest will help to drive continued growth in this segment of the market. Alternative investments, such as real estate and private equity, have also been increasingly integrating ESG factors into their investing practices.

SRI is a "fad." Many industry observers believe that a long-term structural shift to socially responsible investing is taking place. Sustainability is quickly becoming a standard. In January, the world's largest fund manager announced sweeping changes to help position itself as a leader in sustainable investing. It will now assess ESG factors in its investments "with the same rigor that it analyzes traditional measures such as credit and liquidity risk."[4] This demonstrates just one of many significant commitments by industry players to support SRI.

HOW WE CAN HELP

Most of us want to do good for the world. SRI gives investors the opportunity to actively invest and contribute to a better tomorrow. We can help you explore the alternatives based on your ESG values and provide support and clarity in the selection and monitoring process.

1. riacanada.ca/responsible-investment/; 2. tiaa.org/public/pdf/ri_delivering_competitive_performance.pdf; forbes.com/just-companies/#2ea3f1c82bf0; Gunnar Friede, Busch & Bassen, "ESG and financial performance", Journal of Sustainable Finance & Investment, 2015; 3. advisor.ca/news/industry-news/canadas-green-bond-market-still-limited-iiac; 4. https://www.theglobeandmail.com/investing/markets/inside-the-market/article-blackrocks-eco-investing-strategy-is-not-a-moral-awakening/