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Financial services company Allianz, sponsors of Bayern Munich, are one of 2021's top performing ESG – environmentally responsible – companies. Anahtiris/Shutterstock

Big business and climate change: finally, sustainability pays

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One thing becoming clear during the debate over how to respond to climate change is that prioritising profit at the expense of the environment, or disregarding the social consequences, is not just morally unacceptable, it is increasingly difficult. Big corporations are under pressure to take real action on emissions or risk the wrath of protesters, investors and even shareholders.

As part of COP26, former governor of the Bank of England, Mark Carney, led the Glasgow Financial Alliance for Net Zero (GFANZ) initiative as part of the UN Net-Zero Banking Alliance. Members now include 450 organisations that control a total of $130 trillion (£95 trillion) in assets. This accounts for around 40% of global assets.

These companies have signed up to reducing their greenhouse gas and climate change contributions to net zero by 2050 by combining action with accountability, with signatory banks setting an intermediate target for 2030 or sooner, using robust, science-based guidelines.

Mark Carney
@MarkJCarney

The world's biggest banks, asset managers, insurers, & pension funds increasingly see #climate as a fundamental risk to be managed.

This means a virtuous cycle of large-scale investment, faster #decarbonization, and more jobs.

#COP26 #MyFirstGif

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A new kind of company

A spectrum of "purpose and impact-driven" enterprises now exists. This means that organisations actively trying to solve social and environmental problems as part of their main business activities.

These range from social enterprises helping with environmental and social causes locally and nationally, through to certified B corporations, allied to a non-profit set up by three business and private equity experts to "accelerate a global culture shift to redefine success in business and build a more inclusive and sustainable economy". B corporations are legally required to consider the impact of their decisions on their workers, customers, suppliers, community and the environment.

Businesses now have a range of ways to ensure their activities provide a social or environmental benefit. Trying to solve social and environmental problems sets a new purpose for organisations and in doing so, these companies want their solutions to have an impact.

So now even the largest corporations are buying into the purpose and impact trend. Companies publicly listed on stock exchanges want to attract investment and give investors confidence that their business will provide a better than average return on that investment.

Purpose and impact in investing terms can be captured by environmental, social and governance (ESG) investments which report and track these factors as well as financial performance. In the US S&P500 index (which tracks the performance of the 500 largest companies on US stock exchanges), 16 of 27 ESG investments outperformed the market in 2021. In Europe a sample of 745 Europe-based ESG funds shows that the majority have done better than non-ESG funds over three, five, and 10 years.

Making big corporations accountable

The strong performance of ESG investment is turning both corporate and investor heads. The notion that fossil fuel is a sure-fire investment has also been questioned as future returns are expected to be lower. Earlier this year, leading petrochemical corporations ExxonMobil and Chevron suffered shareholder revolts over their failure to demonstrate strategies to curb emissions, while Shell suffered defeat in the Dutch courts in a citizen-led case and was ordered to expand its plans to cut its levels of emissions.

The ability to ignore social and environmental risks in investment portfolios is evidently reducing. Meanwhile, the benefits of investing in socially and environmentally responsible business are becoming clearer and more attractive.

Shell has been ordered by Dutch courts to cut its emissions. Jointstar/Shutterstock

The 2017 Task Force on Climate-Related Financial Disclosures (TCFD) is moving towards greater scrutiny of scope 3 emissions of greenhouse gases. Scope 3 emissions are the indirect emissions that are incurred by a company's activities such as transport, employee commuting, waste disposal and so on, which are created as part of the business's value chain.

For the finance sector this typically includes the emissions of companies in receipt of investments and lending. This initiative will likely be boosted further by the Science Based Targets Initiative (SBTi) which launched the world's first net zero standard at the end of October 2021. This initiative will help organisations measure greenhouse gas and climate change contributions across all of their activities.

What this means is that customers of banks themselves will also have to be net zero if banks are to achieve their own commitments. So if a small company is looking for a business loan, its lending bank will expect that company to also have net zero commitments on greenhouse gases and climate change.

Financial firms signed up to GFANZ also have huge investments in stocks and shares. Large companies listed on stock exchanges which are looking for investment will need to convince banks that they too will be moving towards net zero on greenhouse gas emissions and climate change. Businesses which cannot demonstrate clear commitments to net zero will have far fewer lenders and investors to choose from.

Eight years after the G8 Social Impact Investment Taskforce was set up, finance and business are finally now aligning themselves to social and environmental goals. Companies which pay careful attention to their social and environmental impact will have more opportunities to secure investment.

Socially and environmentally responsible companies with sustainability at the centre of their business are already finding success in the market. And the way financial markets are moving would indicate that investment in sustainability will only continue to pay off.