The rise of ESG investing

Investing with a purpose – with environmental, social or governance (ESG) aims in mind – is becoming mainstream and offers opportunities for biotech companies and investors alike. *By Erik van Buuren*

At the beginning of September 2016, the United States and China, the world's biggest emitters of greenhouse gases, announced they will formally ratify the Paris climate change agreement in a move hailed as a significant advance in the battle against global warming. David Waskow, international climate director of the World Resources Institute described the announcement as a sign the world's two largest economies had moved from "making commitments to delivering action". The EU, for example, has a "national determined contribution" of cutting emissions by 40% by 2030 on 1990 levels, and the US by up to 28% by 2025 compared with 2005.

Influential bond market

The bond market has proven to be an influential tool in financing the transition towards a low-carbon economy. The current $694bn climate aligned bond market includes $118bn of labelled green bonds and is made up of approximately 3,590 bonds across various climate related sectors such as transport, energy, buildings& industry, water, waste and pollution control, and agriculture & forestry. In contrast to the global bond market, currently standing at approx. $90tn, climate aligned bonds are edging towards 1% of the total market and last year increased by $96bn last year. [Bonds and Climate Change – The state of the market in 2016].

Double digit growth in ESG investments

More and more investors are looking to reach their financial goals and opportunities to fulfill their obligations in a manner that achieves a long-term, positive effect – from the large global institutions to individual investors. Assets under management incorporating sustainability investment strategies reached $21.1 trillion globally as of the beginning of 2014, up 61% from the onset of 2012, said the Global Sustainable Investment Review 2014, In 2014 Assets under management from Environmental Social Governance (ESG) and Impact Investing Strategies totalled $13.6tn in Europe and $6.6tn in the United States with annual growth rates of 26% and 33% respectively.

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Over the years a variety of sustainable investment strategies have been developed and a shift in recent years can be observed away from traditional negative screening (exclusion criteria) to positive screening, engagement and impact investing. In my opinion the main reason for this is that investors and companies have identified non-financial criteria as a means to manage financial stability.

By focussing on ESG issues an enhanced, sophisticated risk management process is achieved centring on physical risks, liability risks and transition risks covering all stakeholder groups. For the biotech and health care industry, the ability to innovate, operate within ethical standards, attract and retain talent, to maintain healthy supplier relations and to foresee regulatory changes, for example, matter to investors as these factors have an impact on competitive and long-term financial performance.

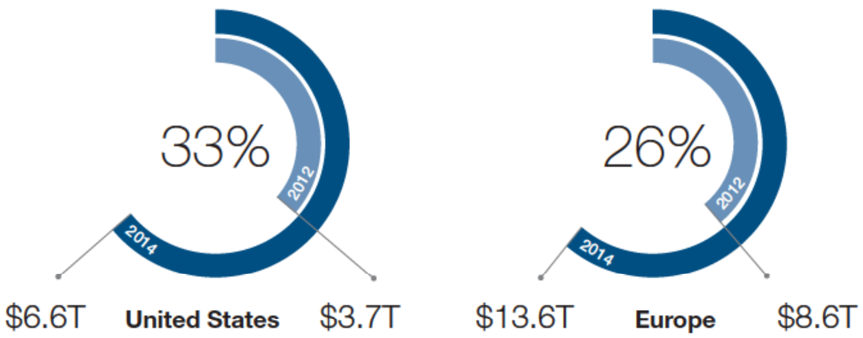
Increasing need for transparency
Stock exchanges are also uniquely positioned to influence their market in a way few other actors can. In addition to their ability to influence investor and company behavior, exchanges often support regulators in promoting the adoption of market standards. The Sustainable Stock Exchanges (SSE) initiative is a

European Stock Markets according to SSE

Stock market segment	SSE Partner exchange	Requires ESG reporting as a listing rule	Offers written guidance on ESG reportinge	Provides sustainability related indices	Has green bonds listings
Euronext	Yes	No	No	Yes	Yes
AIM	Yes	No	Committed	Yes	Yes
Nasdaq OMX Main	Yes	No	Committed	Yes	Yes
FSE	Yes	No	Yes	Yes	No
Alternext	Yes	No	No	Yes	Yes
Oslo Børs	Yes	No	Committed	No	Yes
SIX	No	No	No	No	No
Nasdaq OMX First North	Yes	No	Committed	Yes	Yes
WSE	Yes	No	No	Yes	No

Source: Sustainability Exchange Initiative, Progress Report on 2016

Growth rates of ESG assets and Impact Investing Strategies



Source: Global Sustainable Investment Review 2014. Figures include Exclusionary Screens, Environmental Social Governance (ESG), and Impact Investing Strategies. Stated percentages are compound annual growth rates.

peer-to-peer learning platform for exploring how exchanges in collaboration with investors, regulators, and companies, can enhance corporate transparency – and ultimately performance – on ESG issues and encourage sustainable investment. SSE is organised by several UN entities and the Principles for Responsible Investment in order to promote improved ESG disclosure and performance among listed companies. According to SSE, exchanges are currently using a number of mechanisms to advance sustainability in their markets. (see table p. 20)

Transparency is of particular relevance within the context of the pharma and biotech sectors as the level of controversy tends to be more elevated here compared to other industries. Despite this controversy, those companies addressing relevant issues in a transparent manner and providing evidence of corrective or operational measures will gain investors' trust.

As an example of increasing ethical transparency, the UK's Local Authority Pension Fund Forum, a GBP165bn collective of local government pension schemes has joined a group of investors lobbying pharmaceutical companies to improve clinical-trial transparency. According to the AllTrails campaign, the involvement of investors is a game changer as it forces chief executives to recognise medicine is changing.

Private equity embraces responsible investment principles
Both growing numbers of pension funds globally allocating capital to private equity and increasing numbers of signatories of the six Principles for Responsible Investment means that ESG is steadily finding its way into private equity investments. This voluntary and aspirational set of investment principles is an investor initiative in partnership with UNEP Finance Initiative and UN Global Compact. It has nearly 1,500 signatories from over 50 countries representing US$60tn.

As a result, ESG factors are being implemented in the due diligence on behalf of pension funds. Therefore private equity managers are finding themselves integrating ESG in due diligence, post-investment and financial reporting practices. The outcome of due diligence is fed into the decision-making process and becomes part of the ongoing monitoring of the private equity manager.

ESG reporting is the new benchmark
My research shows that a majority of small and mid-cap listed biotech companies have yet to discover the potential of reporting on ESG issues as a means to attract capital, to present their achievements and to manage risks. As most companies will position themselves as developing medical solutions for the benefit of society, embedding ESG on an operational level would appear to be logical. On the other hand, public opinion perceives ethical challenges in the biotech industry; hence actively reporting on ESG seems appropriate.

In general reporting on ESG is gaining wider importance with the adopted EU-Directive on the disclosure of non-financial and diversity information by certain large companies entering into force in December 2014. The Directive introduces measures that will strengthen the transparency and accountability of approximately 6,000 companies across the EU. These so-called 'public interest entities' with more than 500 employees will be:

- Required to report on environmental, social and employee-related human rights, anti-corruption and bribery matters;
- Required to describe their business model, outcomes and risks of policies on the above topics, and the diversity policy applied for management and supervisory bodies;

Member states have two years to transpose the directive into national law and it is expected that the first company reports covering the financial year 2017-2018 will be published in 2018. There is no doubt the directive will trickle down to a wider scale of companies and stakeholder groups.

Expand your ESG footprint

Access to capital is crucial for biotech companies in the healthcare sector. Based upon the above information, incorporating ESG into business strategies, due diligence and in reporting practices represents a real opportunity for attracting a wider range of potential investors and to boost company valuations. Therefore I encourage companies accessing private finance to expand their ESG footprint!

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