Climate Change, Divestment & Sustainability Governance Scorecard

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Sometimes circumstances may lead us to believe that excluding or sidelining a group of people or assets may be the best solution, when faced with a situation that we find morally questionable. We may do this on a personal level when as an individual we boycott the products of an organization. At other times, we may form a group of individuals to exclude a specific organization, or alternatively, it may be a whole group of organizations sidelining another large group of organizations.

In the investment world, this is called divestment. In fact, divestment is the reverse of an investment – it simply means leaving stocks, bonds and other investment vehicles that may be perceived to be unethical or morally uncertain.

Recently, the divestment movement has been associated with attempts, led by the investment community, to reduce climate change by employing social, political, and economic force on a whole set of companies considered to be causing environmental deterioration due to climate change. As some market participants would say: "One thing that makes managements and boards do the right thing is when the share price of their company becomes of no value."

According to a report from 350.org, an environmental organization advocating for divestment, there has been a rapid increase in investors who are abandoning questionable holdings. Back in 2014, investors with a total $52bn in assets under management had agreed to leave their fossil fuel holdings. That group now represents more than $11tn in total assets. Additionally, the number of institutional investors committed to cutting fossil fuel stocks from their portfolios has risen from 180 in 2014 to more than 1,100 now.

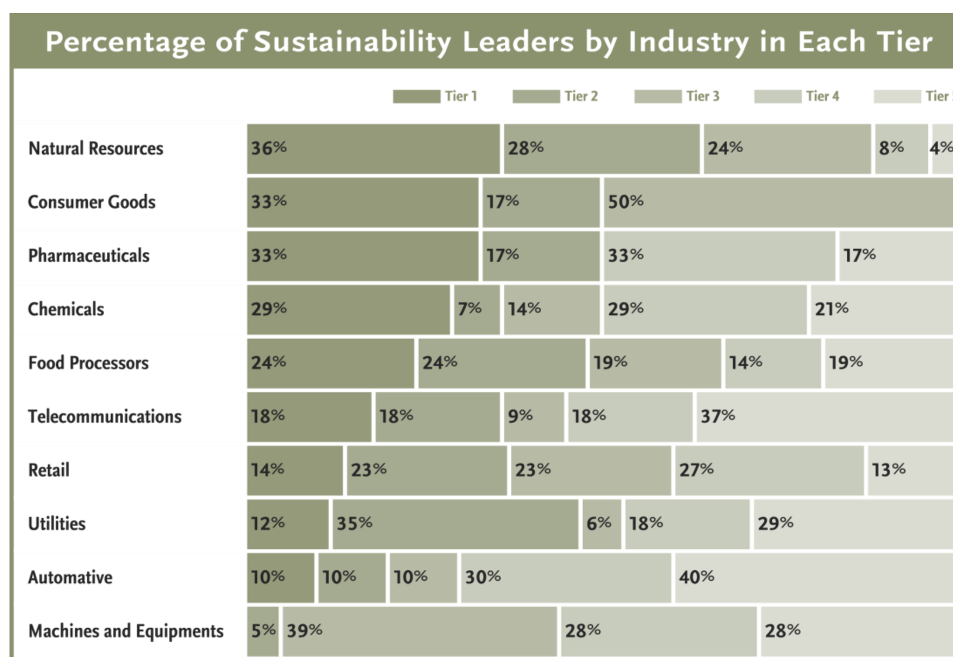
Big miners are likewise facing increased pressure from institutional investors concerned about global warming to exit coal or cap production. Norway has just announced plans to tighten restrictions on coal investments for its $1tn sovereign wealth fund, targeting producers including BHP, Glencore and Anglo American.

As investors are paying attention to these subjects, managements and boards are inevitably paying more attention as well. In order to ensure sustainability, investors are rightfully on top of these issues and are promoting better transparency. Transparency and consistency in accurate reporting are two key concepts in making progress to improve sustainability. Therefore it is crucial for investors to push for more transparency

and to expect corporations to meet certain ESG criteria consistently, before giving them access to funds or, in more extreme cases, before denying them from funding altogether.

Consequently, there is some evidence that pressure from investors and other stakeholders is succeeding, at least in terms of higher transparency in reporting ESG results for certain sectors. Sustainability Governance Scorecard©, an impact-research conducted by our Academy - Arguden Governance Academy- shows similar implications. Our comparative review, which covers ESG-compliant companies in 6 countries across 10 sectors shows that natural resources as a sector scored highest and made it to the best 2 Tiers out of 5 Tiers, 36% of them being in Tier 1 and 26% of them being in Tier 2.

Our study, which aims to contribute to global efforts in improving sustainability reporting, also showed the following data: More than 50% of ESG-compliant companies analyzed in our research that belonged to natural resources, consumer goods, and pharmaceuticals sectors made it to Tier 1 or Tier 2. We believe that this result is due to increased investment pressure related to "license to operate" for natural resources, to tighter regulations, to longer-term thinking because of investment horizons in natural resources and pharmaceuticals, and finally due to being closer to sensitive consumers in the consumer sector.



Based on Argüden Governance Academy research for Sustainability Governance Scorecard©

There is also evidence from recent news that managements are responding to such pressure, as some specific companies may be working to achieve faster and more impressive progress. For example, BHP's CEO Mr. Mackenzie recently disclosed three steps he wants to take: the company is setting public goals next year on reducing greenhouse gas emissions from its products even after they have been sold to customers (so-called Scope 3 emissions); spending $400m in R&D over the next five years to reduce carbon emissions; and tying executive pay more closely to environmental targets for the company. His choice to tie his pay to emissions among BHP Billiton's customers and in setting targets for those customers may be worth highlighting, because

until recently most mining groups had been convinced that they could not be held responsible once their products landed at their customers.

BHP's announcements put the company in sharp contrast to Rio Tinto, an Anglo-Australian miner, which discarded this idea of setting targets for customers as an unworkable proposal. Rio did commit itself to setting new targets in 2020 for its direct (or Scope 1 and 2) emissions, which are aiming for a "substantial decarbonisation" of its business by 2050. Yet to put things in context, Rio's customers released 536m tonnes of greenhouse gases last year, according to its recently published Climate Change Report, while Rio's Scope 1 and 2 emissions were just 28.6m tonnes. This is why BHP's step towards measuring its customers is worth highlighting as a positive step forward in reporting, as investors are pushing for more transparency in results. [i]

Another convincing sign that investment pressure has an influence became obvious in a recent statement from Royal Dutch Shell chief executive. He said last year that his corporation had decided to list divestment campaigns as a material risk in its annual reports going forward. [ii]

Vale - the world's biggest producer of iron ore - on the other hand, is a case where investors have been responding on a negative set of news by pressuring the company to improve its work safety, fix its safety issues on its dams used to store industrial waste or threatening to walk away. Vale has been under intensified regulatory inspection after deadly dam collapse in Brazil earlier this year. It has been forced to close mines and reduce production. As an example, Germany's third largest asset manager Union Investment has sold all the bonds and shares it held in mining group Vale, right after the news of collapse. [iii]

Some market participants will say divestment does not provide a solution but it is only transferring one asset from one entity to another entity, therefore for instance in case of climate change it will do nothing to reduce emissions. In fact, Bill Gates a few days ago came out and argued this point and offered as a more effective alternative to do positive screening in investment rather than divestment strategy, which means investing in companies with a direct mission to reduce emissions. Bill Gates has a point in that indeed whenever there is a seller there is also a buyer. So in aggregate there may not be much improvement.

Then there other market participants who will go for "stay invested and advice" strategy where they will push for change by exercising power as shareholders. For example, they would argue that there is no alternative to fossil fuels for flying or shipping. This means there will always be a market for fossil fuels and it is therefore better to stay invested and exercise influence.

Finally activists say opinions against fossil fuel divestment miss a larger point. The idea is not to starve companies of capital but to attack their "social license to operate" according to US-based climate activist group 350.org.

In the past there have been few instances where divestment movements did reach their goal. The most prominent example is the divestment movement from South Africa in the 1980's. Anti-apartheid protests started in the 1960s, particularly on the campuses of American colleges and universities. Initially, protesters wanted to influence the South African government using traditional forms of protest but demonstrations were ineffective. Eventually, they thought of a more effective way to cause change by pressuring their universities to divest stocks of companies doing business in the country. Even though the decline in value caused by the sales

of stocks was insignificant the fact that the South African corporations did not want to deal with bad publicity made sure that the divestment movement ended with success.

Even though we are not in a position to make a judgment which climate change strategy would be most effective, it is worth highlighting the fact that the investment community and various stakeholders are increasingly exercising pressure on natural resource companies or other sectors perceived as causing climate change. As our impact research Sustainability Governance Scorecard indicates, no matter what strategy investors go for, pressuring corporations to do the right thing will have an impact. At the least, it may have an effect on the global efforts to improve transparency and quality of sustainability reporting as indicated by higher scores than average from natural resource companies in our study. For more information on our Academy's research, please go to https://sgscorecard.argudenacademy.org/

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