

# **PitchBook's guide to sustainable investing and ESG strategy**

# Overview

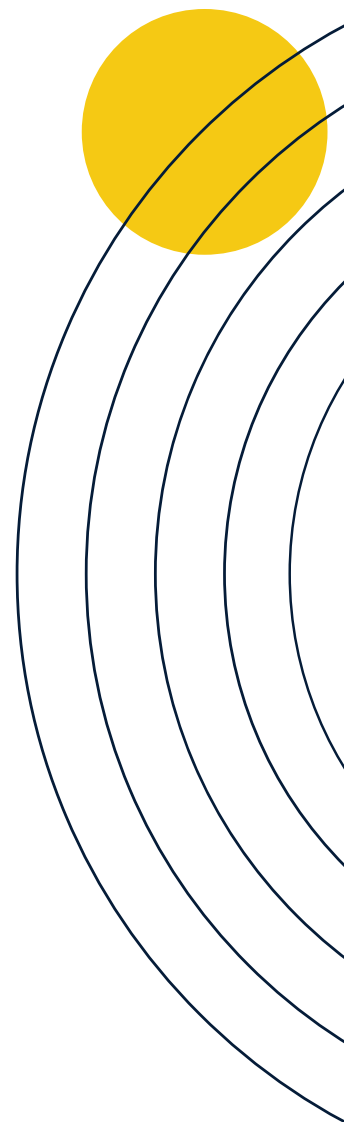
The economic downturn caused by the COVID-19 pandemic and its associated labor and global supply chain challenges brought to light many vulnerabilities or deficiencies in present day businesses. Investors watched in real-time as companies struggled with extreme volatility in labor, stock prices and revenue volatility and began to explore other metrics by which to judge a prospect's viability.

Among these strategies, one of the most prominent and most explored is sustainable investing, which looks at company performance along the lines of social, environmental, and ethical issues. Sustainable investing can also be broken down into more specialized facets like environmental, social and governance or ESG factors, which serve as a vector for measuring and anticipating risk. Following companies that perform environmentally or ethically can be advantageous to investors, since these companies are significantly less likely to experience regulatory penalties, litigation, reputational backlash and operational inefficiencies.

Directing capital to prospects favored by the ESG framework protects investors against these risks and therefore helps insulate them through periods of economic uncertainty. In this sustainable investment guide, you will learn about the history of the field, its advantages and disadvantages compared to other methodologies, and why it is relevant in the current market environment.

## Table of contents

3	What is sustainable investing?
5	History of sustainable investing
7	Why sustainable investing is important
9	Risk mitigation
10	Pros and cons of sustainable investing



# What is sustainable investing?

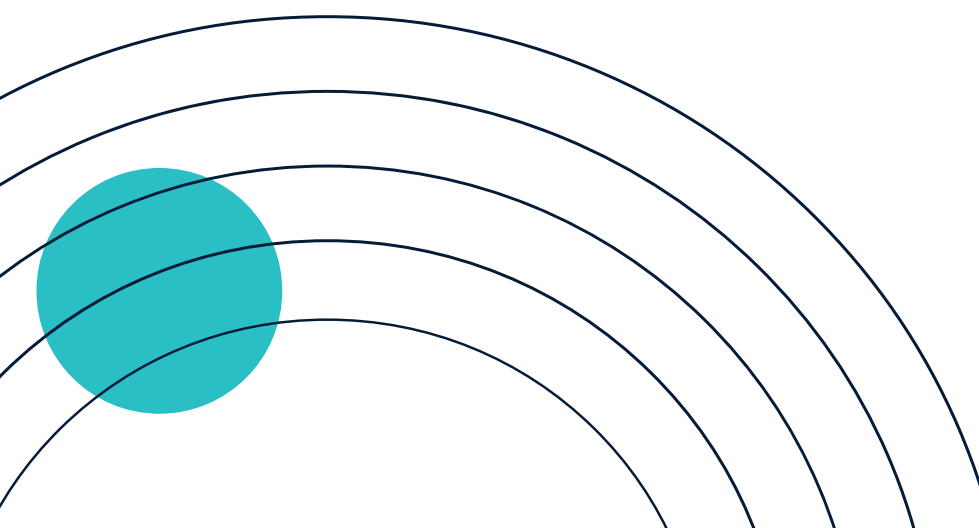
**Sustainable investing is an investment strategy that accounts for one or more environmental, social and/or ethical factors.** It seeks to focus investments and the movement of capital towards companies and funds that either further these causes, have a positive track record in how they've handled them or intentionally seek to mitigate their negative effects in these areas.

Sustainable investing can be motivated by personal and/or strategic objectives and may emerge from either a desire to support companies that align with one's morals or the more practical goal of avoiding risk-prone investments. Both sides of sustainable investment have wide appeal and are not mutually exclusive; investors may embrace both its moral and financial component or some combination of the two in varying degrees.

Depending on what specific element of sustainable investing appeals most to an investor—such as environmental impact, treatment of workers, political actions, relationships with partners and stakeholders, transparency, etc.—they may choose to drill down on specific aspects within this strategy.

**Sustainable investing serves as something of an umbrella term that includes many associated ideas** and offshoots such as socially responsible investing (SRI), impact investing, green investing and environmental, social and governance (ESG) risk mitigation and value creation principles, which each represent different facets of this practice.

Though all of these can be considered subsets of sustainable investment and therefore have some overlapping interests, because sustainable investment represents such a wide band of potential subjects and data, its more targeted derivatives like ESG and impact investing are able to home in on more specific results, making it easier to communicate on such a broad subject.



# What is sustainable investing?

## Sustainable investing variants and adjacent terms

The following are a collection of terms and strategies related to or spun off from sustainable investing. Sustainable investing is often used interchangeably with these terms or meant to serve as a stand-in for them, though each of these represents a more specialized aspect of this larger category. Though each derivative has its own specific identity and application, there are many areas in which they overlap and can be used in tandem.

### **Green investing:**

Refers to investments relating to environmental impact, which can include other initiatives like CleanTech and ClimateTech. This can either manifest in favoring companies with good environmental policies or initiatives or backing organizations explicitly built around environmental goals.

### **Socially responsible investing (SRI):**

The practice of investing in a company that conducts socially conscious business. This is usually carried out through SRI funds, which employ techniques like screening and exclusion to avoid potentially risky investments.

### **Environment, social and governance (ESG) factors:**

Measures a company's competency in environmental, social and governance issues, which themselves encompass subjects such as energy management and resource efficiency, employee diversity, equity and inclusion, data privacy and security, etc. ESG scores rate the company across these three factors.

### **Impact investing:**

Seeks to target investments that have both financial potential and the ability to effect positive social and environmental change, at times referred to as the "double bottom line." Because of this dual purpose, impact investing is regarded as something of a bridge between profit-driven investments and capital dedicated to philanthropy.

# History of sustainable investing

19<sup>th</sup>  
century

Although sustainable investing has been gaining visibility in recent history, it and similar ideas like corporate social responsibility, community foundations and Howard R. Bowen's "Social Responsibilities of the Businessman" have existed for many years. Throughout history, there have been organizations and interest groups that have withheld partnerships, investments, and other resources based on a company's performance in areas such as worker's rights and their involvement in illegal or unethical business.

**Sustainable investment would first begin to shape into its more contemporary form in the nineteenth century during the industrial revolution.** This period saw many issues such as child labor, unsafe working conditions and unequal employment become magnified as early corporations began to emerge. This period ushered in work and environmental challenges we still grapple with today and introduced some of the early groups that opposed them.

Religious and community groups collectively chose not to invest in certain companies on moral or religious grounds, such as Methodist and Quaker trusts avoiding alcohol, tobacco, and gambling investments. Prohibitionists similarly opposed what would become known as "sin stocks" and used their collective bargaining power by not supporting companies that dealt in this type of business. Though investing during that era is a far cry from today's market, it still provides us with something of a historical precedent or precursor for contemporary sustainable investment. The role of those religious or community-based trusts lives on in modern sustainable investing funds, which now address problems such as climate change and human rights.

## Did you know?

The beginnings of our more modern conception of sustainable investing originated in the 1970s, which saw the formulation of corporate social responsibility (CSR) and the idea that companies hold a certain degree of onus to act in the public's best interest. CSR built upon the preceding 1940s legislature that allowed companies to donate to charity, cementing the role of business as a social actor, and stemmed from the 1971 social contract from Committee for Economic Development. It posited that business must generate jobs and economic growth, treat employees and customers fairly and broadly improve its surrounding community and environment, standards which are still true today and echo in the ethos of sustainable investing.



# History of sustainable investing

The most recent and perhaps most visible development in sustainable investing happened in 2020, since it and its derivatives now see significant public awareness and increased usage in the common vernacular. The year 2020 not only coincides with initiatives on the parts of companies to respond to sustainable investing issues, but also the creation of supporting entities like the reporting organization “group of five” meant to arbitrate these developments.

In contrast to previous periods, the average LP or GP now has much more information at their disposal and generally has greater selection and control over their investments. As such, they can take a more active and informed role in sustainable investing than they ever could in the past.

It should be noted, however, that this wasn't an overnight shift, but rather the culmination of years of developments, approaching up to 20 years in some countries.

**Though sustainable investing may seem like a recent development to less familiar investors, it and ESG have existed in more or less their present state for years in different parts of the world.**

2020

# Why sustainable investing is important

Sustainable investment is an increasingly popular strategy, both for those that want to use investing as a form of shareholder activism and those that simply want to make safe investments. Both these goals are fairly common among investors, even those that don't actively pursue sustainable investing or even know what it is, so what accounts for the recent uptick?

## Interesting fact

Though many were introduced to sustainable investing in 2020 or sometime thereafter, it would be inaccurate to say that was its beginning in the public eye or even its first major push.



ESG has gradually sloped upwards in usage throughout the United States for the last five to ten years, with Impact following a similar trajectory. Preceding this were ESG movements in Europe, which date back to the early 2000s and are among the first to implement ESG-oriented regulations.

Following several overlapping crises emerging in 2020 including the COVID-19 pandemic, global supply chain shortages and upheavals in the job market from unemployment and the shift to remote work, the market became increasingly visible and scrutinized. Many were exposed to the potential fragility of small and mid-size companies, while larger corporate entities such as Amazon and Walmart saw increased profits, often off the back of more demanding and unsafe work conditions.

Whether it was exposure to numerous companies trending downward and closing or seeing prominent stories surrounding unionization and class action lawsuits at Kellogg's, Nabisco, REI and Starbucks, there have been multiple catalysts to reinvigorate discussions of risk and ethical investing.

The Black Lives Matter movement in 2020 is also a major factor in the development of ESG in the United States, as it reopened many discussions on corporate DEI deficiencies and called for a reexamination of how companies performed in this area. This introduced many American investors to ESG and the broader field of sustainable investing.



**Want to know how ESG scores are calculated and what they say about a business?**

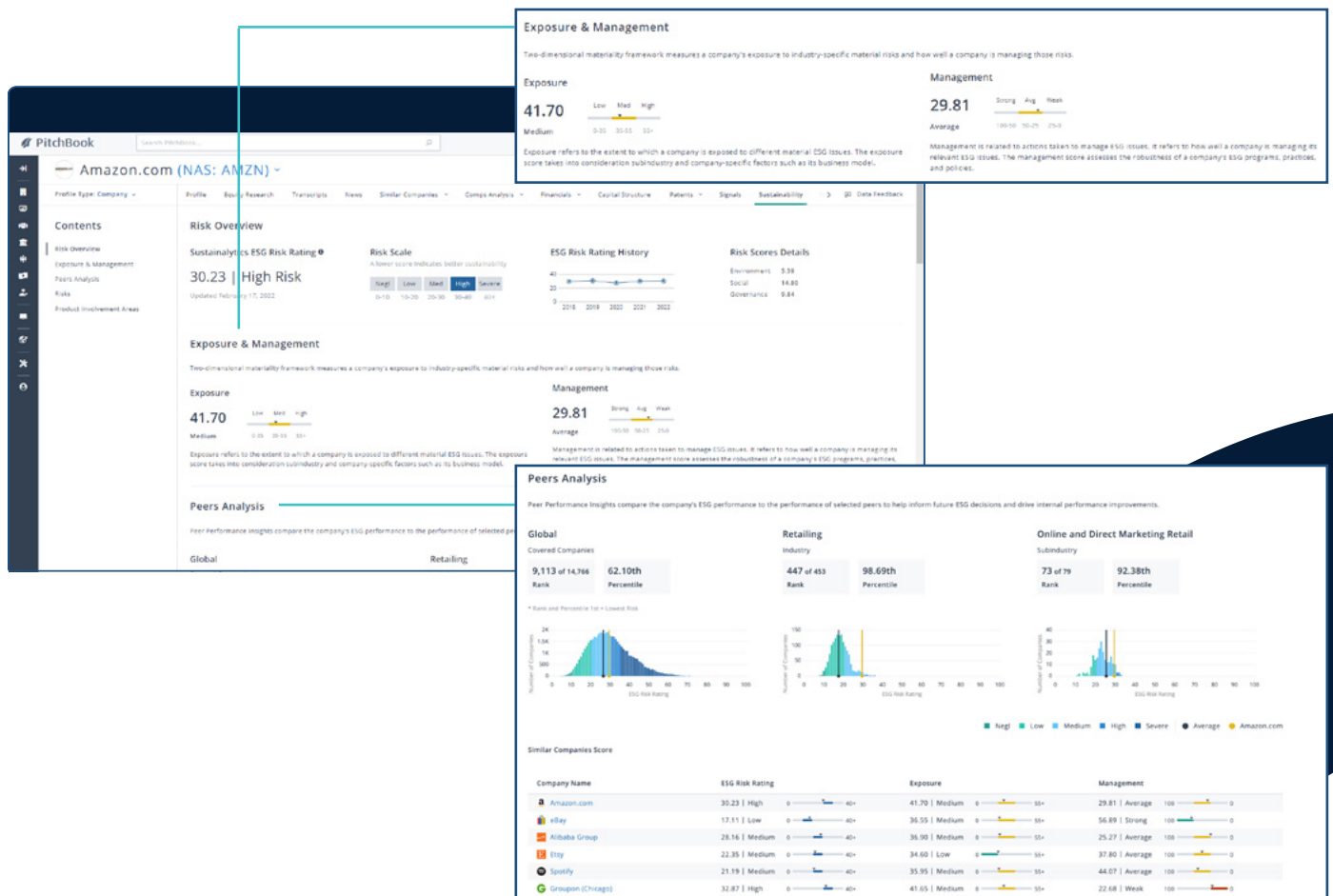
Check out our blog, [What is ESG?](#)

# Why sustainable investing is important

Following these events, the image of many companies, both as investments and as institutions, has been called into question. As such, sustainable investment has seen greater traction, with investors making a more concerted effort to support investments they either align with philosophically or believe to be low risk.

As more investors begin to adopt sustainable investing, companies and funds have moved accordingly to appeal to them. Some companies have made changes to appeal to these investors, like Google's 2020 carbon-free initiative. An even more direct result and indicator of the expansion of sustainable investing are the mutual funds or ETFs explicitly built around sustainable or socially conscious investments, which reached the \$1.7 trillion AUM mark in 2020.

The prominence of sustainable investing has also led to the introduction of several related technologies, standards and methodologies. For example, sustainable investing has given way to ESG scores, which in turn have gained enough of a following to merit groups and methods dedicated to calculating, displaying and evaluating ESG. These include the formation of GRI, CDP, SASB, CDSB and IIRC and in 2020, which are organizations with the collective goal of ensuring reliable ESG reporting. Sustainable investing has become its own vector for evaluating investments, completely separate from metrics such as stock prices, revenue or company size.

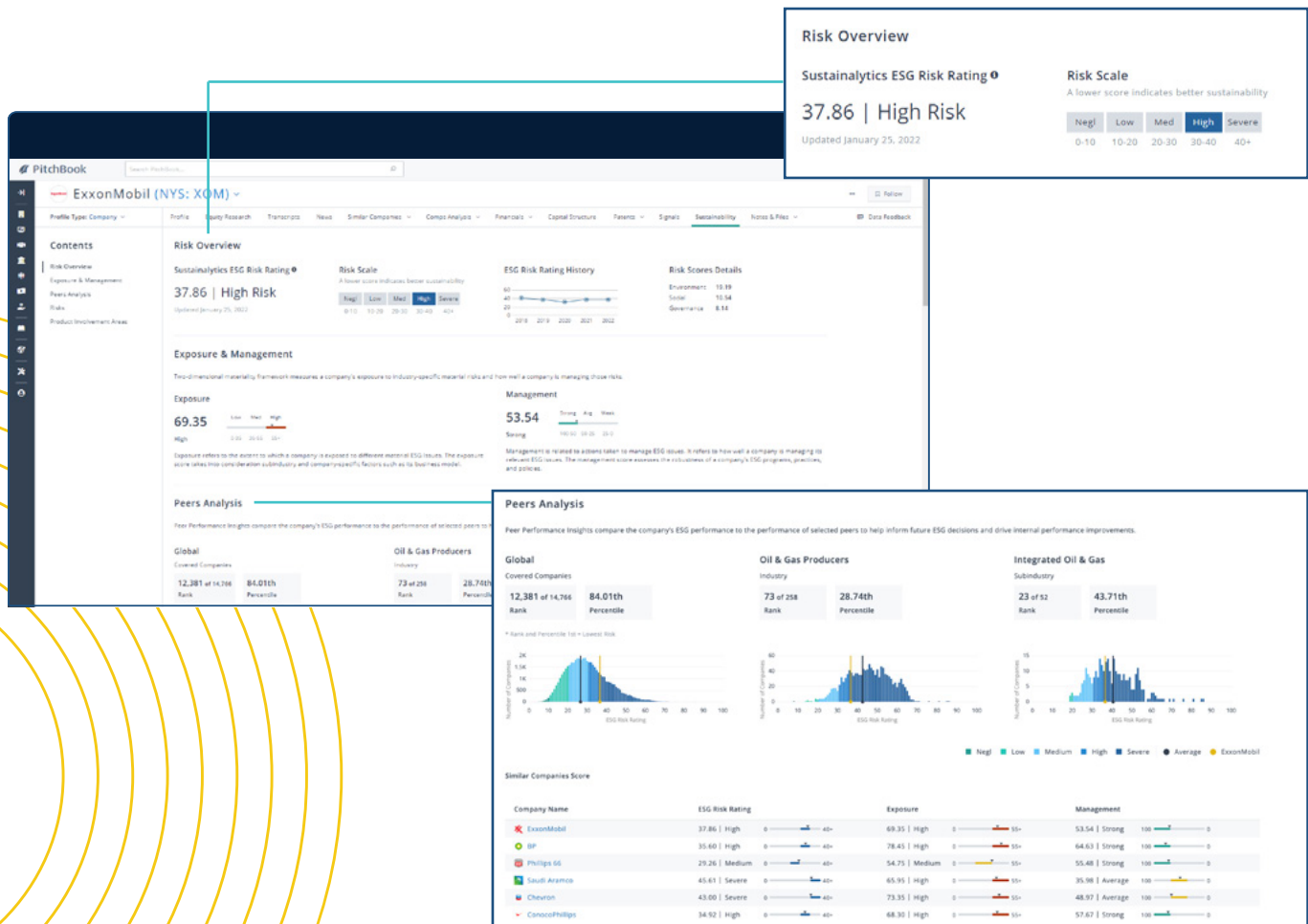


# Sustainable investing and ESG risk mitigation

A notable example of sustainable investing assisting with economic objectives is the use of ESG investing as a means of risk assessment. Through this strategy, investors can identify companies that perform poorly in or more pillars of ESG and take action to mitigate these risks.

This action may take the form of avoiding these companies as a precautionary measure, since a less desirable record on these issues can correlate with risks such as strikes, regulatory intervention and litigation, which in turn leads to losses on their part. However, there are also many investors that use poor ESG scores as a sign of opportunity, opting to buy or invest in a company with a poor performance

Though risks still exist even for companies that perform well across different sustainable investing criteria, it is generally reliable and grants some amount of foresight when targeting what one knows to be a safe or risky investment. Knowing which companies over or underperform with regards to sustainable investing can also inform which parts of an investor's portfolio may merit closer inspection or their assistance in passing policies which may help with these issues.



# Pros and cons of sustainable investing

Though sustainable investing has seen significant traction in recent times and shown its utility to the investors that adopted it, preferential or exclusive usage of it above other frameworks also have its disadvantages.

Looking first at the moral component of sustainable investing, it stands to reason that one would want to support companies and funds they align with philosophically. Sustainable investing is a logical choice for investors that value social responsibility, as it can enable better working conditions, environmental protection and other assorted benefits.

As more investors use sustainable investing, the market may continue to skew towards companies with better ethics and possibly incentivize companies that underperform in these fields to change their behavior. **Though this seems like a purely positive phenomenon, it also has the unintended consequence of incentivizing greenwashing.**

## What is greenwashing?

Generally, greenwashing refers to branding around or claiming to “do” sustainability, whether through ESG, Impact, or other means, but not following through on the efforts stated or implied by those claims.

Though this form of obfuscation is probably the most common, companies may also attempt to do something similar with other social factors, making false claims in the interest of attracting those that apply sustainable investing.

In assessing the financial component of sustainable investing, we also see both positives and negatives. Using ESG methodology can help prevent risk and therefore provides insulation against potential losses. Avoiding industries or companies that commonly rate poorly among sustainable investment standards is a safe strategy, but far from the only indicator of how a stock might do.

Traditional signals like quarterly earnings, staff changes, and stock trading volume must still be taken into account and selecting an investment opportunity purely based on sustainability may yield a stock that never trends down, but also has little potential for significant growth. By the same token, applying a blanket exclusion to companies that don't fall within a specific sustainability parameter may lead investors to lose out on opportunities with greater risk and reward.

## Learn more about greenwashing, Impact and the different approaches to ESG

Check out our [Analyst note: ESG, Impact, and Greenwashing in PE and VC](#)



# Conclusion

Sustainable investment is a far-reaching field that builds on decades of evolving dynamics between business and investor. It encompasses a variety of challenges and concerns such as climate change, governance, and labor rights, generally reflecting contemporary concerns of investors and society at large.

Though sustainable investment at times serves more abstract purposes like achieving fulfillment and acting on one's morals, it also serves a tangible business benefit that is relatively unique amongst investment strategies. Sustainable investing alone cannot completely carry one's investments, but it is a resource that will only continue to grow in refinement and utility as more people continue to adopt it.



## Sustainable investing through PitchBook

Get hands-on experience with sustainable investing on the PitchBook platform, which includes resources like ESG scores on thousands of global company profiles backed by [Sustainalytics](#)— recognized leader in the field and winner of the Award for ESG Research Innovation of the Year. Our award-winning data and market research will allow you to connect with companies on a completely new level and extract the insights needed to help you win.

Log in to the platform or [request a free trial](#).