Marketing

Embracing ESG

Sasha Jensen, CEO of Context Jensen Partners, highlights four considerations for IRs wanting to tap into a growing trend

The ESG investing movement continues to gain steam, with a reported $8.7trn in assets invested across ESG strategies in the US, according to a 2016 report from the US SIF Foundation. But for all the talk about the importance and value of responsible investing, the alternative investment industry still lags far behind. Just $206.3bn, or less than 2.5%, of those assets come from the alternative investment industry, with hedge funds representing a paltry $11.7bn.

Just as institutional investors pushed hedge funds for lower fees and increased transparency, many of these same investors are now demanding fund managers incorporate ESG factors into their strategies.

According to a 2015 study from Mercer, two-thirds of investors think about ESG factors when making hedge fund investments.

While adoption has been slow, it's clear what direction hedge funds must take if they want to continue attracting institutional capital. Indeed, some pension funds have slashed their hedge fund allocations, citing a lack of commitment to ESG standards. According to a CAIA/Adveq survey, 78% of alternative investment professionals believe responsible investing will grow in importance over the next three years, with 67% citing pressure from institutional investors as one of the greatest drivers of increased adoption.

Sasha Jensen, CEO of Context Jensen Partners

So what can fund marketers do to embrace ESG investing and use it as a growth opportunity?

Show investors how ESG fits into the strategy

Investors are unlikely to want to sacrifice returns just to make their portfolio ESG-friendly, but there is a growing body of evidence demonstrating that ESG can improve long-term returns. It's up to marketers to show how implementing ESG factors represents a value-add for the portfolio and is not just an aggressive attempt to raise assets. Marketers should be prepared to describe changes to the strategy in detail or, if it's a new fund, clearly differentiate it from other offerings.

Marketers should also take the time to educate investors about the nuances of ESG investing, as only 46% of asset owners fully understood responsible investing. Business development teams have to walk investors through the specifics of the strategy and explain why the firm is incorporating ESG into its investment decisions in the first place.

Promote stronger ESG practices

ESG investing isn't just about screening out companies that don't meet the strategy's requirements, such as removing oil and gas industry holdings. Hedge funds should also consider proactively engaging with the companies they're invested in to ensure they are upholding the desired ESG standards. This could mean making recommendations to management about ways to improve, working with other shareholders to push for changes or even launching a public proxy fight. While this high level of engagement is typically favored by activist investors, the movement towards responsible investing means that all fund managers adopting ESG strategies are effectively activist.

Hire ESG experts

Hedge funds new to the world of ESG investing should strongly consider bringing in specialised analysts and portfolio managers to help spot the right opportunities. The ESG industry is becoming increasingly competitive, so hedge funds need to ensure they can stay ahead of the competition. The US SIF Foundation report identified 413 alternative funds across the venture capital, private equity, real estate and hedge fund industries that use ESG criteria, compared to 475 mutual funds. There is a deep talent pool out there just waiting to be untapped.

Measure and share your results

The responsible investment movement is laser-focused on measurement. This was a key point among respondents to the CAIA/Adveq survey, with 84% claiming that responsible investing lacks clear industry standards, and 89% saying better-defined standards would help in the industry's development.

Since ESG investing is still a relatively new practice, advocates want to make sure they can communicate to investors and managers the value and long-term return potential of incorporating ESG strategies. For managers, this means more than just reporting performance numbers – investors want to see specific data on how ESG factors were incorporated in the company and the community, for example: number of jobs added, gallons of water saved or kilowatts of sustainable energy generated.

The United Nations Principles for Responsible Investment took a major step towards helping achieve this standard when it announced it will publish a due diligence questionnaire for institutional investors, which will give investors insight into how well hedge funds are incorporating ESG into their investments. It is clear ESG investing is here to stay. Which hedge funds will lead the way? ■