ESG and corporate strategy in a climate-constrained world

Remarks for Panel Discussion

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What does finance say about ESG?

**Perspective A**

“Portfolio diversification”

A “green” investor should hold more “brown” stocks

— *Portfolio theory*: Simple diversification argument

— Green *endowment fund* can get “mission hedge” via brown assets

⇒ Hard to make sense of divestment strategy…

See Roth Tran (2019)

**Perspective B**

“Portfolio optimization”

Portfolio reweighting cuts CO₂ footprint (30%+), matching risk-return of traditional index

Low-C/high-ESG index:

— “Do good at zero cost”

— Plus: option on future outperformance when climate policy tightens

⇒ ESG = free (healthy) lunch

See Andersson et al. (2016)
Better firms are (usually) also better at ESG

Within an emissions-intensive sector, the more productive firms, on average:

— Also have better environmental performance (newer technology, less waste, lower CO₂)
— Can better cope with tighter climate regulation

See Bloom et al. (2010) & many others

⇒ ESG screening criteria likely identify companies with superior management & technology

(≈ “Matthew effect”: Better firms get stronger still…)
Questions for discussion

① Corporate strategy – so what to do?
   a) Harvest existing assets, no new fossil investment
   b) BAU with mix of new fossil & low-C investment
   c) Transform into low-C & sell fossil assets

② Will shareholders vote against management team that does not deliver “enough” ESG?

③ What will happen to ESG in next financial crisis? (ESG = normal good, i.e., rises with income…)
References


Bloom, Nicholas, Christos Genakos, Ralf Martin, Raffaella Sadun (2010). “Modern Management: Good for the Environment or Just Hot Air?” The Economic Journal 120, 551-572