UNIVERSITY OF CAMBRIDGE | Energy Policy Research Group

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 <u>more</u> "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 **CO_2 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 CO_2)

—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

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