# An Institutional Investor's Commitment to Climate Conscious Behavior

*By Farhad Amiri*

## Introduction

To discuss about the climate conscious behavior of an institutional investor; first, we must know ESG that stands for environmental, social, and governance. The environmental factor accounts for companies' impact on the environment (climate change, natural resources, pollution and waste and environmental opportunities) and the controls they put in action to mitigate their negative impact. The social factor focuses on companies' relationships with their employees, customers, suppliers, and the communities they do business with. Lastly, the governance factor discusses about how the company deals with its leadership, audits, executive pay, shareholder rights, and internal controls. Most of the companies hire an independent rating agency to evaluate their business from the perspective of ESG risks. The ratings of the independent rating agencies are important to anlyze a company's goodwill. One of the most famous rating agencies that the client (institutional investor) is using, is MSCI ESG Research.

## *Problem Statement*

Considering the recent years incidents in US, Brazil, Australia, and some other countries like flood, heavy snow, forest fire, droughts and overheat, climate change has become a vital part of the world's agenda to sustainability. It is important that everyone should think about mitigating their negative impacts on climate, especially the major investors or coal financers. The coal industry is one of the major contributors of global warming and climate change. Based on Paris Agreement, major participants of the conference had to exit all their financing from the coal industry by the end of 2021. However, most of them have not taken any action towards exiting. According to Louvel and Seizov (2022), from 2019-2021 more than $1.5tr was channelled to coal industry by the commercial banks from which six countries are responsible for 86% of the coal financing. These countries are China, the US, Japan, India, the UK, and Canada.

### *Purpose Statement*

The purpose of this paper is to investigate the ESG performance correlation with financial performance of a company or a fund. Generating a better financial performance incentivise investors and individuals to care more about sustainability and less about higher returns.

## Methodology

As previously mentioned, this paper aims to find out the correlation between ESG performance and financial performance, in a systemic manner. For finding the correlation, the paper analyzed the results of regression analysis from different studies about the impacts of ESG integration on the performance of the corporates and funds.

### *Sampling*

The paper's approach to the research is in a systematic manner and the research studies have been disaggregated into three types. The studies that analyzed the ESG performance and financial performance of corporations, the studies that analyzed the financial performance of ESG indices, portfolios, and funds, and finally, the studies with focus on analyzing a specific theme like climate change.

## Results

After analyzing the studies, the paper reach to a result that better ESG performance leads to a better financial performance. Further, the paper broke down the results into eight results. Stock-level price impact: the stock-level price impact and institutional investor's equity portfolio-level are positively correlated with the sustainability ratings of a company's stock. A better financial performance due to ESG integration is visible over a longer-term. Investment in ESG integrated stocks and portfolios provides downside protection, especially during financial crisis. Sustainability plans at firms drive financial performance because of improved risk management and innovation. Managing for low carbon improves financial performance. The financial performance of an investment in ESG on average is not so different from conventional investments. The data about ESG is often noisy, ESG ratings Should be inclusive.

## Discussion

According to Atz et al. (2021), ESG integration has a positive correlation with financial performance in the corporate and portfolio level. Brandon, Kruger, and Mitali (2021) add that the sustainability footprint of institutional investors will drive price pressure and performance. They also suggest that high sustainability ratings are more attractive and demandable to investors; thus, it creates higher price pressure. Whelan et al. (2021) emphasizes more on the correlation between lower risk related to sustainability of a company or fund and their better financial performance. The paper analyzed Fernández et al. (2019)'s finding that German green mutual funds offered slightly better risk-adjusted returns than their peers during the financial crisis of 2008.

## Conclusion

This paper examined the ESG ratings and its impact on the financial performance. After analyzing different research papers, this paper concludes that ESG integration has positive impacts on the stock price of a company and the financial performance of a portfolio in a longer time horizon. Moreover, the study shows that the institutional investor as the steward of the nature has taken some steps towards reaching its commitment to net-zero carbon emission. Finally, the paper recommends the investor to research about its investment in coal industry which is a major driver of climate change in the world. Therefore, exiting from the coal industry by the investor would be a great step towards sustainability and fulfilling its commitment by 2050.