

# How to Sustain Sustainability

Disruptive Forces in Investing

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- Anu Rajakumar:** The integration of ESG, or Environmental, Social and Governance factors, into the investing realm has transformed the asset management industry. Investors, now more than ever, are demanding to know how their investments, whether in equities, fixed income, or even private markets, align with their personal values. Whether that be related to people, planet, or a company's good stewardship. My name is Anu Rajakumar, and today on Disruptive Forces we'll be taking an inside look at sustainability, and how companies around the world are becoming more intentional in integrating ESG principles into their operations. I'm delighted to welcome Hendrik-Jan Boer, Lead Portfolio Manager of Neuberger Berman's Global and European Sustainable Equity Strategies, to share insights about ESG integration across industries around the globe today. Thanks for joining me today.
- Hendrik-Jan Boer:** Thank you. Great to be here.
- Anu:** Great, so just to start us off, give our listeners a broad definition of ESG investing and maybe briefly summarize why investors across the globe should be paying attention to this space.
- Hendrik-Jan:** Yeah, the word sustainability already gives you an idea of what people look for. It's something that can continue, can go on, forever, preferably. So normally, from the way ESG is now interpreted these days, people always link that of course to environmental, social governance type of, uh, factors. But it should be linked to financial factors. If the two go together, then indeed you can have a fantastic recipe for very long-term, uh, financial success, and talking about corporates that are actually also doing well for-for society at large.
- Anu:** Great, that's a helpful primer. Now you've been an investor for a long time, a couple of decades, at this point. How do you think about ESG adoption across industries, and how has it grown over the last few years?
- Hendrik-Jan:** Yeah, we think that it's already there for quite a while, so 10 to 20 years. But actually, over that period we've seen various methodologies and ways people perceive sustainability, and how they integrate it in investments, and how we should move forward on this. And also, the enthusiasm by which it's being taken up by investors, but also consumers in their products. So, in other words, it has been quite a volatile ride, and we are certainly not there yet in experience being mature and having sufficient grip on all these aspects. That is something we think is also a great opportunity for investors, because we all know that in areas where not the whole public is already completely aware of what's going on, there are fantastic opportunities for investors to get a good valuation, and, in other words, a strong return on early discovering fantastic insights.
- Anu:** Yeah, you know, and you sort of mentioned that this is not a fully mature area of investing just yet, so, you know, it sort of implies – and correct me if I'm wrong here – that there can be a little bit of a gray area when it comes to ESG investing. You know, whether that's definitions or accountability, etcetera. So, I'm just curious: how have companies adapted to those challenges, and really met investor demand for metrics when it comes to sustainability? And just out of curiosity, what have you seen in terms of adoption across regions?
- Hendrik-Jan:** Yeah, for that you actually need to take back a few steps and look indeed at the history of sustainable investing. And you could say from a societal but also a financial perspective, it started off on the wrong footing, in a sense that sustainability was initially largely about excluding corporates that were involved in activities and behavior that were seen as unethical. And quite often these two don't go very well together in analysis. An ethical opinion, in combination with financial return analysis, that's not a good way to start a discussion. And that has evolved dramatically over time. People started to discover that you should talk about sustainability perspectives in relation to corporates where it really matters to the corporate. So, think about materiality. What is it in the environment or social aspects, or the way a corporate is governed, where it touches upon their future return, and how they can continue to be successful? That is what we should think about. But then you can also imagine that it can differ extremely in between individual companies, even within industries, depending on their location, depending on their end clients, etcetera. And that has taken quite a quantum leap, a quantum leap in expectations from the general audience, consumers, investors, and the industry we're in ourselves, the ones that need to analyze it and apply this.

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And of course, for that you need a lot of useful data and insights that ultimately starts and have their beginning in the corporate itself. And what you also see is that also the corporates are still quite inexperienced, and quite young in generating this type of data that comply with the demands of society in it. And thanks to these developments, you've also seen more and more involvement of regulators and all sorts of societal groups around it, to have a discussion on what do we need to focus on. What should we look at? And actually, that is very helpful to make sure that a multi-stakeholder approach is being used here, which makes it possible that ultimately financial returns go very well together with having your thoughts around these societal aspects in investing.

**Anu:** Yeah, that makes a lot of sense. And now your approach in making these assessments is a value chain approach, rather than looking at traditional sectors, uh, to evaluate the risk and the opportunity set. So, I'm just curious, if you could explain a little bit about what the value chain approach means for our listeners, and maybe just comment on whether you think that's a more proactive – whether it's more proactive to change or reactive to potential disruptions. And how do you identify who could benefit from that?

**Hendrik-Jan:** Yeah, let me start by saying that a value chain approach is not something that has been undiscovered. I think in literature you can read a lot about these aspects if you think about the so-called Porter effects of studying a company, which means you don't need only to look at direct competitors in products, but you should, for example, think about the threat of replacement of products by another type of product, which comes out of another industry. That is the type of thoughts that we have on the long-term sustainability of a firm, and having a very strong, durable, competitive position. Quite often the opportunities and threats for these corporates are not only presented in the industry it's currently working in, because this industry is just a classification that we made as mankind, and that is being sorted out by a benchmark provider. That the categorization, the classification of corporates that are peers of each other. But we should have a much wider lens in thinking about future opportunities and threats for individual companies. Who could have thought that actually in the lunch space or the restaurant space, a big competition would start to arise from people working from home, being made possible by software developers like leading corporates like Microsoft, who has made a lot of apps that make it possible to work from home, but which ultimately has meant that people don't have their regular lunch close to the office anymore, but just at home? And that is the sort of threat that from this traditional perspective would never come up in the minds of the investors. And you can apply that from different angles. It's not only in demand for products, it's also about marginal cost developments of individual technologies. Another example is maybe the energy space, where we were quite negative in the past as sustainable investors, maybe, just for the negative footprint of the fossil fuel producers. But as long as those, uh, fuels were cheaper than the renewable energy, there was actually not an incentive for consumers to step over. That has dramatically changed. If you see what the cost development has been in, uh, solar energy production, as well as offshore wind production, that is highly competitive. And even the traditional oil companies are not able anymore to compete on costs versus those industries. So, it has just been economic rationale why people stepped over. So where actually the new preference in society has been realized thanks to technological progress and innovation.

**Anu:** Yeah, I think that's very helpful to hear, and you make a good case for why traditional sector analysis needs to maybe be reassessed, given certain conditions of today. So, I think very reasonable value proposition that you've shared. But you know, Hendrik-Jan, one of the biggest concerns that investors have about portfolios that focus on ESG factors is that by doing so, it comes at the expense of performance. So, I'd love for you to answer the question: are investors forfeiting returns in favor of a sustainable outcome in these types of portfolios?

**Hendrik-Jan:** [Laughs] Happy to answer that question, and maybe you already can expect that I completely disagree on this statement.

**Anu:** I figured that you might. [Laughs]

**Hendrik-Jan:** But it is highly depending on the type of methodology, and the type of criteria that you apply. The cases I just made are already showing that if you look at sustainability, it should be linked to the business model, and where it makes sense, where it is a factor that can be a hurdle, or some tailwinds on business practices. That you then screen your universe on this is nothing strange. You also do that in other investment styles that we see around. If we think about people doing quant investing, maybe typical style investing, deep value or high growth, these investors also use an overall screen on the universe, and with that they actually exclude lots of names from investment in the ultimate portfolio. But for a clear reason, they think there's a strong link between the factors they study and the ultimate result of the end portfolio. But the same applies to sustainability investing. That means looking at factors that really matter in individual business models, and that could be of great help for a corporate to continuously produce great results going forward, from the perspective evading, big bumps or hiccups from a liability and penalty perspective, or in a more positive perspective, profiting from a very nice tailwind for its products and services that it's providing to the market, and the changing preferences of consumers.

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So, all in all, sustainability, for us, is just effective to check if corporates are adapting to a changing world, and making clear that they can continue to be future winners. Which will be, of course, very helpful for the ultimate wealth accumulation, thanks to this compounding effect, if a corporate has longevity.

**Anu:** Great, thank you. I think that's very convincing. Now, earlier you commented on the evolution of ESG to present day. What about your outlook? How do you think investor perceptions will change regarding ESG? And what other trends are you expecting in the coming years?

**Hendrik-Jan:** Yeah, these developments don't go very rapidly. We always need to get used to how to treat new type of data, and how to integrate it. But we see in these promising developments that people start to deal with data from what's called the ESG arena, more and more, as quite necessary data to understand business models, and to get the full picture on what are threats and opportunities for firms, and that sustainability is not just determined by maybe malpractices of corporates, always from this retrospective perspective, on what they did wrong in the past, but it's much more making your mind up on what are actually the intrinsic motivations of a firm going forward in doing good to society. We all know that corporations that provide products and services that are very much liked by consumers, and don't face any obstruction from regulators, are also economically much more successful corporations than the ones that face all these hurdles. So that means that ESG data, integration of it, and the study and the forward-looking perspective on this, is becoming more and more the part of what we used to do also in traditional financial metrics. In collecting them, getting efficient on it, and implementing that in your investment portfolio. But we also know that as long as there is change and further enhancements, that is creating fantastic opportunities for additional alpha from an investor perspective.

**Anu:** Yeah, terrific. I think we'll wrap it up there. Hendrik-Jan, thank you so much for providing your insights on how you approach ESG. It's a topic that is very relevant today, and I think really will be going forward as well. So, thank you again for joining me.

**Hendrik-Jan:** Thank you very much. It was a pleasure.

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