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Perspective

Investing for Impact: Our Take

In early 2019, Stephanie Braming, CFA, partner, global head of William Blair Investment Management, participated in *The Economist's* Investing for Impact conference in New York City. We later sat down with her to discuss sustainability, environmental, social, and governance (ESG) factors, and the changing demands of the industry.

Stephanie Braming, CFA, Partner
Global Head of Investment Management

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As a global investment firm, William Blair views impact holistically, as true impact must be imprinted into a firm's culture, values, and purpose.

What are your values?
What do you believe?

Q. What does "impact" mean to William Blair as a global asset management organization?

Braming: The definition of impact is "having a strong effect on someone or something." As a global investment firm, William Blair views impact holistically, as true impact must be imprinted into a firm's culture, values, and purpose. What are your values? What do you believe?

It seems like such a hot topic now, given a confluence of factors globally with increased urgency around climate change, heightened engagement of women in politics, as well as concern about rising inequality and its resulting impact on economies and societies. However, from my perspective, it's really a return to explicitly highlighting personal and professional value systems and setting expectations on how we treat each other.

Sustainability also requires a longer-term view: What do we want our imprint to be for the future? How are we going to alter the future trajectory for our children and grandchildren? What will be required of each of us to do that? What do we do when resources, such as human capital and natural resources, are limited? It requires us to be more creative about how we attract and retain individuals as well as how we evaluate potential investment ideas.

Q. When it comes to impact, what are your goals?

Braming: When I think about impact, first and foremost, our goal is to individually and collectively have a positive impact on those we serve, in the industry, in our communities, and with each other. William Blair's biggest positive impact is for our clients, as our purpose is to drive strong client outcomes. We invest on behalf of some of the largest public and private pension plans, non-profits, foundations and endowments, and high-net-worth individuals around the world, and take seriously our role as stewards of client capital. Our ultimate clients (millions of them) rely on us to help them have enough for retirement, to generate results to meet their missions or other long-term goals.

The second significant area of impact is softer. How do we ensure that our teams are energized and internalize our purpose into their every day? We do so by promoting an intellectually curious, non-hierarchical structure, which is based on ethics, engagement, and empowerment, as well as actively investing in the communities in which we live and work through philanthropic activities and investment—after all, to whom much is given, much is expected. As studies have shown, employee relationships are the most important—because they translate directly into results. We invest in education through generous educational assistance programs, we treat each other with respect, and we provide an environment where individuals are empowered to have a voice on key strategic issues and to put their fingerprints on the future of William Blair.

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Our third area of impact is in the industry, both in terms of leadership roles in professional organizations, such as the CFA Institute and our local societies, and in terms of our engagement with management teams on corporate sustainable growth. When we think about sustainability, we think not only about corporate sustainable value creation over time (as an antidote to corporate short-termism), but also the link between traditional sustainability factors and financial performance. As part of our fundamental research process, we engage with management teams and assess their actions regarding environmental impact and their behavior toward employees, customers, and across their supply chain. We believe that material issues in these areas can have a significant impact on risk and return prospects over time, and we expect management to not only have policies in place that focus on driving value for a multitude of stakeholders, but also to execute on that strategy.

Q. How do you think about sustainability from an investment perspective? Is it merely exclusionary?

Braming: Approximately 25%[1] of our assets are managed through some type of exclusionary filter—investment guidelines that prohibit certain types of investments, such as alcohol, tobacco, and nuclear weapons.

1 As of March 31, 2019.

"Our teams are identifying more enduring sources of competitive advantages and risks."

While William Blair has focused on companies that have created sustainable value over time, we began explicitly incorporating a more holistic sustainable framework in 2011 after we signed the United Nations-supported Principles for Responsible Investment (PRI).

From the beginning, it was important that the investment teams internalized these issues—not only focusing on governance, which of course sets the tone at the top, but also more explicitly environmental and social issues as well.

It was also important that the research around ESG was conducted by the same investment analysts that were engaging with management regarding strategy, growth outlook, and operating performance.

But this meant that it has taken more time to internalize. I think that work is important, and more sustainable frankly, if each of our investment team members understands the impact not only for the individual companies, but also for the growth trajectories of industries and countries.

Q. What are the outcomes of this program?

Braming: One of the interesting outcomes of this exercise is that our teams are identifying more enduring sources of competitive advantages and risks.

We didn't really think about these efforts in terms of sustainability at the time; we were just assessing whether these companies were managed properly. But our efforts have clearly resonated in that way.

For instance, in the throes of the global financial crisis in early 2009, a number of U.S.-based transportation companies had workforce reductions, froze hiring and wages, and suspended 401(k) plan contributions as freight volumes contracted sharply. In contrast, one company within the industry did not cut wages or reduce its benefits. While its earnings before interest and taxes (EBIT) margin trajectory dipped in the fourth quarter of 2009, it outpaced its competitors and rebounded more quickly. When demand returned, freight volumes eventually outstripped competitors and this company had industry-leading profitability.

Is there causality or merely correlation with their employment policies during the financial crisis? It's unclear, but what is clear is that management maintained its social contract with its employees in contrast to competitors, and it therefore had a knowledgeable employee base to leverage when volumes returned.

Q. That's a great example. Do you have any others?

Braming: Another example is a company that addressed a problem of the underbanked in Kenya. This company is the largest telecommunications company in Kenya and it really ties to the United Nations' Sustainable Development Goals pertaining to equality and poverty. In 2007, it launched a wildly popular mobile money ecosystem that disrupted the formal banking system. With 19 million active users, this has effectively increased financial inclusion in Kenya. I'm interested in ideas like this, where companies are innovating quickly to address key issues.

We are also drawn to innovation at the country level. While many emerging market countries are manufacturing hubs, and are using a significant amount of fossil fuels to power their growth, large countries such as China are rethinking that strategy (albeit from a low base) amid an outcry from their populaces. As a result, they are moving quickly on electric cars and other initiatives to improve the environment.

During my panel with *The Economist,* Rasmus Skov, head of group sustainability at Ørsted, used the example of making a significant change in the company's value proposition and growth trajectory when it was at a crossroads during the global financial crisis. I was interested in Rasmus's perspective on the long-term vision that was required to transform a state-owned, coal-dominated Northern European utility company into a global leader in offshore wind over the past 10 years. Rasmus noted that critics were initially skeptical about offshore wind technology and costs. To force change, Ørsted had to deploy new technology and continue to innovate to improve that technology over time. Today, many wind farms are as cost effective as fossil fuels in energy generation, and significantly more efficient. Since 2006, the company's greenhouse-gas emissions have fallen by more than two-thirds, while operating profit touched an all-time high of approximately $4.6 billion in 2018. Ørsted already generates more than 75% green energy and targets 99% by 2025, when it aims to bring renewable energy to more than 30 million people.

Other companies are trying to do the same, particularly in the energy and automotive industries, where there is significant disruption. What is interesting is that these firms are making these changes as they see the changing supply and demand trajectory, and as they evaluate their prospective growth products and markets. Doing well and doing good: it's good for the company, good for the bottom line, and good from an impact perspective as companies use cash flows from their legacy investments to plow into these investments.

Within the healthcare sector, pharmaceutical companies such as AstraZeneca, which also participated in *The Economist* panel, have an essential role to play in the promotion of sustainable development goals focused on good health and well-being. As Jim Massey, global vice president for sustainability, engagement and strategy at AstraZeneca, noted in *The Economist* panel, the company is investing in the prevention of non-communicable diseases through health promotion, training, and education initiatives in Africa and Asia.

Q. How are the other market participants responding?

Braming: We find that exchange listing requirements, as well as stewardship codes that are adopted by local asset owners, provide a significant impetus for companies to address ESG issues.

A recent example is the Korea Stewardship Code. While implemented in 2016, it was really accelerated through the recent adoption by the South Korean National Pension Service, which is the third-largest pension fund in the world.

Similarly, the Government Pensions Investment Fund (GPIF) and other large Japanese investors are promoting the Japan Stewardship Code, which looks to promote "sustainable growth companies through investment dialogue."

While this focus is largely on governance, more independent and diverse directors could provide impetus to set the tone for more proactive environmental and social agendas. When I met with senior members of the Shanghai Exchange last year in Shanghai, we also discussed ESG-related listing requirements, as this exchange has one of the largest listings of green bonds in the world.

There are a number of third-party providers that offer ESG research as well, such as MSCI and Sustainalytics. In our view, these third-party services are a helpful tool in the beginnings of an ESG journey, but breadth, depth, and materiality must be internalized at a firm level, and across capitalizations—an area where these service providers continue to expand. Increasingly, institutional consultants are evaluating how ESG is incorporated into investment processes and within the firm overall, and sustainable investment criteria are thus featuring more prominently in RFP requests globally.

There are also a number of industry-led collaborative initiatives, such as the PRI and the Forum for Sustainable and Responsible Investment (SIF), and organizations that are working to advance reporting and corporate disclosure on sustainability issues, such as the Sustainability Accounting Standards Board (SASB) and Global Reporting Initiative.

Q. What has client response to your efforts been?

Braming: When we signed the PRI in 2011, interestingly, there was significant pushback from a handful of our institutional clients, who questioned the advisability of considering "extra-financial factors" in our strategies. We spent a fair amount of time educating and engaging with these clients on this topic. While we didn't explicitly call out these ESG factors, it became clear that this analysis was meant to identify more sustainable growth opportunities, address a broader array of risks, and improve the return potential of investments and portfolios.

We are now taking this analysis to the next level. Our investment teams have developed materiality frameworks by industry, modelled from the SASB structure, in order to more specifically focus on key issues affecting risk, return, and growth prospects. This materiality framework resonates with our teams, and focuses us on what matters by industry and company.

These issues, of course, are now more mainstream, as approximately 25% of professionally managed assets globally ($22.9 trillion) are managed sustainably, according to the Global Sustainable Investment Alliance.

We continue to actively engage with our clients to help inform our path forward. Sustainability has been front and center of our European client base for quite a while. They have led and frankly challenged us. I love that our clients help us improve our peripheral vision. A handful of our European clients have been actively engaging with us on our sustainability integration, and provided great feedback. Other clients around North America have as well, although these interests have been more recent. Regardless, as a new generation of investors emerges, it is clear this is an area on which they are rightly focused.

In addition to our PRI commitment, we participate in asset owner initiatives, including the U.S.-based Investor Stewardship Group and the International Corporate Governance Network. We have also signed on to national stewardship codes for the United Kingdom, Japan, and Korea, promoting responsible ownership practices.

Q. What are the hurdles going forward?

Braming: Access to information and direct comparability of information varies substantially across countries and industries. And while the tone is set at the top regarding sustainability priorities and establishing policies, understanding how it's incorporated into each company's DNA is another matter.

Some companies, particularly in Europe, have significant sustainability teams, which is fabulous, because it is clear that sustainability is embedded across the entire company. For instance, AstraZeneca has approximately 200 individuals focused specifically on these sustainability initiatives globally. However, small companies do not have the same resources, so it is important to specifically understand how companies are addressing these issues, even if they are not explicit via written policies.

Are there ways to systematically assess integration and sustainability? Not everyone believes the same thing: My values are different than yours. So how does our view of sustainability resonate with clients and prospects? And how leverageable is it?

Finally, firms are at different parts of their journey. Distilling reality from hype is key. And let's make sure that it isn't just about good intentions. It's about measurable action.

Learn more about our ESG efforts at active.williamblair.com/esg/ (in the United States) or active.williamblair.com/sicav/esg/ (outside the United States).

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