Independent Women's Forum®

POLICY focus
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Environment, Social, and Governance (ESG): A Primer

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What You Should Know

In recent years, corporations, investors and consumers have shown increased interest in business practices that go beyond the basics of how goods and services are produced or sold. "ESG" is a set of criteria that measures a business's commitment to Environmental, Social, and Governance (ESG) principles. Often, these take the form of environmental sustainability practices, social justice issues, and democratic and fair corporate governance.

Undoubtedly, every business should act ethically and legally. Every business should treat workers and investors with respect and should be transparent. Every business should consider how its practices impact the environment and society more broadly. It's admirable—and indicative of our wealth—that so many Americans show interest in how businesses behave.

However, incorporation of ESG principles can come in many forms. Some forms are commendable, such as pledging to not use products made by slave labor, while others are misguided, like committing to net-zero carbon emissions even though we lack the technology to make that a sound financial or realistic goal.

At its worst, ESG investing is used as a form of virtue-signaling, promoting issues that are not necessarily related to actual environmental progress, or greater inclusivity and fairness (and can even encourage the opposite). For many companies, incorporating ESG values is simply selling a new product: the good feelings that come along with the belief that one is, by funding certain companies and not others, making the world a better place, even when in reality it is just making the world more politicized and divisive.

IN THIS ISSUE

Why You Should Care

Environmental, social and governance concepts have become a way for companies to "show" that they're invested in social and political issues. ESG investing is becoming increasingly prevalent. While the average American may not follow the trends of investment firms too closely, ascribing to an "ESG framework" is a way for companies to shield themselves from criticism from the "woke" left.

- **Including environmental issues in investment decisions can range from "net-zero" commitments to broad "sustainability" approaches.** Many companies, however, ascribe to the misguided opinion that we are in a climate crisis and promote aggressive approaches to combating climate change that are counterproductive to society and even the environment.
- **Socially responsible investing allows companies to promote political causes and virtue signal.** Our country is often radically divided over social issues. By embracing business practices that incorporate certain positions on social issues, companies appease activists but make our public feel even more divided. Some companies use this as a shield in hopes the public will ignore unsavory behavior, including their relationships with repressive governments like China.
- **Companies are in danger of promoting political causes ahead of their fiduciary responsibilities.** Companies are ultimately answerable to their shareholders. While some may be urged by such shareholders to embrace activist causes, others may incorporate political causes to the detriment of their bottom line and the investment of their shareholders.

More Information

What Is ESG?

Investing that incorporates environmental, social, and governance issues has become increasingly common. Already, **72 percent** of global investors say that they incorporate ESG principles into their business. Ironically, there is no clear consensus on what ESG proponents expect it to solve, much less **what exactly fits** the ESG criteria.

Broadly speaking, ESG refers to taking environmental, social and governance factors into consideration when making business decisions. Most frequently it is discussed in the context of investments by large firms.

While the term "ESG" is fairly new, the concept of socially responsible investing has been around since the **1950s**. Back then, it was considered a fairly radical approach to investments, and companies first used the approach to avoid investments in "sin" stocks involving alcohol, tobacco or gambling. The practice soon broadened to include avoidance of issues such as the

South African apartheid regime or even the Vietnam War. Today, the concept of ESG includes a myriad of issues, with a recent focus on environmental issues.

What Companies Are Doing

Companies throughout the U.S. and the world have embraced the concept of ESG investing. Some have changed their approach due to consumer pressure while others have responded more to the political climate and calls by activists to be more intentional in their investment practices.

ESG principles are not necessarily radical. All that the approach really requires is taking a more holistic method of evaluation that includes these broad categories as well as the traditional financial measures. Focusing on any one of the three different aspects of ESG can look very different.

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As concerns over climate change have grown in recent years, a focus on environmental impact has become widespread. On the more aggressive side, climate activists argue that combating climate change requires a "whole of society" approach, and that the private sector is just as responsible for embracing carbon reductions as governments. On one hand, this can take the form of "net-zero" commitments, while on the other it can simply be companies trying to take a more sustainable approach to investments, often at the request of clients.

The social aspect of ESG can serve as a catch-all for companies trying to act in a socially responsible manner. Initiatives that fall under this umbrella can range from working to advance social justice in terms of "anti-racism" training or trying to provide better working conditions or benefits for their employees. Largely, however, companies embracing ESG principles tend to promote a more "woke" definition of social issues and can end up being divisive and harmful to staff and the public.

The inclusion of governance in ESG principles can seem like an unnecessary addition. After all, companies are already required to maintain certain checks and balances that ensure that managers make decisions in the best interest of the company. Unfortunately, companies have taken these concepts and broadened them to include measures such as requiring gender and race diversity on corporate boards. It's important to note that these issues are prevalent with a variety of companies, even if they do not ascribe to the ESG principles at large.

Potential Pitfalls and Problems

At this time, it's not possible to determine if embracing ESG concepts will hurt a firm's financial performance. While a 2017 study from India found that a social responsibility investment requirement actively hurt the value of companies, the ESG investment approach is much more broad and less likely to show clear harms across the board. But drastic approaches by some companies, however, are likely to result in long-term performance reductions.

One of the major concerns with ESG investing is that it can run counter to sound financial decisions. For example, Blackrock is the world's largest asset manager, managing more than **$9.5 trillion dollars**. In the midst of the coronavirus pandemic, Blackrock pledged to place environmental sustainability at the center of its investment strategy, **saying**: "We believe that sustainability should be our new standard for investing."

The problem, however, with this radical approach is that it may not be in their clients' best interest. There is an appetite for incorporating some sustainability issues into investments, and there is no proven reason for companies to avoid such an approach, but as Blackrock even admits to their clients, they're making this major shift on what they see as "potential" to offer better outcomes, not a clear path ahead.

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And Blackrock has taken this approach even further: they've used their influence to pressure other companies into joining a "net-zero" pledge and have divested from companies that they view as posing a threat to our climate, such as those involved in **thermal coal production**. Ironically, Blackrock has been **called out** for continuing to invest in coal—thanks to a loophole in its climate pledge, the company can still hold shares in companies that earn less than 25 percent of their revenues from coal. This has allowed them to continue holding shares worth a total of $85 billion in such companies. Despite all their public pledges on combating climate change, this would seem to say that even Blackrock can be wary of jumping wholeheartedly onto the ESG bandwagon.

Regardless of Blackrock's inconsistency, they've still worked to influence other firms to join them in public climate pledges. They're part of the recently-formed Glasgow Financial Alliance for Net-Zero, whose members manage assets valuing a total of $130 trillion. But not all companies are on board with an aggressive climate-focused approach to investing. Eight major investment firms, managing $17 trillion in assets, have declined to participate in the alliance, **citing** their "fiduciary duty and a reluctance to be bound by external rules." And beyond running counter to their fiduciary duty, if companies pledge to divest from fossil fuels completely, this could cause a crisis for oil and gas companies, whose products we will continue to rely on for some time to come.

While the environmental aspect of ESG principles often gets the most attention, corporations have been actively embracing the social responsibility side as well. One of the major issues in this category is board quotas.

In 2021, Nasdaq, the second-largest stock exchange in the U.S., began implementing strict board diversity requirements for companies listed on its stock exchange. They require companies "to have at least one woman on their board of directors, along with one person from a racial minority or who identifies as gay, lesbian, bisexual, transgender or queer." Companies that don't meet the requirements must publicly explain why they've failed to do so, and endure the subsequent shaming.

While corporate diversity quotas are well-intentioned, they ultimately undermine the hard work of women and minorities by creating certain positions that can only be filled by individuals who fit in that category, regardless of any further qualifications. Board quotas cheapen the achievement of reaching a corporate board and instead can create token members who are only there to fulfill the quota. And from a broader perspective, corporate gender quotas have already resulted in placing less experienced individuals in leadership roles because of the quota requirements, causing poor firm performance and worse, placing individuals in positions for which they're not prepared.

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Although companies may seem motivated to promote more holistic business practices through ESG principles, many of these companies that embrace ESG in the United States work closely with Chinese entities and ignore the truly alarming human rights and environmental records of those companies. The willingness of major companies to depend on China and the Chinese government, without regard for their use of slave labor, subjection of Hong Kong, censorship of their people, and continued utter disregard for the environment suggests that ESG is a way to avoid criticism and show affinity for certain political movements and actors, not an actual commitment to these principles.

Conclusion

Incorporating ESG principles into business practice can be a good and admirable approach. Every firm, from Starbucks to Hobby Lobby, should be free to do business in accordance with a set of values and principles. Investment firms, too, should have this freedom.

Companies, and investors, should not use ESG concepts to simply score political points or virtue signal that they are a part of a new "woke elite" in the U.S., but should carefully consider how their choices and business practices ultimately foster a prosperous, free and fair society.

What You Can Do

Get Informed

Learn more about Environmental, Social, and Governance issues. Visit:

- Woke Inc.
- Go woke, go broke? Americans don't care for corporate activism
- ShareHolder Equity Alliance

Talk to Your Friends

Help your friends and family understand these important issues. Tell them about what's going on and encourage them to join you in getting involved.

Become a Leader in the Community

Get a group together each month to talk about a political/policy issue (it will be fun!). Write a letter to the editor. Show up at local government meetings and make your opinions known. Go to rallies. Better yet, organize rallies! A few motivated people can change the world.

Remain Engaged Politically

Too many good citizens see election time as the only time they need to pay attention to politics. We need everyone to pay attention and hold elected officials accountable. Let your Representatives know your opinions. After all, they are supposed to work for you!

ABOUT INDEPENDENT WOMEN'S FORUM

Independent Women's Forum (IWF) is dedicated to building support for free markets, limited government, and individual responsibility.

IWF, a non-partisan, 501(c)(3) research and educational institution, seeks to combat the too-common presumption that women want and benefit from big government, and build awareness of the ways that women are better served by greater economic freedom. By aggressively seeking earned media, providing easy-to-read, timely publications and commentary, and reaching out to the public, we seek to cultivate support for these important principles and encourage women to join us in working to return the country to limited, Constitutional government.