IHS Markit Perspectives V (June 2020)

The importance of ESG during a global pandemic

IHS Markit's Perception Analytics team engages in in-depth discussions with investors and analysts daily. In light of market volatility and economic uncertainty, IHS Markit is speaking to investors and analysts on a regular basis to assess how the current situation with COVID-19 is impacting their evaluations of and engagement with corporate issuers.

Environmental, Social, and Governance criteria have become increasingly more important over the last few years within the investment process. Given the significant ramifications of the coronavirus on employee health and safety, corporate governance, and society at large, we felt that it was critical to understand how these factors are being evaluated by investors in current times. **The fifth topic we gathered feedback on is how investors and analysts weigh ESG elements during a global pandemic.**

Some investors and analysts value ESG now more than ever. They observe that the companies which have historically exhibited strong governance and commitment to ESG are more effectively managing through this volatile period.

- "ESG was extremely important throughout last year and the start of this year. We do not see its importance diminishing at all. There is a big demand for sustainable investments, and that demand is there no matter if the global economy is weak or if there is a global pandemic." *Analyst, UK investment manager ($90B EAUM)*
- "COVID-19 has impacted how I view governance. It is an opportunity for many companies around the world to revisit their governance and realize what is really important. Part of that is your shareholders. If you are not acting in the best interest of your shareholders, then I question the sustainability of the business. We have been doing more and more work on ESG for the last few years. It is important for our firm given a myriad of factors. Companies all over the world need to be thinking more broadly about who they want to be in the world aside from being rich. Rich is good. Some of these CEOs are beyond rich. Some of them have wider potential agendas. If they want to keep their positioning, they need to do some interesting maneuvering." *Chief Investment Officer, US investment manager (>$150M EAUM)*
- "It is a very fine balance between the interest of shareholders and the interest of other stakeholders. There is a complex governance question that needs to be addressed. That is a significant driver to valuations at the moment. This is one of the most pertinent times I have ever

seen regarding the need to evaluate how companies are balancing profitability and social aspects." *Portfolio manager, European investment manager (>$2B EAUM)*

- "There is a bare minimum of health and safety standards that need to be met for companies to have received an approval to restart operations after COVID-19. Clearly those that go above and beyond will benefit. That is very important, and it influences our decision to invest. The preparedness of a company and quality of management are very big factors in our investment process. The companies that garner goodwill through their actions is a sign of good management quality." *Portfolio manager, Asian hedge fund (>$300M EAUM)*
- "In the current environment, ESG is especially important in the medium and long term. How companies deal with employees and the environment is important. In the long term, I follow and evaluate how companies behave, make decisions, and consider stakeholders' interest in this crisis." *Portfolio manager, South American investment manager*
- "Companies in the last five years have faced a number of crises, which have brought very strong headwinds. How they have dealt with these over the years have already shaped our view on ESG's importance. COVID-19 is just another disruption. Yes, it is a very large-scale disruption, but it does not affect our view on ESG more than any other large headwind." *Analyst, European investment manager ($10B EAUM)*
- "We have definitely placed a greater importance on ESG in this current environment. Generally, we put a lot of emphasis on ESG across our fund. We have a couple of impact funds that look specifically on the positive measures being taken by companies in relation to ESG. You want companies to be responding in an appropriate way. They need to be managing their own various stakeholder risks. We want to make sure that companies are acting sustainably to maintain the opportunity ahead of them." *Associate portfolio manager, UK investment manager (>$95B EAUM)*
- "If you consider governance, everybody is going to have a lack of visibility. You just saw some new earnings come out. Looking at how companies report is going to be extremely important in the next 3-6 months because there is not going to be any comparability given that we have never experienced this before." *Portfolio manager, US investment manager ($1B EAUM)*

Investors and analysts believe that how companies treat their employees during this time can be indicative of the long-term sustainability of their businesses.

- "We would prioritize companies that are helping to solve the situation more than those that do not show that they are caring for the situation. Companies have to show that they care for their workers and the environment. For example, if a new plant opens, disregarding the health of the personnel because profits are prioritized will not be a positive in our view. At the moment, it is too soon to evaluate the winners from an ESG perspective, but what I can see is that companies are trying to be cautious and are communicating with the investment community in these times." *Analyst, South American investment manager*

- “One company in China has given up 10% of renumeration for the rest of 2020 to help the families of frontline employees. They already had a history of investing in employee retention, so they were just applying this philosophy again in light of COVID-19. In China, you do not necessarily get paid by the State if there is a forced holiday. Some of these companies have distinguished themselves from this perspective, which is great.” *Analyst, Asian investment manager ($10B EAUM)*
- “ESG’s importance in regard to COVID-19 will eventually play out. If a company is not treating its employees well, it might not be able to continue to hire good talent. It will eventually come back to bite the company. If a company is known to have a good culture, it will not have an issue with that.” *Portfolio manager, Asian hedge fund*
- “ESG practices are part of the overall impression of a company. The more companies take care of their employees and take ESG seriously, the more likely it is to be a high-quality company. These companies tend to hold a higher multiple when it comes to valuation. That is not to say if you do not do ESG box-ticking, then that makes you a bad company. Part of what we try to do is see through this and determine whether this is a good company to work for by asking employees about their views. The priority is getting an attractive combination of growth and valuation. ESG is supplemental to the fundamentals.” *Portfolio manager, UK investment manager ($40B EAUM)*
- “The social aspect of ESG is something we have been increasingly cognizant of whether it is a supplier of a customer or the special activities around employees. A portion of communities in the supply chain that we work with have been making efforts to improve their social activity levels. They are improving the wellbeing of the workforce along with other stakeholders that interact with the business. Having good marks in the regard is very important in this current environment.” *Portfolio manager, European investment manager ($5B EAUM)*
- “Some of the shorter-term questions have changed. We are certainly not changing our medium- to long-term approach in terms of our engagement and the topics we engage with our investee companies. In the shorter term, we are looking more at the stability of the companies. For example, if you look at share buybacks and dividend payments in terms of their management of capital in that regard, how are they protecting their employees and their businesses? I suppose that the main feedback we are giving to companies is that this is the right time for them to take a pause and think about their company, staff, and business. They need to make sure that their business can come out of this situation ready to return to strong performance, but they should not be losing sight of their longer-term strategy. In the short-term, we are focused on how companies are managing capital and staff, but over the medium and long term, our approach will not change.” *Analyst, UK investment manager (>$90B EAUM)*
- “The social element comes down to how companies are treating their employees. If you are laying off many people, how does that come into play? You have not heard so much of that in China. China is a little different from Europe and the US. There are a number of different provinces and Shanghai and Beijing were not impacted as much as Wuhan. China did close down, but it did not have quite the spikes and spreads because of how they handled it. If you have a company that has laid everyone off, how does that impact G versus S? There are massive companies from the cruise lines to the hotels and the airlines that have laid people off. How that gets extrapolated is going to be compelling. Some technology and healthcare companies have done well. Zoom is an example. It has its own problems with privacy, but if you

look at the winners and losers, Gilead Sciences has been up. Some of the Chinese technology names have held their own. Anything related to travel has been hurt dramatically. Those are the global themes." *Portfolio manager, US investment manager ($1B EAUM)*

A few investors and analysts believe that there is risk and opportunity from an environmental perspective given what has transpired with oil prices and the energy sector in 2020.

- "Resource companies seem to be the clear losers in this environment. Some of the emerging markets seem to be losing. Global tech seems to be the biggest winner. The environmental aspect of ESG is what has become emphasized a lot more recently. Governance has been the top priority, then environmental, and lastly social. Companies have articulated that they are working to become carbon neutral in X amount of years. Companies that can take these initiatives are in an advantageous position over companies that cannot." *Analyst, UK investment manager ($90B EAUM)*
- "On the environmental side, at the same time that coronavirus appeared, oil plummeted 60%. They are not directly related, but the fact that demand has fallen off globally, probably in half, compounded with Russia and Saudi Arabia increasing production 20-30%, there is a massive market dislocation. To take that one further, anyone who has high energy exposure will score poorly on ESG, whether it is Morningstar or another valuation technique. When you look at plots and satellite videos of nitrogen in the air and carbon dioxide, you have seen pretty dramatic differences in China and metro areas like Chicago, New York, and LA because everyone has been staying at home for a month and a half. If you step back and ask yourself how this impacts the E, it is pretty obvious that it does. The question is how do you benefit from that in the future? You have to also ask yourself, who benefits from lower oil? China does as a net importer. India and many of the Asian countries benefit from lower oil. The exporters like Saudi Arabia, Russia, Venezuela, Iran, and Middle Eastern countries are decimated by that. Our shale industry is hurt dramatically, but it is not a big component of our GDP. We cannot have the energy sector go to zero, but if it did, it would not kill our economy. If Saudi Arabia's energy business goes to zero, it has bigger problems." *Portfolio manager, US investment manager ($1B EAUM)*
- "There are clearly some beneficiaries to the structural changes that are coming as a direct relation to COVID-19. Those companies would get a positive ESG scoring on that front. Other businesses are struggling to compete and are seeing increased pressure from ESG trends. Those businesses are likely to see an increase in the discount in which they trade at. The winners are going to be businesses that can compete in the digital world in terms digitalization, e-commerce, online gaming, and similar areas. Businesses will benefit if they have exposure to countries that are still going to have structural growth, for example, China. Some countries have a post-COVID-19 economic outlook that is quite poor. It will take them years to be able to return to any semblance of economic growth. It will be incredibly positive for businesses that can give you the ability to participate in growth and are in sectors that benefit from these structural changes." *Portfolio manager, UK investment manager ($50B EAUM)*

A few investors and analysts state that the current environment does not impact how they evaluate ESG and, in fact, some have de-emphasized it over the near term.

- "ESG issues have initially taken a backburner to the issue of COVID-19. The issue is more political than economic at this stage. If there are environmental issues attached to the company, then ESG will continue to be very important. ESG in general has been dominant in the past, but not right at this moment." *Portfolio manager, US investment manager (>$90B EAUM)*
- "The social issues of ESG have a larger range of outcomes now. We just hired a head of ESG in January, and they might say that their job has become less important. There are a lot of companies that are more focused on if they will exist in a year instead of reducing their carbon footprint. They care less about excellent employee treatment because they will not have any employees if they do not survive. Companies need to prioritize survival rather than excelling in ESG criteria given that they have justified reasons. It is a resource maximization principle. If you do not have resources, you do not have a choice in using them. It depends on if the company has been directly or indirectly affected by COVID-19. If they have been indirectly affected, you must be transparent on the changes. If they have been directly affected, ESG will take a backseat regardless of whether or not management is transparent about it because there are no resources to spend." *Analyst, US investment manager (>$40B EAUM)*
- "At this moment, COVID-19 has not impacted how we evaluate companies and ESG, but it will be more important in the future. Given the market volatility right now, it is not something that we are focusing on yet." *Analyst, US hedge fund*
- "My view on ESG has not been impacted by COVID-19. I have seen that the main companies have actually reacted really well. Oil and gas companies have started to help communities where they have fields. The reaction has been really good. Companies have gone further than they should have in terms of helping the community. The response has been really good." *Director of research, South American sell-side firm*
- "It is a bit premature to determine if COVID-19 has impacted the importance of ESG factors. I am not sure if we have changed our view." *Analyst, European investment manager (>$2B EAUM)*