Rotterdam School of Management
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Decrypting Sustainable Finance

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RSM - a force for positive change

Question: sustainable finance

What is the aim of sustainable finance?

a. To make the financial system sustainable

b. To promote sustainable business practices at companies

c. To accelerate the transition to a sustainable economy

Agenda

Sustainability journey:

Part 1) **why**: sustainability challenges

Part 2) **what**: sustainable companies

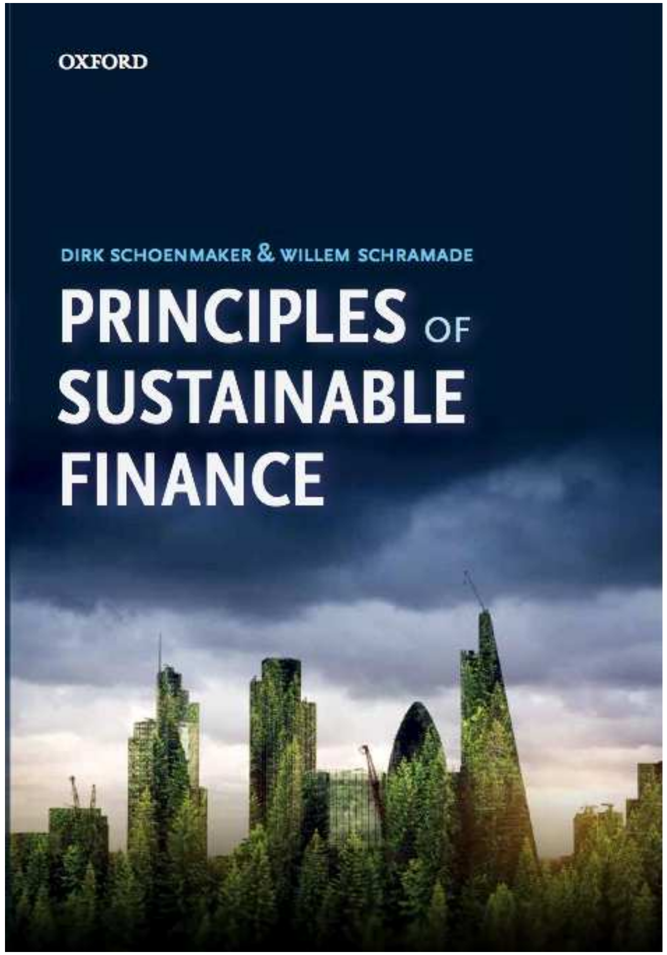
Part 3) **how**: financing of sustainable companies

Part 4) **transition**

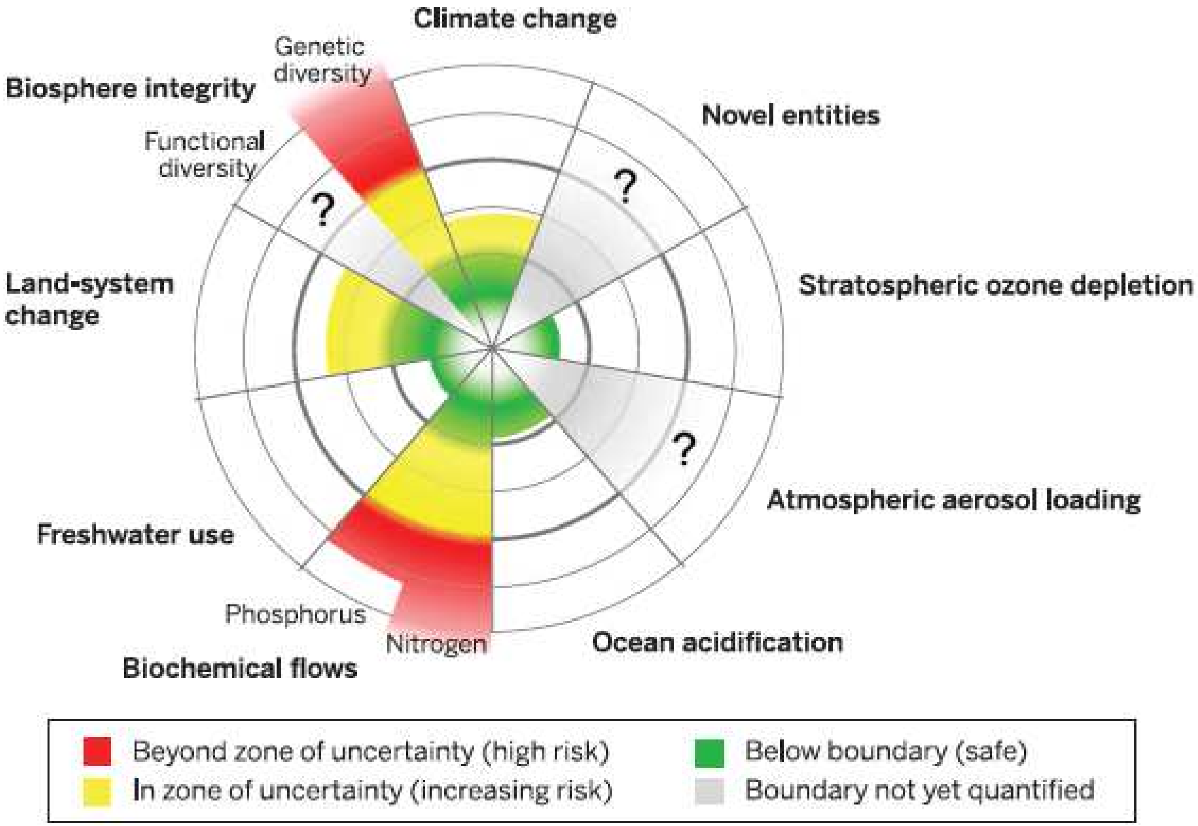
Key message:

From maximising profit **F**

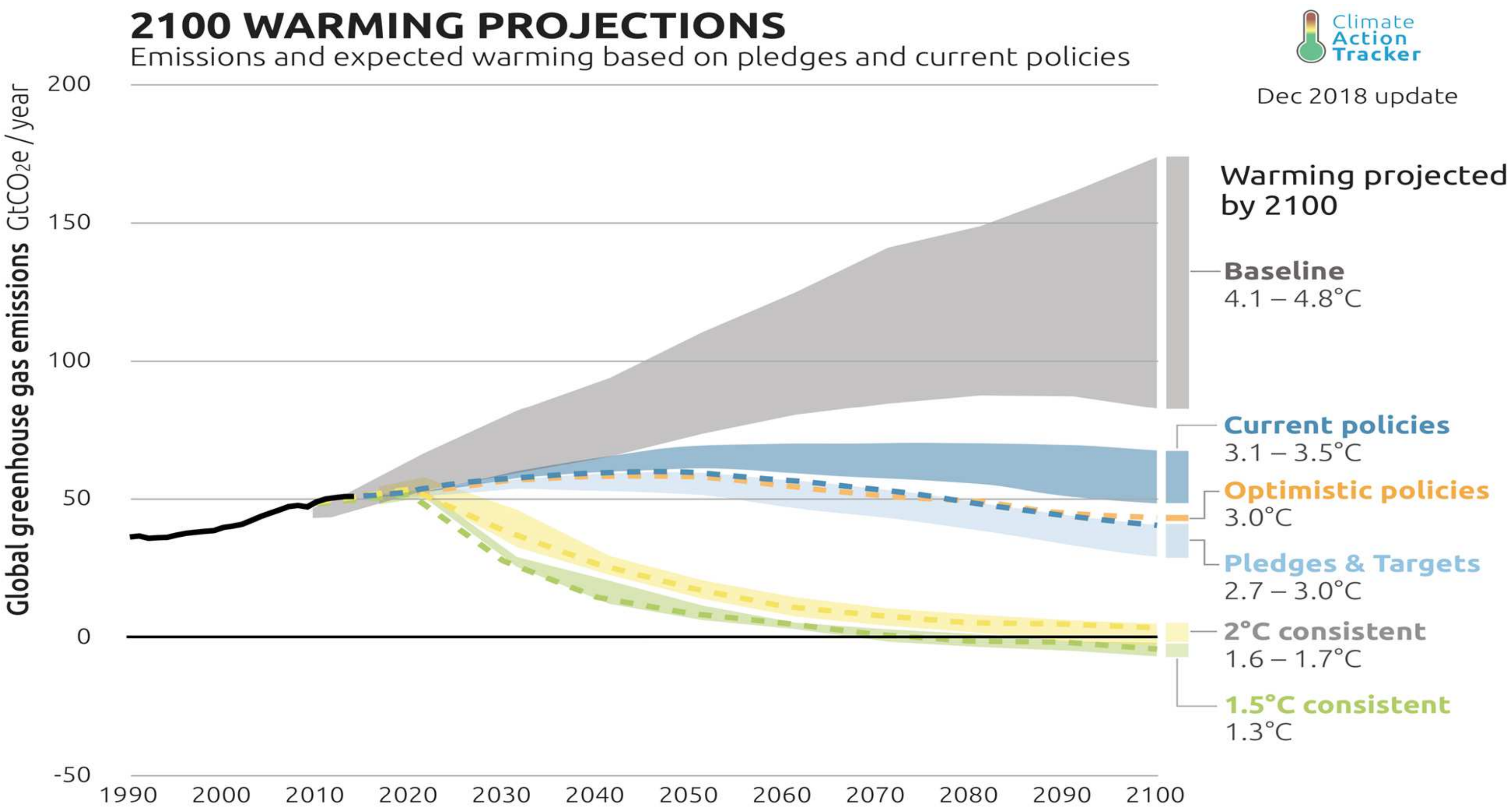
To maximising integrated value **I = F + S + E**



Planetary boundaries framework



Climate policy gap

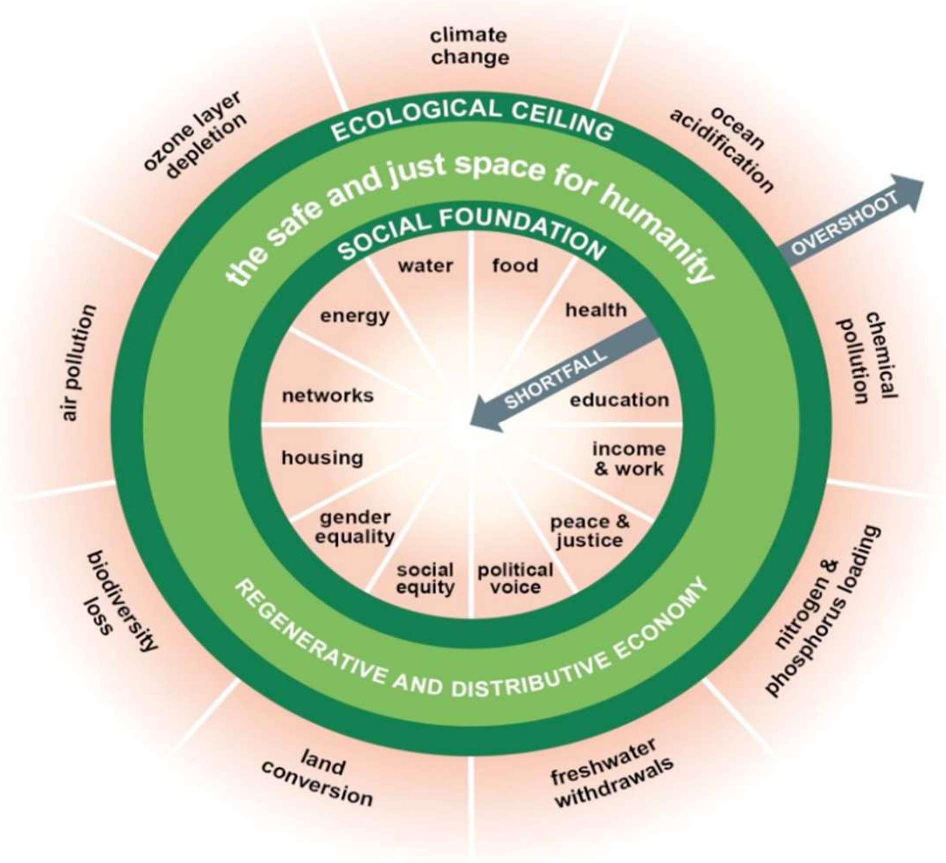


Social foundations

- Food security (no hunger)
- Adequate income (no poverty with income of less than $3.10 a day)
- Access to health care
- Access to water
- Access to energy and clean cooking facilities
- Education
- Decent work (living wage)
- Gender equality and social equity
- Political voice: right of people to be involved in decisions that affect them

Many people **live below** these social foundations

The Doughnut of Kate Raworth



Global goals for sustainable development

Question: SDGs

What is the most important sustainable development goal (SDG)?

a. SDG 8: Decent work and economic growth

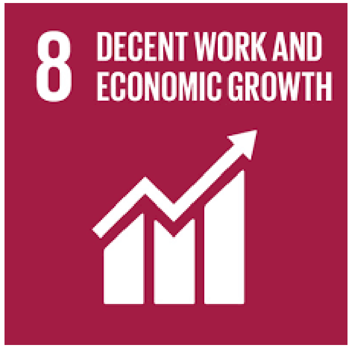
b. SDG 12: Responsible consumption and production

c. SDG 13: Climate action

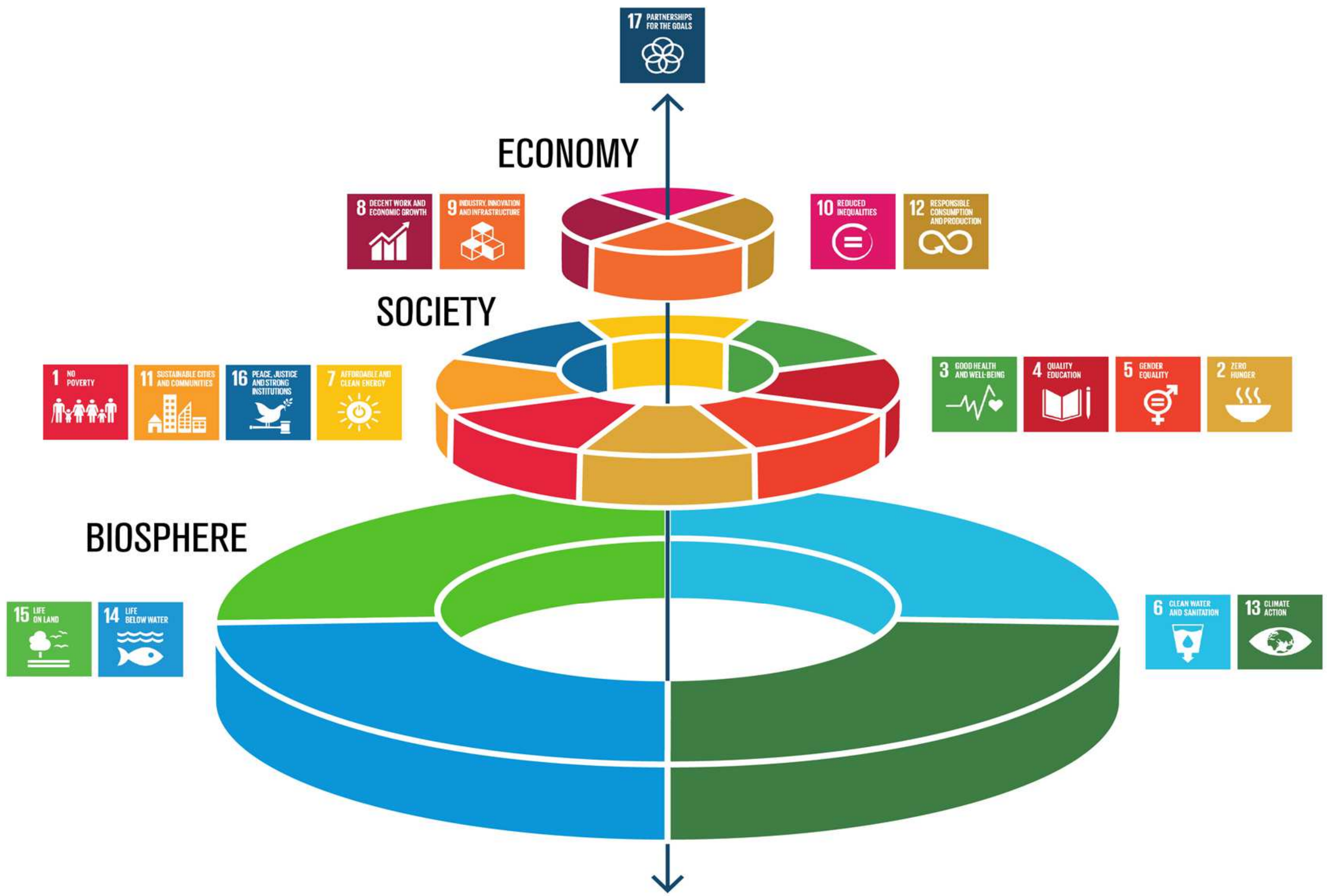
d. All are equally important

How to make it operational?

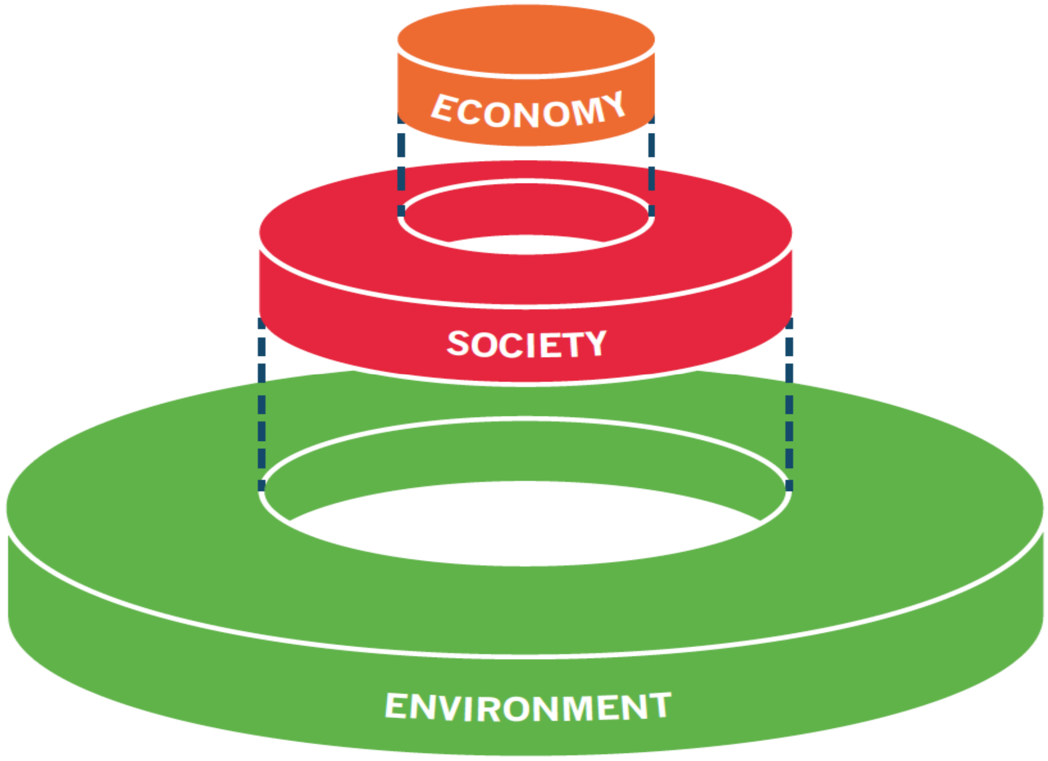
- Example: Living wage
  - ➢ Linked to SDG 8 - decent work and income
  - ➢ Provides a family with the means to buy life's



- Potential impact of living wage on other SDGs


17 PARTNERSHIPS FOR THE GOALS
ECONOMY
8 DECENT WORK AND ECONOMIC GROWTH
9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
10 REDUCED INEQUALITIES
12 RESPONSIBLE CONSUMPTION AND PRODUCTION
SOCIETY
1 NO POVERTY
11 SUSTAINABLE CITIES AND COMMUNITIES
16 PEACE, JUSTICE AND STRONG INSTITUTIONS
7 AFFORDABLE AND CLEAN ENERGY
3 GOOD HEALTH AND WELL-BEING
4 QUALITY EDUCATION
5 GENDER EQUALITY
2 ZERO HUNGER
BIOSPHERE
15 LIFE ON LAND
14 LIFE BELOW WATER
6 CLEAN WATER AND SANITATION
13 CLIMATE ACTION
Graphics by Jerker Lokrantz/Azote

Managing sustainable development



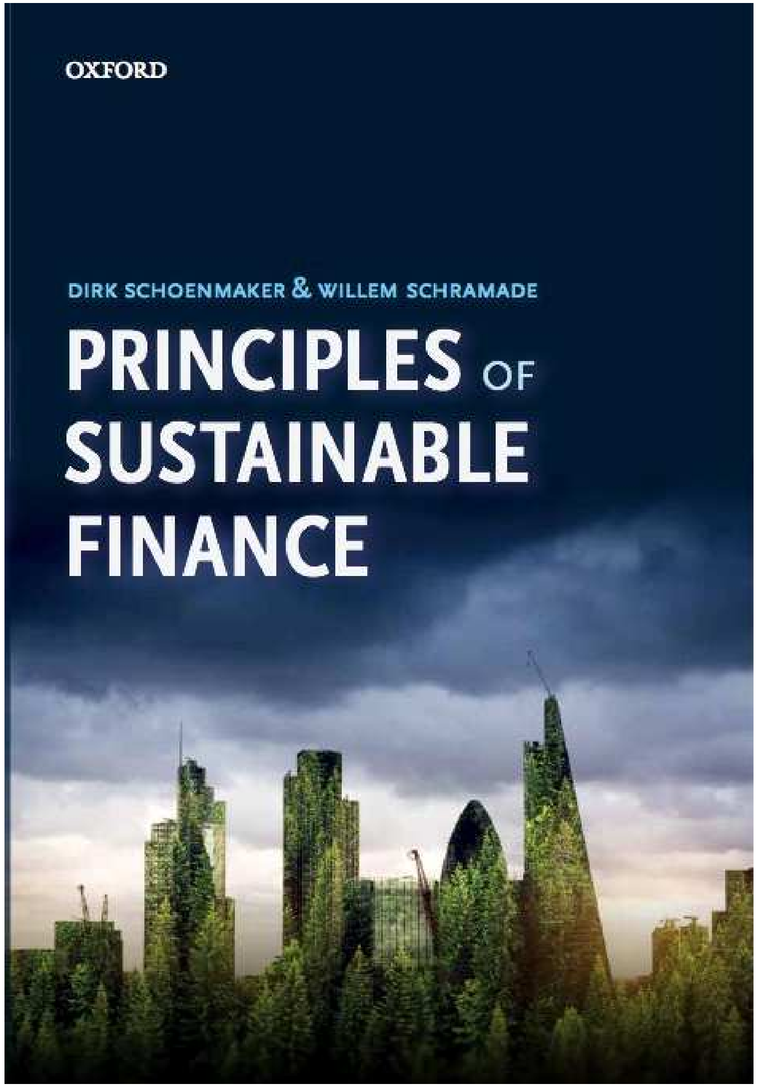
- financial return and risk: **F**
- impact on society: **S**
- impact on environment: **E**

Perspectives on externalities

- Sustainable development: I = F + S + E

Principles of sustainable finance

Sustainable Finance Typology	Value created	Ranking of factors
Finance-as-usual	Shareholder value	F
Sustainable Finance 1.0	Refined shareholder value	F >> S and E
Sustainable Finance 2.0	Stakeholder value	I = F + S + E
Sustainable Finance 3.0	Common good value	S and E > F



Question: barriers

What is the most important barrier to sustainable finance?

a. Value: shareholder value versus common good

b. Horizon: short term versus long term

Why integrate ESG?

Why would financials and corporates look at ESG?

- Anticipation of regulation / taxation (e.g. carbon tax)
- Reputation – pressure from NGOs / consumers
- Future-proof: transition to SDGs by 2030

How to do it?

HLEG (2018): fiduciary duty of investors

- Yes, excellent to include sustainability in fiduciary duty

HLEG (2018): official taxonomy of sustainable investments

- Sustainability is about companies' preparedness for transition
- No, administrative approach by officials stifles innovation
- Our proposal (2019): market-led approach through fundamental investing and banking

Active investment approaches

- Institutional investors can realise LT returns by **investing in** and **engaging with** companies that pursue long-term value creation

- Requires **fundamental analysis** of companies' business models
  - ESG ratings have limits by design

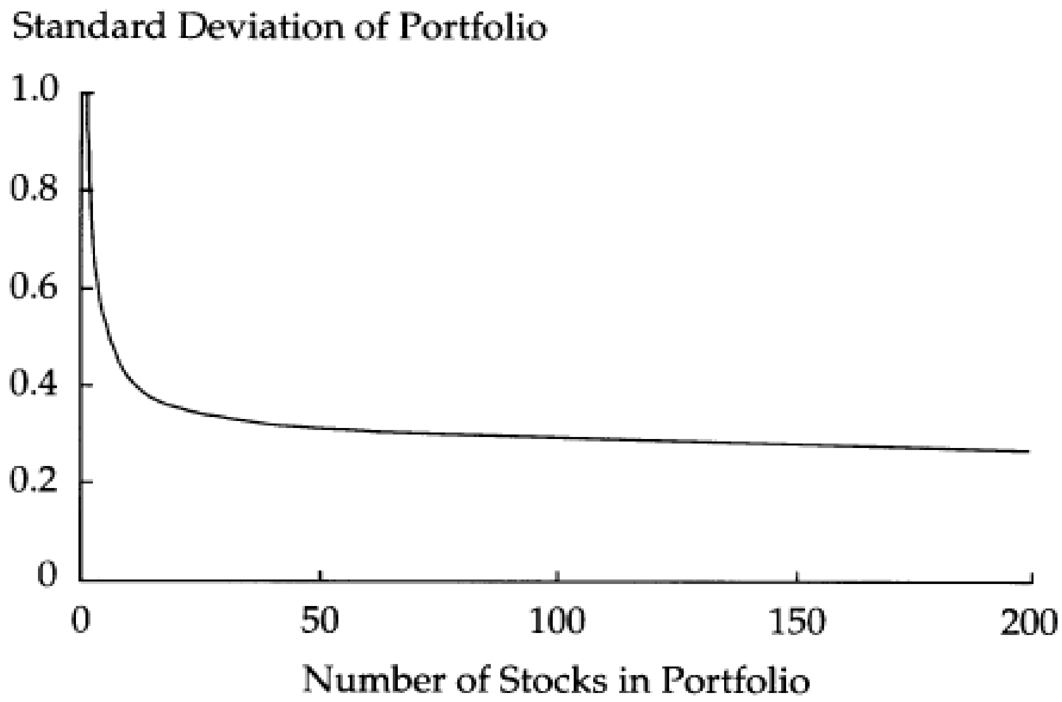
- Aim: to uncover companies' social (S) + environmental (E) value, alongside financial (F) value
  - Calculate integrated value: I = F + S + E

From extremely diversified to concentrated portfolios

Pension funds may hold thousands of different securities

Serious engagement not feasible…

…, while not necessary from a diversification perspective….



Elements of sustainable investing

RSM Erasmus

- Long investment horizon (intended holding period)
- Active management in concentrated portfolio
  - You can only do fundamental analysis of 50 to 100 companies
  - Information advantage: investor reaps benefits
- Effective engagement by analysts
- Performance analysis of value-added
  - Market benchmark counterproductive
  - Absolute return target, e.g. 5-year average

And sustainable banking

S and E factors → Factors influencing creditworthiness → Credit risk indicators

- Examples of sectoral lending policies
  - Westpac : zero net deforestation
  - Rabobank: food and agri standards

- New approaches with focus on transition towards 2^{0}C scenario
  - ING: Terra – look at technology scenarios for each industry
  - Grant loans which are consistent with projected installed base

Conclusions

Long-term value creation to achieve SDGs

- From narrow F dimension
- To integrated value: I = F + S + E

Finance is about anticipating events and pricing them in today

- Finance contributes to swift(er) transition