In 1994 John Elkington developed the phrase “Triple Bottom Line” (TBL), describing a sustainability framework to examine a company’s social, environmental and economic impact.

“Bottom line” is an accounting term, but this wasn’t designed to be just an accounting tool. It also intends to promote deeper thought about capitalism and its future, with an ultimate aim of changing the system...transforming capitalism.

The “people” bottom line is a measurement of how socially responsible a company has been in its operations.

The “planet” bottom line is a measure of how environmentally responsible a company has been.

The “profit” bottom line is the traditional approach of preparing the profit and loss account.

Last year the author revisited his work¹, concluding that CEOs and CFOs focus primarily on the “profits” target and not so much on the “people” and “planet” ones. He also noted it isn’t supposed to be a trade-off between the elements. This was Elkington’s attempt to look at the full cost of doing business, with the additional intention of starting change and disruption.

Elkington quotes Covestro’s² retired CEO, who having moved in the direction of the TBL approach noted that “proper use of the TBL means, at a minimum, progress in two elements with the third unaffected”.

² Covestro is a German listed company which manufactures polymers and high performance plastics for the automotive, healthcare, construction and electronics sectors.
Elkington observes that some companies have moved in the right direction and that B Certified Companies\(^3\) are a "ray of hope", with signatories configured to be the "best for the world" as well as the "best in the world". He notes the need for pace and scale and hopes for a blueprint for "tomorrow’s capitalism with the regeneration of our economies, societies and biosphere".

Many ESG frameworks reference the TBL or “People, Planet, Profits”. Much has evolved since 1994, but Elkington’s point, even recently, is that there is more to do.

This year I passed the CFA UK Certificate in ESG Investing, the first formal qualification of its kind in the UK. It is a strong professional foundation for increasing our understanding of the evolution of ESG investing, alongside the changes that lie ahead and frameworks that may be adopted.

**ESG in our world**

There are a myriad of definitions associated with ESG. Below I have illustrated some of them.

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**Traditional**

- ESG factors not considered
- Financial returns prioritised
- Diversified universe

**Responsible**

- ESG factors integrated - mitigating risk
- Ethical/ moral returns prioritised
- Narrower universe

**Sustainable**

- Deliberate pursuit of ESG opportunities

**Impact**

- Impact

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Traditional investing, considering every company available to you while prioritising financial returns above everything else, does not typically involve specific consideration of ESG factors. However, these days, given improved reporting it is likely that the factors are considered, but not fully integrated into the final decision.

Responsible investing starts to integrate ESG factors in order to mitigate risk. This makes sense from a logical perspective. If poor practices in a company’s supply chain are widely exposed, the company suffers reputational damage and the share price typically responds accordingly. Consider the recent supply chain issues at Boohoo, where the share price outcome was a fall of 44% in the first week of July this year.

Sustainable investing involves the deliberate and specific pursuit of ESG opportunities. Courtiers considers ethical investing within this segment. Pursuit of ESG opportunities may be thematic (focusing on renewable energy for example) or focused in an area such as companies aligned with the UN Sustainable Development Goals\(^4\). It may be exclusionary (employing negative screening to avoid companies) or employing a positive

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\(^3\) [https://bcorporation.net/](https://bcorporation.net/) Certified B Corporations are a new kind of business that balances purpose and profit. They are legally required to consider the impact of their decisions on their workers, customers, suppliers, community, and the environment. This is a community of leaders, driving a global movement of people using business as a force for good. There are more than 1,300 companies certified. These are mostly smaller companies but there are many household UK names on the list including Charlie Bigham’s, Teapigs, Riverford Organics and The Body Shop. [https://bcorporation.uk/about-b-corps](https://bcorporation.uk/about-b-corps)

\(^4\) [https://www.undp.org/content/undp/en/home/sustainable-development-goals.html#%20text=The%20Sustainable%20Development%20Goals%20-%20SDGs%20peace%20and%20prosperity%20by%202030.](https://www.undp.org/content/undp/en/home/sustainable-development-goals.html#%20text=The%20Sustainable%20Development%20Goals%20-%20SDGs%20peace%20and%20prosperity%20by%202030) The UN Sustainable Development Goals are 17 integrated goals adopted by all UN member states in 2015. The goals are ambitious and...
engagement approach (investing in companies who are improving their business practices). An exclusionary strategy will result in a narrower choice of companies, which may affect financial returns when those sectors perform well.

Impact investing covers a wide range of investment opportunities, all aimed at improving environmental or social issues. Some of them focus on financial returns to investors. Others are more focused on benefits to the wider community or the environment, and the financial return potential is secondary.

The lines between responsible, sustainable and impact can be blurred. There is an increasing body of academic evidence to support the fact that investing responsibly or sustainably will not result in inferior returns. At first glance, restricting your pool of investments is likely to limit returns in certain market conditions. But by not investing in companies that are unsustainable, you can be doing yourself a favour in more ways than one. The devil is in the detail.

Most fund managers are now very keen to emphasise that ESG factors have been at the forefront of their investment processes for many years. However, there wasn’t a need to highlight those factors over any other financial factors until now. Communication of ESG factors has increased due to demand from investors. Some investment managers have recently adopted ESG factors whereas others are now communicating the fact that they adopted the factors years ago.

Many sustainable investing funds have launched recently. According to Morningstar research, there were 106 sustainable funds launched in the first quarter of this year and 106 launched in the second quarter. A further 40 funds were “converted” from “traditional funds” to “sustainable funds”. These have tapped into the demand from investors to invest money in companies deliberately focused on ESG factors. The ESG factors considered are broad and differ per sector.

The SASB Materiality map is one tool that can be used to identify material sustainability issues relevant for companies in the range of sectors. For example, ecological impacts (one of the environmental factors) is not particularly material for financials such as banks, but is a key issue for companies involved in the extraction and processing of minerals. Conversely, data security and customer privacy are key concerns for companies in the communications and technology sector, but are less material for most infrastructure companies.

We are now communicating more actively how ESG factors are involved in our existing process. Our analysts consider ESG factors when analysing a company. John Elkington put an accounting tilt on it. We think there is a logic to explain why you should consider these factors. If you are choosing to invest your money in a company, it makes sense to ensure that company is:

- well run
- treats its supply chain, customers and employees appropriately
- treats its community with respect
- acts with due regard to the environment to ensure the survival of itself and the environment in which it operates.

Of course analysts look at ESG factors. But do portfolio managers actually exclude companies because of these ESG factors? Or is there just an adjustment to price targets and expectations, and assessments of risk? Or, do portfolio managers seek only the best in class?

The implementation varies widely. There is no right or wrong but it is important that investors understand how decisions are made, so they can make appropriate choices. Communication of the process is increasingly important.

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7 https://materiality.sasb.org/
Courtiers assesses the ESG factors when we analyse any company. For several years, we’ve documented the governance factors we consider to be material. These are more easily measured than the social and environmental factors.

Let’s take a look at what sits within these ESG factors.

**E for Environment**

Some of the key issues within the environment factor are connected to climate change, but this factor also includes consideration of the natural resources on our planet. Water, biodiversity, land use, pollution and waste management should all be taken into account.

**S for Social**
The social factor covers a broad range of social megatrends including artificial intelligence (AI), globalisation, digital disruption, family structure, demographics and urbanisation. As analysts we also focus on internal social factors – those within companies – such as health and safety, human rights, labour rights and the right to a living wage. We look at external social factors including animal welfare in the supply chain, consumer protection and stakeholder opposition, where companies should ensure that indigenous people are informed and able to participate in consultations regarding commercial activity on their land. Enforcing product safety is also a social factor.

**G for Governance**

The governance factor is one of the easiest to assess as it is more measurable in data terms than the other two factors. It is very easy to see how many members of the Board there are and assess that Board’s diversity. It is simple to find out how many years the auditor has been in place and check for meeting attendance. Comparisons across companies and sectors are straightforward with numerical data.

However, there are nuances. The UK introduced a Corporate Governance Code in 1992… the first in the world. One element is the observation that CEO duality (the CEO and the Board Chairperson as a single role) is not desirable. It operates a “comply or explain” model so you can easily see areas of non-compliance in an annual report. The US is the only major market without a corporate governance code.

Other countries and regions have different policies and attitudes. A single tier board is the norm in the UK, US, Japan and France. But the US and France often have CEO duality. Japan usually has only one non-executive on the board and they are often not independent. There is typically a two tier board structure in Germany, the Netherlands, Scandinavia and China involving a supervisory board with all board members as non-executives overseeing a management board.

Audit is a key governance area but awareness of the limitations is important. Auditors only check and assure the financial statements. They do not check every line. It’s a sampling approach and there are likely to be further improvements via technology and developments in artificial intelligence (AI).
ESG in Courtiers Funds

Environment examples: Pollution / Waste Management / Climate Change

Courtiers has held exposure to infrastructure assets since 2011. For the infrastructure assets we hold (bridges, roads, schools, hospitals) there is an ESG report for each one. Each asset is different, so there may be a focus on a particular factor or an improvement in a certain area. An example of action to improve the environmental impact of these infrastructure assets includes the rollout of LED lighting on roads and in hospitals and schools. Social action examples include afterhours community services at school and hospital sites.

The bridge image above is Kicking Horse Canyon in Canada. On this particular project, there is a “no idling” policy for staff and sub-contactors, where limiters shut off engines in the maintenance vehicles after three minutes of idling. The project has also reduced its use of salt for de-icing as it is a water pollutant with much of the salt wasted. Using a calcium chloride brine solution limits water pollution. Asphalt recycling is also used to minimise asphalt waste. The recycled asphalt is included in the fresh asphalt and also in the sub-base layers underneath.

We bought shares in Drax in 2019 (the Drax Power Station in Yorkshire is pictured) and still hold the position. Drax Power station uses biomass for 2/3rds of its input. It is the UK’s 4th largest power generator and supplies 5% of the UK’s electricity needs and 12% of the UK’s total renewable power. Drax also owns two hydroelectric assets in Scotland, and has launched a Carbon Capture project. It aims to be carbon negative by 2030 and plans to convert its remaining coal units to biomass at Drax Power Station.

Social example: Animal Welfare

We have been doing this sort of analysis for some time. In 2015 we engaged with Cranswick, the 3rd largest supplier of pork in the UK. It has its own brand products (Simply Sausages) and also supplies pork for the Duchy Originals and Sainsbury’s Taste the Difference sausages. In 2012, instances of animal cruelty were exposed at a farm that supplies Cranswick with pork. Considering its proven strong animal welfare policy, we engaged with Cranswick over the incident. Five employees involved were suspended as Cranswick engaged with its supply chain.

We are happy to engage with companies and will do so when appropriate. We felt comfortable enough to invest initially with Cranswick and invested for a couple more years following our engagement. We sold our position in December 2017 after Cranswick exhibited more growth than value characteristics.
Governance example: Ralph Lauren

In 2017 we sold our holding in Ralph Lauren from our Global (ex-UK) Equity Income Fund over governance concerns. We had held it since 2015. The share structure means that shareholders had no meaningful voting rights, holding A shares. The Class B shares were held entirely by the Ralph Lauren family and carry 10 x the rights of Class A shares. This in itself was a negative factor which existed when we bought the original position and we were aware of it. However, two years later there was another governance issue surrounding the succession plan for the business. Ralph Lauren was then 77 years old and the new CEO had left the business after only 18 months due to “creative differences”. The long-time collaborator of Ralph Lauren had also left, supposedly to retire but actually ended up at a major competitor. The concerns over management were building and these two governance factors combined were sufficient to trigger our sale.

We look at all factors when we analyse a company and continue to monitor these if we choose to invest, engaging whenever we feel appropriate. Factors include environmental, social and governance. We can then form our decision in conjunction with price, value characteristics, geography, existing asset allocation, trends and themes.

Sometimes, concerns over one factor will be sufficient for us to exit a position. We may engage if we wish to remain shareholders. Sometimes we just don’t buy. When factors remain positive, we may hold our position for many years.

ESG analysis is part of our process, but it doesn’t result in broad exclusions. We believe that an awareness of all factors associated with the companies we invest in is important, and will seek to engage whenever appropriate. In addition, we always vote at the shareholder meetings. So we do not simply invest and focus on other businesses. We remain focused on maintaining our levels of satisfaction and make sure if there’s an opportunity to speak, we are heard. Or, if we feel the need to be heard, we seek to ensure there is an opportunity.

The evolution of integrating ESG factors into investment decision-making is work in progress across our industry. To us it points to greater awareness, greater transparency and a general desire to do good for the world we live in. Courtiers continues to engage and evolve with ESG.

Caroline Shaw CFA
Head of Fund & Asset Management

Past performance is not a guide for future returns. The value of your investments and any income you take from it may fall as well as rise and is not guaranteed. You might get back less than you invest. Further details of the risks associated with investing in Courtiers funds can be found in the Key Investor Information Document or Prospectus, copies of which are available on request or at www.courtiers.co.uk.

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