Sustainability: An Opportunity To Attract Better Long Term Investors

Flora RENCZ, Sustainability Analyst at World Benchmarking Alliance
Andrea WEBSTER, Finance Lead at World Benchmarking Alliance, Senior Advisor at SustainFinance

Navigating a path to thriving in a changing landscape

Sustainability efforts within companies are currently focused on reporting. While good and transparent sustainability reporting is crucial, this is only a baseline. Upcoming regulation and evolving institutional investors' expectations will create a fundamental shift in capital towards sustainable business models, and those businesses with strong sustainability competencies embedded into companies; from board level governance down to operations and materials. Companies who understand this now will thrive in this new landscape.

In this article we lay out what companies need to know about upcoming regulations as well as what pressures institutional investors face from both regulators and their clients. If companies learn to navigate this, they can deepen their relationships with institutional investors.

The investor perspective

Institutional investors naturally want to ensure that their portfolio companies have strong governance structures. This encompasses corporate strategy, financial structures, executive compensation and risk management. However, there is a growing awareness that governance extends beyond these traditional aspects. Practices such as sustainability oversight and board diversity are now recognised as important components of strong governance, indeed these are increasingly demanded of financial institutions themselves.

This shift in perspective has been driven by the trend of investors choosing engagement over divestment, utilising tools like proxy voting and private channels to influence portfolio companies.

As a result, financial institutions will increasingly seek to invest in companies that not only demonstrate a commitment to sustainability but also have robust systems and practices in place to fulfill those commitments.

Shifting regulatory tides

The growing importance of sustainable business strategies and governance on both the investors' and investees' sides are strengthened by a regulatory push in several jurisdictions around the globe. While in recent years the corporate sustainability disclosure sphere has been dominated by voluntary memberships and pledges, after much discussion about their (in)effectiveness, the tides are now shifting.

The most significant legislation in the process is the European Union's (EU's) Corporate Sustainability Due Diligence Directive (CS3D). Expected to apply to over 17,000 companies, both within and outside the EU, CS3D would necessitate better management of environmental and human rights impacts both in value chains and financing activities. While the CS3D has not yet been formally finalised and adopted, in its current form it will require institutional investors to conduct environmental and human rights due diligence in their financing activities.

The Power of Engagement

In this new sustainability landscape, high quality and frequent engagement with investors, that moves beyond proxy voting, will be essential for corporates. But what does a good engagement process look like? Good engagement on sustainability topics is guided by a policy agreed by both parties which includes clear frameworks with success criteria.

Companies might find it useful to look at frameworks and guidance such as the UK Stewardship Code, the Principles for Responsible Investment's Investment and Stewardship Policy or the Global Investors for Sustainable Development Alliance's Sector-Specific SDG-related Metrics for Corporate Reporting.

These can provide guidance for companies about what to expect when engaging with investors.

Engagement does not necessarily mean resource-intensive one-on-one conversations. Initiatives like Climate Action 100+ (CA100+) exemplify investor-led efforts that engage high-emitting sectors to drive change on climate issues. The alliance includes 700 investors committed to engaging their portfolio companies not only on cutting emissions and improving climate-related disclosures but also on improving climate change governance. Recent research by the World Benchmarking Alliance (WBA) shows that out of the 400 largest and most influential financial institutions in the world 105 are CA100+ members.

Actions for Corporations

In terms of specific actions, firstly, corporations need to embrace and enhance the quality of their engagement with investors. Use well-defined policies and frameworks to help guide the engagement process, lean into it and help make practical suggestions for measurable success. Keep in mind that often those investors who are taking the time to engage with you and your business will more than likely be supportive long-term partners rather than short term profiteers.

Secondly, lean into the direction of travel and make sure your businesses are aligning with the demands of institutional shareholders. Look at your governance structure, elevate sustainability decision-making to the board level and up-skill your board if necessary. Look at tying performance indicators to renumeration. Tone from the top matters, both internally and externally.

The key point is to recognise this is the growing global trend and direction of travel. Those companies who embrace building sustainability into their business, beyond the reporting requirements, will have a head start in attracting long term investors.companies to change their behaviors, raise their awareness and cause the formation of governance resources to support them in this regard.