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Expanded scope for ESG Impact Ratings

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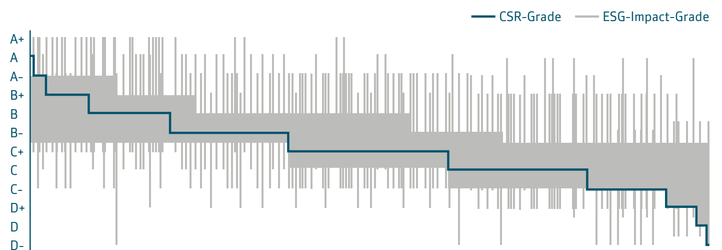
Current sustainability analyses of companies are mainly based on traditional ESG assessments, i.e. the assessments of CSR management. However, since most companies only cover parts of value chains, such analyses are not sufficient. An overarching ESG impact assessment for corporate investments requires the consideration of the entire value chain. This includes the impact evaluation of procurement, production, use and disposal of products and services. Such an assessment is based on the identification of economic activities that the company is engaged in, weighted by the respective shares of turnover generated therewith.

Companies operating in industries with high negative impacts are more likely to have highly professional CSR management systems. Accordingly, the impact of companies often deviates considerably from the quality of CSR management (see graph).

Recognizing the environmental and social impact along entire value chains allows investors to effectively contribute to sustainable development. It is also necessary to identify and manage transition-related technical, economic and legal risks and opportunities associated with these impacts.

ESG IMPACT VS. CSR ASSESSMENT: ASSESSED COMPANIES, SORTED BY ESG IMPACT GRADES FROM A+ TO D-.



Source: Inrate 2019

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ESG Impact on the performance of Factor Portfolios

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Most meta-studies conclude that ESG improves performance. However, we think that ESG represents a value per se and not necessarily a way to improve return. The value added goes beyond risk/return considerations. There are other more effective ways to improve performance compared to the benchmark.

We investigated several factor portfolios (Value, Quality, Momentum, Low Size, Minimum Variance) for the MSCI World Index over the period 02.2008–03.2020. We computed six versions: one without ESG restrictions and five with an ESG score 10%, 20%, 30%, 40% and 50% larger than the benchmark (BM). It is not possible to observe a systematic improvement in performance with ESG restrictions for the factor portfolios. For ESG score increases of up to 30%, the portfolios are barely affected (except for Size and Value). For a larger increase, we notice a convergence (lower dispersion) due to a strong contraction in degrees of freedom. Independent of ESG considerations, some factor strategies (Quality, Minimum Variance) are able to systematically improve return compared to the benchmark.