PwC's Global investor survey

The economic realities of ESG

December 2021

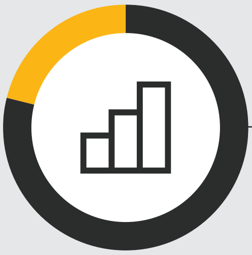
Investors are focused on how companies are managing environmental, social and governance (ESG) issues. Businesses need to pay attention and respond.

We surveyed 325 investors around the world, the majority of which were self-identified active asset managers making investments for the long term, and had in-depth conversations with 40 more. Here's what we learnt.

Priorities, progress and performance: Investors want companies to focus on the ESG issues that are most important to their business

ESG is becoming a critical component of investment decision making.

How a company manages ESG risks and opportunities is an important factor in my investment decision making



79% agree

I consider a company's exposure to ESG risks and opportunities when screening potential investment opportunities

76% agree

"People have been doing ESG long before it was called ESG. Many of these topics have been part of long-term investment thinking for quite a while, but perhaps haven't had that label.

Sustainable equities analyst

For ESG issues to be managed effectively, investors expect ESG to be a core part of a company's strategy.

Companies should embed ESG directly into their corporate strategy

82% agree

I'm more confident that companies are on top of ESG risks and opportunities if someone in the C-suite is accountable

66% agree

ESG performance measures and targets should be included in the executive pay arrangements

68% agree

Board directors are sufficiently knowledgeable about the ESG issues facing the company

54% agree

Investors think tone from the top is critical, and many told us that responsibility for ESG should lie with someone in the C-suite. They see executive pay as a lever to encourage sustainable change. Another element is the skill set and experience the board brings, and investors aren't confident that directors have the requisite knowledge about ESG issues. As one portfolio manager told us, **"When investor relations has no clue on ESG questions, and you ask the board and they also have no clue, that tells you the story."**

"ESG goals need to be tied to the compensation of top management. If management is sacrificing the long-term goals – for example, minimising capital investment today or minimising research and development – in order to maximise short-term returns, they should be penalised.

Wealth manager

Investors are clear that reducing greenhouse gas emissions should be the top ESG priority for business.

Top ESG issues in order of importance

Reducing Scope 1 and 2 GHG emissions	65%
Ensuring worker health and safety	44%
Improving workforce and executive diversity, equity and inclusion	37%
Addressing human rights in the supply chain	34%
Reducing Scope 3 GHG emissions	34%
Minimising data security and privacy risks	31%

Respondents were allowed to select up to five issues to prioritise

Investors understand that managing these issues comes at a cost, and think companies should make investments that address ESG issues relevant to their business, even if it reduces profits in the short term. And if done properly, this can be an investment in the future of the company that can be value enhancing.

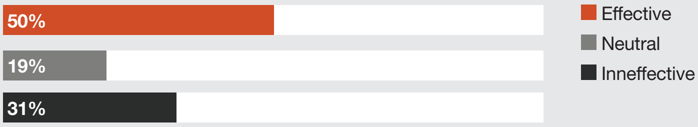
75%

of respondents agree that companies should address ESG issues even if doing so reduces short-term profitability

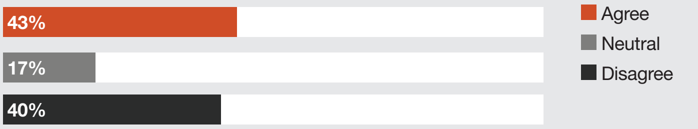
Seeking change: Investors want to play a part in incentivising companies to take action – while protecting their investment

Capital allocation can be a critical lever that can incentivise sustainable business practices and punish those that aren't undertaking them.

How effective is the investment profession currently at shifting capital to companies that are making progress towards net zero?



ESG investing should focus primarily on companies or assets that require the most change on their transition to become sustainable rather than those that already are



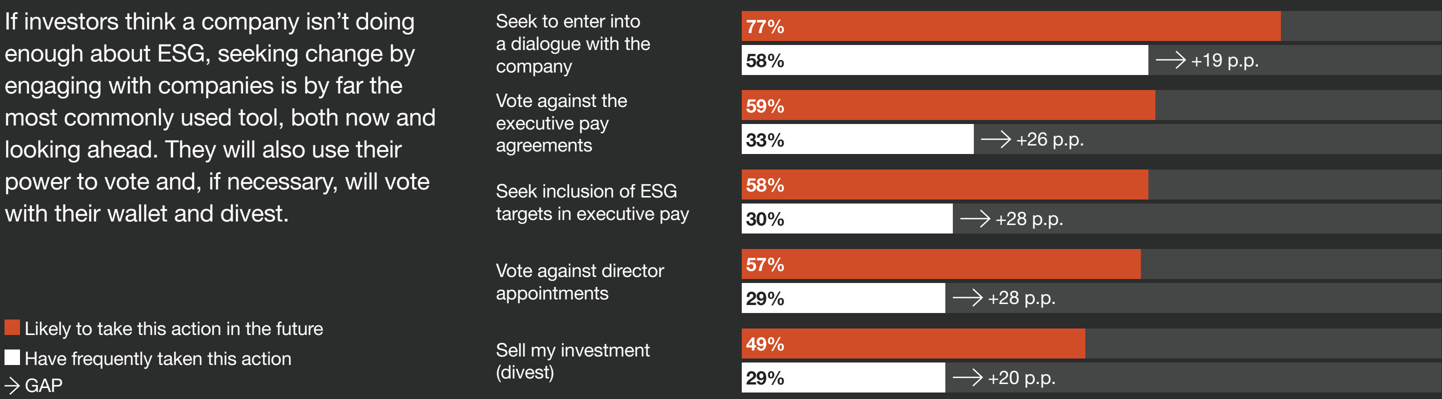
Asset managers are making a difficult decision every day: should they back only sustainable companies or direct capital towards and use their influence as shareholders with those that require the most change to become sustainable?

But investors are able to shift capital towards companies making progress towards achieving net zero only if they have the information they need at their disposal to inform their decisions.

> We actually work very hard to watch, try to understand, try to become active and engage on ESG issues and risks. For us that's a major part of stewardship.
>
> Portfolio manager

Investors will take action if they think a company is not doing enough to address ESG issues.

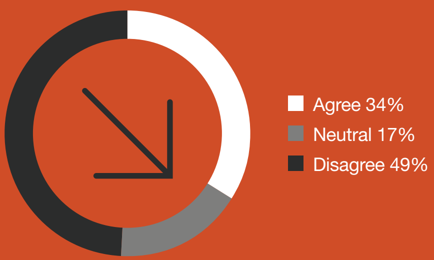
If investors think a company isn't doing enough about ESG, seeking change by engaging with companies is by far the most commonly used tool, both now and looking ahead. They will also use their power to vote and, if necessary, will vote with their wallet and divest.



The tradeoffs are real and managing investor expectations is critical.

Investors are torn between what they view as a responsibility to the planet and society and their fiduciary responsibilities to their clients. Although they said they think it is worth companies sacrificing short-term profitability to address ESG issues, they don't feel the same way about the impact such actions may have on their investment returns. Nearly half of respondents said they would not take any hit to returns. Most expressed reluctance to take a haircut exceeding 1 percentage point in the pursuit of ESG goals.

I would be willing to accept a lower rate of return on investment in a company that undertakes activities that have a beneficial impact on society or the environment



% of respondents either unwilling to accept a reduction in returns or would accept only a drop of 100bps or less

81%

To put it into context, losing 1% of the annual investment return on a portfolio of $100,000 invested in the S&P 500 over 10 years means that it would be worth about $22,600 – or 8.7% – less than it would have been otherwise. This is not a small sum of money, whether it's their own or belongs to their clients or beneficiaries.

> If you believe that the climate will have a long-term effect on the business then you understand the company is going to have to spend a little bit extra on it. And that's the gamble [for an investor]: if we sacrifice a little bit in the short term, will it pay off in the long term?
>
> Pension fund governance expert

Bringing investors along on the ESG journey: Investors have high expectations of reporting, but their information needs are not being met

Corporate reporting is the first port of call for investors trying to understand business performance and prospects – and the risks associated with them.

Most frequently used sources of ESG information

1. Annual report, sustainability report
2. Investor presentations, earnings calls
3. Third party data providers
4. Press releases
5. Analyst research reports

Investors look to companies to explain the meaning, relevance and effect of ESG issues on their business. If the market has the information it needs to factor into asset prices the expected payoff of a company's ESG investments, there shouldn't be a hit to returns – which means that investors don't have to sacrifice returns in an effort to do the 'right' thing.

> Companies need to play some role in educating the market on these issues, including why they are significant to the business.
>
> Investment consultant

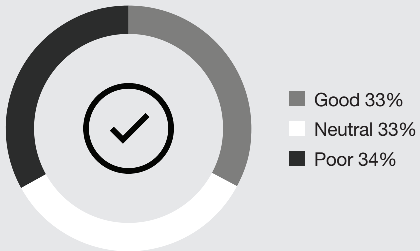
Top characteristics investors are looking for in ESG reporting

Characteristic	%
It explains the relevance of ESG factors to the company's business model	84%
It provides detailed information about progress towards ESG targets	83%
It explains the rationale for environmental commitments made and detailed plans for how to reach them	82%
It explains the governance over ESG risks and opportunities	79%
It describes the impact the business has on the environment or society	78%
It describes the impact the environment or society has on business performance	77%
It explains the rationale for social commitments made and detailed plans for how to reach them	76%
It shows a link between ESG risks and opportunities and financial performance	75%
It shows a link between ESG risks and opportunities and executive pay	66%

% of respondents who think this characteristic of reporting is important

Investors need information about how companies deal with governance and social issues. Not only is the quality of information lacking about companies' plans for reaching environmental and social commitments made and their progress towards ESG targets, investors even struggle to get good information on areas as fundamental as the relevance of ESG factors to the company's business model.

How would you describe the current quality of ESG reporting?



Based on the average response to a series of questions on ESG reporting quality

Investors are making a clear call for standardisation, comparability and consistency in reporting to help them do their job more effectively.

"In [making an] equity investment, it is important to make relative comparisons among securities. If comparisons are difficult, evaluations are difficult.

Senior equity research analyst

It is important that ESG reporting is prepared in accordance with a recognised non-financial reporting framework (e.g., SASB, TCFD, GRI)

73% agree

My investment decision-making would be better informed if companies applied a single set of ESG reporting standards (e.g., similar to IFRS for financial reporting)

74% agree

A company should prepare ESG reporting using a reporting framework in its entirety (where material), not a subset the company chooses

74% agree

ESG ratings also play a part in informing investment decisions.

I use ESG ratings and scores in screening potential investment opportunities

68% agree

While many investors rely on ESG ratings in their investment screening and their ongoing analysis, a significant minority place little trust the information they are getting.

To what extent does your investment analysis pertaining to ESG issues rely on external ESG ratings and scores?

Entirely	5%
Significant extent	25%
Some extent	37%
Minimal extent	27%
Not at all	6%

To what extent do you trust the ratings and scores provided by ESG ratings agencies?

Completely	4%
Significant extent	36%
Neither trust nor distrust	26%
Minimal extent	31%
Not at all	3%

"We know that the correlation between [ESG rating agency] provider scores is low... predominantly because they don't agree on how to measure outcomes, which is really where the rubber hits the road for sustainable investment.

What all this shows is the importance of investors doing their own work, owning the process yourself, and being ready to accept the nuances that are inherent in investing, dealing with uncertainty, and ultimately, taking your own view.

Sustainable equities analyst

Auditing in the spotlight: Investors have more confidence in the information they use when it has been independently assured

A fundamentally important quality of good reporting is its reliability.

Investors trust ESG information more when it has been assured. They value independent assurance on metrics and KPIs more than on narrative disclosures given investors' intense focus on numbers in their daily work. They also don't want companies to pick and choose the parts of reporting that they get assured.

I place more trust in the ESG information if it has been assured

79% agree

Companies should be required to obtain assurance on all material ESG information, not on a subset that the company chooses

70% agree

It is important that reported ESG information has been independently assured

ESG-related metrics

74% agree

ESG-related narrative disclosures

65% agree

Companies' disclosures of ESG information should be assured at the same level as a financial statement audit (i.e., reasonable assurance)

ESG-related metrics

73% agree

ESG-related narrative disclosures

70% agree

In our interviews, investors expressed uncertainty about whether it's evident which parts of reporting have been assured, let alone the type of assurance that has been provided. But they were clear: many prefer a reasonable assurance level – that is, the same as the financial statement audit – on company ESG reporting.

> In order to avoid an overexpectation by users about the assurance of ESG information, it may be necessary to educate and enlighten them about the scope, level and nature of assurance.
>
> Research analyst

Investors have high expectations of an organisation providing assurance on ESG reporting.

> Regulation of auditors helps with accountability. Otherwise, I have no one to make a complaint to if I think something's not right.
>
> Analyst

Investors expect assurers to have experience in applying assurance methodologies and standards, but that alone is not enough. They also prioritise assurers having appropriate quality management systems in place, as well as expertise in what's being assured. Also critical is having an ethical framework that reinforces the assurer's independence, integrity and objectivity.

The assurance work is conducted using a recognised assurance standard

82%

The firm has appropriate quality management systems in place

82%

The assurance work is conducted by a team that collectively has expertise in both providing assurance and the subject matter covered by the assurance

81%

The firm and its employees are subject to regulated ethical standards and independence requirements

80%

% of respondents who think these attributes of an assurance provider are important

Investors find value in assurance reports as a way find out if there is something they need to know.

I read them as a matter of course

20%

I read them if I have a specific interest or concern

26%

I skim them to see if there is something I should be aware of

36%

I never read them

18%

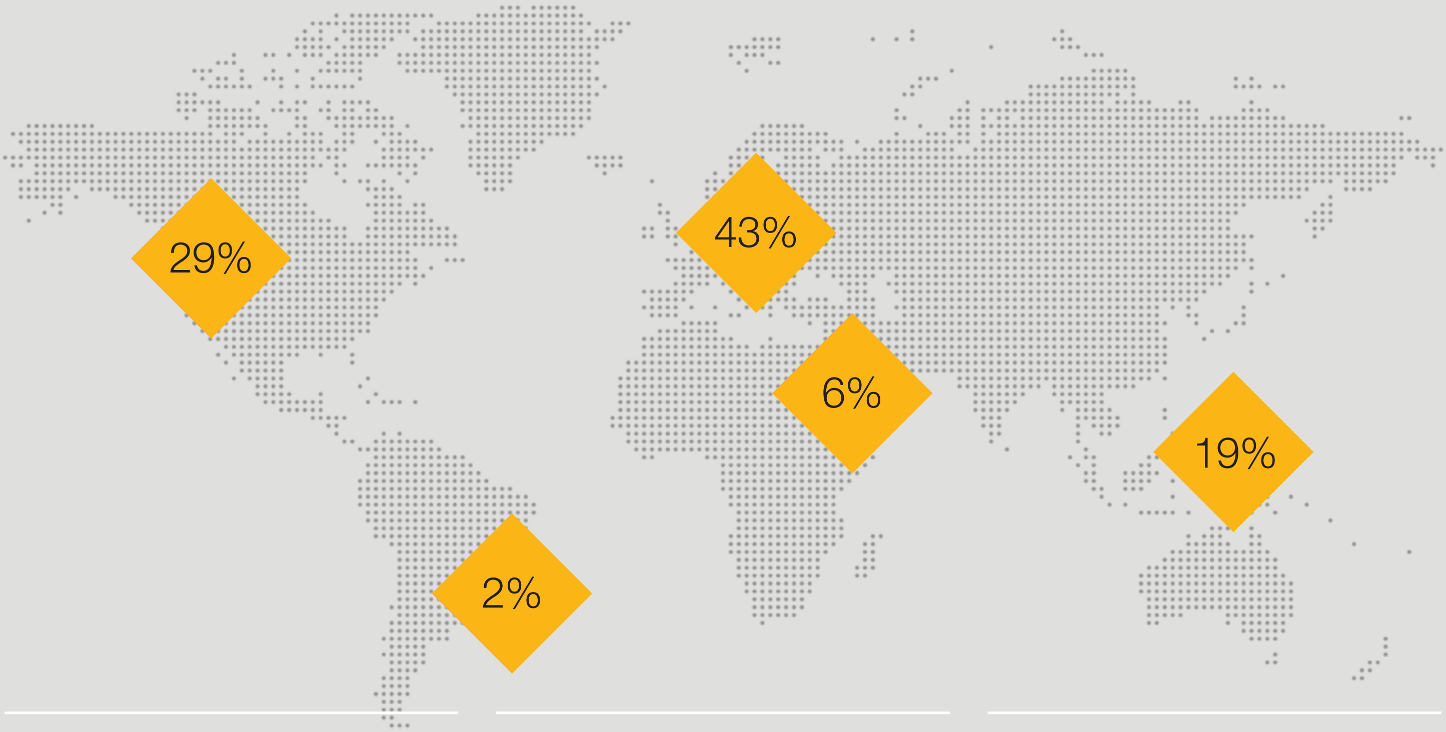
% of respondents indicating they read assurance reports for these reasons

Methodology

About our survey

In September 2021, PwC conducted an online survey in which we received responses from 325 investment professionals across 43 territories. We also conducted 40 in-depth interviews with investors and analysts in 11 territories who represent a combined assets under management (AUM) of more than US$14 trillion. The respondents to the online survey were spread across a range of industries, roles and specialisms. The online research was undertaken by PwC Research, our global centre of excellence for primary research and evidence-based consulting services. The in-depth interviews were conducted by partners and staff of PwC.

Respondent demographics



Asset classes

Publicly listed equity	75%
Fixed income	43%
Private equity	18%
Physical investments (e.g., infrastructure, real estate)	18%
Derivatives or other structured instruments	11%

Respondents were asked to indicate which asset class they focus on and could select more than one response

Equity investment horizon

Less than 2 years	13%
3–5 years	42%
More than 5 years	45%

Is your organisation a signatory of a responsible investing body or initiative (e.g., Principles for Responsible Investment)?

59% yes

Role

Asset manager	53%
Analyst	34%
Institutional asset owner	6%
Governance professional	3%
Retail investor	2%
Other	2%

Please note: throughout this document, due to rounding, percentages may not add exactly to 100%

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