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UNIVERSITÉ DE GENÈVE
GENEVA CENTRE FOR PHILANTHROPY

Philanthropy Lunch

ENGAGE OR EXCLUDE: WHAT IS THE BEST WAY TO ALIGN INVESTMENTS WITH MISSION?

Geneva, 22 February 2018

WELCOME

Prof. Henry Peter, Head, Geneva Centre for Philanthropy

PANEL

Vincent Kaufmann, Chief Executive Officer, Ethos Foundation and Ethos Services
Prof. Oğuzhan Karakaş, Senior Lecturer in Finance, Cambridge Judge Business School
Pascal Becker, Head of Sustainability, Givaudan
Moderated by **Prof. Luc Thévenoz**, Head, Centre de droit bancaire et financier, UNIGE

CONCLUSION

Prof. Luc Thévenoz, Head, Centre de droit bancaire et financier, UNIGE
Laetitia Gill, Executive Director, Geneva Centre for Philanthropy

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Professor Henry Peter introduced the second Philanthropy Lunch. Under the title "Mission alignment and performance optimization: how to square the circle", he provided an overview of the event and of its rationale.

He said that this Philanthropy Lunch is really a joint-venture between the GCP, Ethos and the University of Cambridge. The project started after it had appeared useful to make a deep dive into the concept known as "mission alignment", namely whether, in order to be consistent, philanthropic actors should mirror their mission in the way they are managing their assets. The answer should clearly be yes, but it necessarily raises a further question, namely whether this results in a suboptimal financial performance.

This is the reason why the Geneva Centre for Philanthropy decided to also look at the index which was launched in 2017 by Ethos (the Ethos Swiss Corporate Governance Index, ESCGI) which is a selection of listed companies chosen in view of the fact that they are behaving in accordance with certain environmental, social and good governance (ESG) benchmarks. Besides the interest of looking at this index per se, the question is whether its performance beats the Swiss Stock Exchange general index.

This, in turn, leads to look at whether or not ESG concerned investors should play an active – engaging – role as opposed to a simply passive one, or, alternatively, if they should rather exclude non-complying companies from their portfolio.

The findings seem to be that by investing and engaging in ESG compatible companies the performance which is obtained beats that resulting from an investment strategy reflecting the general index.

If this is true, the circle would have been squared: not only is it a logical and moral obligation to invest only in an ESG compatible manner, but it is also in the well understood financial interest of any organisation because it objectively produces better returns. Also, by exercising a reputational pressure on the listed companies, it produces a beneficial knock on effect, sometimes referred to as "delegated philanthropy" where the company acts as a channel for expressing the stakeholders' (e.g., customers) values.

This is at least the thesis or at least the hypothesis which will be discussed during this Philanthropy Lunch.

Prof. Peter then introduced the moderator for the panel, Prof. Luc Thévenoz, who introduced the first panel speaker, Vincent Kaufmann, the CEO of Ethos Foundation and Ethos Services.

After providing a brief overview of Ethos, its key services, and underlying principles, Mr. Kaufmann began to discuss the main topic of his presentation, which focused on the role of an organization such as Ethos as an ethical investor. This is achieved in one of two ways – 1) being an "active investor", both before and after the investment decision, and 2) designing investment vehicles that are ethically responsible through exclusion and ESG integration. In light of the expansion of passive investment solution, Ethos has developed two specific indexes, one for the international equities and another one for Swiss equities. Both Ethos' indexes take underlying indices (particularly the MSCI World Index and the Swiss Performance Index), and adjust the weight of the constituents by removing companies that are active in undesirable activities (such as adult entertainment, coal, tobacco, or simply those that have poor governance practices). In recent months, both indexes have been performing at least as well with the underlying market indices. To close his presentation, Mr. Kaufmann stated that these indexes are driven largely by the values of their investors, a point which he highlighted periodically throughout the moderated Q&A session as well.

After Mr. Kaufmann, Prof. Thévenoz introduced Prof. Oğuzhan Karakaş, Senior Lecturer in Finance, Cambridge Judge Business School. While the previous presentation focused on exclusion to drive investment strategies, Prof. Karakaş focused on the role of engagement by discussing the results of the two academic studies he has conducted with Prof. Elroy Dimson at CJBS and Prof. Xi Li at LSE. Both studies analyze the shareholder engagements of companies, on Environmental, Social and Governance (ESG) issues. In particular, determinants of targeting and of successfully adopting the engagement recommendations, together with whether successful compliance with the recommendations contributes to market performance, are studied. The first study, titled Active Ownership, found that companies for which success was achieved (18% of the sample) experienced high returns and created greater shareholder value, particularly for companies that have high market capitalization and reputational concerns. The study also documents that collaboration among active investors yields more effective engagements through more credible voice. In the second study, titled Coordinated Engagements, Prof. Karakaş and his co-authors focus more on the collaborative/coordinated aspect of the ESG engagements, and find that successful coordinated engagements have the following features: 1) a lead investor who is local, 2) large institutional investors to drive change, and 3) an investor mix that included foreign and domestic investors.

In the subsequent Q&A session, Prof. Karakaş also discussed the complexity of the ESG movement, speaking first to some of the difficulties involved in defining/measuring the "success" in ESG engagements, particularly for engagements in social issues (relative to environmental issues, which are often more concrete).

Importantly, he also drew on historical experiences to discuss that this complexity is deep-rooted, particularly as it comes to the role of Corporate Social Responsibility (CSR) in the marketplace. While previously viewed by managers, at best, as a secondary consideration to the ultimate goal of maximizing shareholder value (and in direct contradiction to the basis for capitalism), this has started to change in recent years. This change has been driven by several mechanisms, for example: 1) "doing well by doing good": the idea that ESG can signal a better governance, lead to innovation to drive value, cause long-term stability (which can reduce volatility and in turn the cost of capital, leading to greater investment opportunities), and 2) the concept of "delegated philanthropy", which refers to the firm acting as a channel for expressing the stakeholders' (e.g., customers') values – in other words, it refers to firms' engaging in philanthropy on behalf of and at demand of their stakeholders.

The third and final panel speaker was Mr. Pascal Becker, Head of Sustainability at Givaudan. Mr. Becker began with a question – how can you run a profitable company while addressing the broader expectations from global stakeholders? He followed this with several examples of key ESG challenges facing a company such as Givaudan, and how the company is working with societies, farmers, and families to address them. These examples were meant to illustrate how Givaudan has designed its sustainability program to be a key part of its overall corporate strategy – a business-driven, long-term focused approach to sustainability and ESG. Most importantly, he noted that such a sustainability approach has come hand in hand with strong and stable financial performance, indicating that the two are not at odds with one another. Mr. Becker ended his presentation by contemplating whether companies are successful because they invest in sustainability, or whether they invest in sustainability because they are successful, ultimately concluding that this is likely a complex issue that is likely driven by both sides. In the subsequent Q&A session, Mr. Becker also pointed out that sustainability truly is a long-term business decision – operating a business sustainably forces managers to think, optimize, and constantly innovate, which drives value not only socially, but also financially.

After the panel presentations and Q&A session, Prof. Thévenoz thanked everyone and provided some final thoughts. He questioned whether it is adequate for an ESG-responsible investor to benchmark the performance of its portfolio against the general performance of the markets. He noted that most philanthropic institutions do not have the size and resources to directly engage with companies in which they are invested nor to assess how effectively their asset managers do. The expanding offer of ESG products and investment solutions is very positive but creates its own challenges. Assessing the real "sustainability" of the many products on offer remains difficult. There is also a risk that the marketing of ESG products distracts philanthropies from paying enough attention to the total costs incurred by their portfolio.

The lunch was concluded by Laetitia Gill, Executive Director of the Geneva Centre for Philanthropy, who provided a brief overview of the Centre, its three-pronged interdisciplinary model (based on teaching, research, and events), as well as a summary of some of the upcoming activities that will be offered by the Centre in the coming months. These can be found on the organization's website at unige.ch/philanthropie which will continue to be updated as more information becomes available.