Finance and investment impact, and its relationship with ESG

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ESG stands for Environmental, Social, and Governance (ESG), referring to three central factors in measuring business sustainability as well as environmental and societal impact of an enterprise and investment in a business or project. ESG factors are becoming key criteria in determining the future of financing and capital raising as well as financial performance of enterprises (i.e., return and risk). Historically, decisions of where investment in financial assets would be placed were based on financial returns, but in these past few years this has changed significantly.

The current trend is that there has been a new form of pressure applied by political activists, environmental groups, social activists, and those who promote good corporate governance leveraging the power of their collectiveness to sensitize investors and financiers and encourage companies and financial markets to incorporate environmental, social and governance challenges into their strategic and operational decision-making.

It is from such kind of initiatives that the United Nations Sustainable Stock Exchanges (UN-SSE) came about, which is a peer-to-peer learning platform for exploring how exchanges, regulators and companies can enhance corporate transparency on performance on ESG issues while also encouraging sustainable investments.

The UN-SSE, to which the Dar es Salaam Stock Exchange (DSE) is a partner exchange, is overseen by UNCTAD, UN-Global Compact, the United Nations Environment Programme Finance Initiative (UNEP FI) and the Principles for Responsible Investment (PRI).

In a larger context, these sensitivities inform us that unless concrete actions and measures are taken, we may be headed to the wrong end – as a humanity.

From the environmental perspective – threat of climate change and depletion of resources has grown; many investors are now making clear decisions as to which factors of sustainability issues should go into their investment choices.

The issues often represent externalities, such as influences on the functioning and revenues of the company that are not exclusively affected by market mechanisms. As with all areas of ESG, the breadth of possible concerns is vast (e.g., Green House Gases emissions, biodiversity, waste management, water management, etc).

In these past few months, we have observed on what has happened with the fires in Amazon, California, Australia and then of course the melting glaciers of Mount Kilimanjaro – not a good sign at all.

On the social aspect, investors and financiers' concerns are on the level of diversity and inclusion in companies' governance bodies, and in recruitment policies.

There is a growing understanding that the broader the pool of talent open to an employer the greater the chance of finding the optimum person for the job. Innovation and agility are also seen as the great benefits of diversity.

And of course, there also issues of human rights, child labor, and consumer protection. Investors are becoming even more keen on these issues prior to making their investment and financing choices.

On the corporate governance, concerns are on the rights and responsibilities of the governance and management of a company—its shareholders, its board of directors and the various stakeholders in that company.

There are also matters of management structures, executive and employees' compensations as well as employees' relationships.

As matters stands, the three domains of social, environmental, and corporate governance are

intimately linked to the concept of responsible investment (RI). RI began as a niche within the investment area, serving the needs of those who wished to invest but wanted to do so within ethically defined parameters.

But, in recent years it has become a much larger proportion of the investment market and decisions. Such that, we are now experiencing situations where global investors in DSE demand that listed companies produces ESG Reporting (in addition to financial reports), which forms a core part of their investment decision process.

In this aspect, we, as exchanges are expected to play a major role in supporting enhanced disclosures on ESG practices by listed companies.

Now, this conversation doesn't end on how exchanges facilitate capital raising from "responsible investors" – it also involves financiers such as banks and financial institutions and how they relate to who they finance but also how they raise their finances – i.e., banks are now encouraged to issue green bonds and social sustainability bonds from the capital markets to finance environmentally friendly projects or those with positive social impact. As it were, the financial system includes commercial banks, insurance, capital markets, standard setters, sector regulators, etc. These market players and regulators plays a pivotal role in capital allocation, managing risks and mobilising savings and investments.

However, the financial system is dependent on other sectors of the economy.

For instance, the bulk of companies listed on the DSE consist of commercial banks which majorly lend to agriculture, real estates, manufacturing, tourism, mining, and transportation sector. The inter-dependence of financial system on these sectors puts the stability of the entire financial system at risk due to credit risk exposure and systemic risk arising out of the effect of climate change, social irresponsibility, or poor corporate governance behaviours.

The shift of mindset, raising awareness and being conscious on ESG issues and how they impact investment and finance is a matter of necessity.

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