Behind the numbers

Statistics can obscure as much as they illuminate. **Ivo Knoepfel** and **Gordon Hagart** caution that the rash of numbers showing the growth of socially responsible and sustainable investments should be treated with caution

We live in a world in which media reporting of headline statistics and indicators has a big impact on how we perceive reality. Recent data detailing the impressive growth of socially responsible and sustainable investments (SRI) in different regions of the world (see *Environmental Finance*, April 2008, page 4) are attracting interest from journalists, investors and financial services providers who had previously been indifferent to such investment styles.

Our own interest in these statistics is not merely academic – our company produces a regular study of the Swiss SRI market[1]. This personal experience convinces us of the need to take a critical look behind the numbers in order not to jump to simple conclusions.

First of all, we must be aware that SRI market reports focus on specialist investment styles where social responsibility or sustainability is an explicit part of the investment strategy. They therefore generally do not capture the extent to which environmental, social and governance (ESG) issues are being used to manage 'mainstream' assets (nor would it be easy to quantify this trend). That is why we think that SRI market reports can lead to observers underestimating the importance of ESG issues to investors and the speed at which they are being taken up by market participants. This is important because ESG sceptics often use the fact that SRI investments are only a small percentage of the total market as proof of the limited importance of ESG issues to investors.

In addition, most SRI market surveys focus on funds managed by the asset management industry, without including assets managed in-house at large institutional investors, such as pension funds. Indeed, probably only a part of the more than $13 trillion owned or managed by the signatories of the UN-backed Principles for Responsible Investment (and therefore having committed to integrating ESG issues in their investments) are captured by SRI market statistics.

Another open issue is how market surveys should treat the growing volume of investments geared to environmental and social themes such as clean technologies, climate change, water, healthy living, etc. A large number of funds and mandates dedicated to such themes have come on line in the last year, and we believe their volume will continue to increase.

Theme funds (and the indexes on which they are sometimes based) often focus on the revenue exposure of companies to the themes, without including an additional analysis of the companies' own ESG performance. The European (Eurosif[2]) and Swiss SRI market statistics require such an additional analysis – showing that fund managers apply ESG criteria – for funds or mandates to be included.

Depending on one's viewpoint, this can be seen as understating the full extent of the market's interest in sustainable themes. In Switzerland, for example, it was shown that only about 45% of themed investments also apply an ESG analysis of the companies themselves. This share may be lower still in other countries. How to deal with theme funds in the context of SRI market statistics is particularly important given the observed trend in some countries (eg, Switzerland, as shown by our latest market study) for institutional and private investors to replace broad-based SRI strategies with ESG theme funds. The growing interest of the private banking industry and its clients in ESG themes also seems to point toward a larger share of themed investments compared to broad-based SRI strategies.

Finally, we also need to take a look at the potential risks of overestimating the success of SRI. We must be aware of the fact that by far the largest part of SRI investments are in equities (in Europe typically between 80% and 90%). It is therefore misleading to compare the growth of SRI markets with the growth of total managed assets in a country (which includes a large share of lower-growth fixed income assets).

For example, in its latest report[3] on SRI trends in the US, the Social Investment Forum reported a growth in SRI assets of 18% between the end of 2004 and the end of 2006. In the same period, the total return (ie, dividends reinvested) of the S&P 500 and MSCI World in dollar terms were 21% and 33% respectively. If we assume that the US study assets are equity-dominated, and that their financial performance on average was in line with broad-based equity benchmarks, then we see that the growth of 18% probably doesn't point to great net inflows to SRI once it is normalised for the performance component.

In conclusion, we see a risk in focusing the public attention on single measures such as specialist SRI market growth. When market downturns or other external factors such as currency swings inevitably arrive, the trend can suddenly reverse, leaving investors confused and disillusioned. We also think that public opinion and policy-makers are interested in knowing the full extent of the growing interest of investors in ESG issues. In that sense, we also need measures for the growth of investments in sustainable themes and for approaches aimed at integrating ESG issues in mainstream investments – a challenge that we hope organisations such as the social investment forums and the Principles for Responsible Investment will take on. EF

Ivo Knoepfel (right) is managing director and Gordon Hagart is senior consultant at onValues, a Switzerland-based investment consultancy.
E-mail: info@onvalues.ch

1 *Sustainable Investments in Switzerland 2007*. See www.onvalues.ch/e/News.html

2 *2006 European SRI Study*. See www.eurosif.org/publications

3 *2007 Trends Report*. See www.socialinvest.org/resources/research