What are ESGs? What does ESG mean?

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What is ESG?

Environmental, social, and governance (ESG) have become focal points for companies, analysts, and investors. The evolution of ESG has created a growing awareness among the public about how companies formulate criteria for socially conscious decisions.

For decades, analysts and financial advisors determined how well companies were performing by their earnings and revenue growth. ESG now injects a more subjective, non-traditional metric into how well companies are being managed for the future impact of the environment and social consciousness.

Recent global events including the invasion of Ukraine by Russia and global warming trends have compelled governments in Europe, Asia, and the U.S. to re-examine their energy initiatives as well as mandates for corporations. Companies today are starting to be measured by how well they apply ESG formats and follow their success. As a result, asset managers, mutual funds, ETFs, and advisors are introducing portfolios and screening methods that identify which companies are implementing and adhering to ESG guidelines.

Understanding the dynamics behind Environmental, Social, and Governance (ESG) can be complex at times, as guidelines and parameters evolve throughout the industry. As a recent form of identifying and recognizing companies based on specific characteristics, ESG is becoming broadly accepted as its understanding takes hold. ESG is considered a financial philosophy where investors inspect these non-traditional aspects of companies, in addition to traditional formats of analyzing companies. The most prolific of these is Environmental, with more and more retail and institutional investors becoming concerned with the effects a company has had on the world around us.

Environmental

ESG considers the environmental side of a company, evaluating the effects the company at hand has on the natural environment around it. For example, one may consider the company's role in climate change, deforestation, energy efficiency, or waste. With a rise and the expectation of continuing “green” legislation around the world, many companies are adhering to environmentally friendly solutions in order to comply with ESG.

As far as the environmental aspect is concerned, it has become widespread for corporations to shift away from fossil fuels and toward new green energy. A prime example sits in the automotive industry, with many companies committing to transitioning their lineups away from gas engines and toward electric vehicles. Renewable energy is also becoming increasingly popular, with companies focused on the growth of electric, solar, wind, and other renewable energy forms. Even in oil and gas, a trend has emerged in which companies purchase carbon offsets, significantly increase the safety standards of their operations, and even put money toward innovation away from fossil fuels (for example, many oil and gas companies have hydrogen or biofuels as a large part of R&D).

Social

The ESG strategy will also consider the social aspects of the company, which encapsulate the company’s treatment of customers, employees, and the communities in which they reside. To effectively evaluate these aspects, one can look through how the company ranks in regard to work-life balance, high customer satisfaction, high labor standards, and customer service.

Companies have also continued to increase their focus on employee standards and customer service, finding these key ways to draw in investors and raise satisfaction with their products. ESG may soon guide the decisions of many more corporations who look to draw in more progressive-minded, generally younger, investors.

Governance

ESG also considers governance. While many investors of all kinds may look for Environmental and Social as key qualifications for an investment, Governance is the most important item for shareholders whether they realize it or not. Governance encompasses a wide range of company operations but focuses around accountable and transparent standards to make sure that a company can create long-term gain for all shareholders.

Governance standards help to ensure that there is a transparent and clear framework for managers to run the company, board members to oversee the company, and shareholders to own the company. Some key factors to consider include a staggered board tenure to ensure the turnover is not concentrated at one time, a minimal amount of super-voting shares (shares with more than 1 vote per share usually given to founders), or fair executive compensation packages that attract and retain talent without placing an undue burden on the company's financials or increasing risk.

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