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Sustainable Perspectives

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Mick and Bertie explain why they view ESG as more than a fad, and the importance of ESG in their Global Leaders Strategy



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Environmental, social and governance (ESG) considerations are being increasingly embraced by investors around the world. The concept of ESG, or sustainable investing, manifests in many ways in our industry, and we are hopeful that capital will continue to flow into shining examples of corporate citizenship.

To us, corporate sustainability is more than a fad—it is primarily good business sense that goes hand-in-hand with value creation. As such, ESG research is an essential part of our Global Leaders investment strategy. It helps us to make intelligent choices about investments and to engage with company management teams on a wide variety of important topics that may affect their long-term prospects.

PHILOSOPHY AND APPROACH

We are long-term investors, and in our management of the Global Leaders strategy, we focus intently on companies that we believe create exceptional customer outcomes as a driver of long-term value creation. In an ideal world, we would never sell any of our investments, and we would be able to allow each franchise that we own to compound forward for decades.

Unfortunately, capitalism can create an unbridled fixation on profits, and on short-term profits in particular. Companies and investors with a short-term mindset might ignore ESG issues and create significant business risks. We do not believe it is possible for a company to create value over the long term if it is damaging the environment or society with poor governance that fosters egregious and reckless behaviour. In the U.K., BP's 2010 Macondo oil spill disaster and Sports Direct's exploitative employment practices are examples of when environmental and social issues undermine a franchise's ability to generate long-term cash flow.

Accordingly, the consideration of ESG issues is a matter of perspective, and how one views these issues often has a great deal to do with one's investment timeframe. For example, we take a very dim view of companies that do actual damage to their customers. For this reason, the Global Leaders strategy has never invested in

tobacco companies, despite the fact that the addictive nature of nicotine has fostered powerful economic engines in many cases. Over the very long term, we believe tobacco companies will shrink out of existence as they continue to harm their customers. It is all a matter of perspective—the core of sustainable investing is sustainable value creation.

ESG research can do more than help us avoid bad investments—it can also help us find good ones. We look for companies that have “sustainable business advantages” (SBA)—in other words, companies that incorporate sustainability into their business in a way that can add real value for customers and shareholders, in the form of revenue growth, cost improvement or enhanced franchise value. To be compelling to us, a company's SBA needs to have a material impact on the business—for example, an increasing percentage of a company's overall revenue is driven by a product line that helps customers save energy. It also needs to be differentiated, meaning that the company is delivering something over and above its industry peers. For a number of our portfolio companies, a key part of our investment thesis is a specific SBA that, in our view, passes these materiality and differentiation tests.

To us, the ESG movement in investing is a breath of fresh air and makes perfect business sense. Indeed, we view it as a positive step towards long-term investment thinking, and a great improvement over the fishbowl myopia that still afflicts most short-term investors.

FINDING WINNERS

Our investment process centres on finding “win-win” relationships between the customer and the company, whereby the customer gets something special from the company and the company is rewarded with outstanding economics. Embedding ESG considerations into our investment analysis not only helps to shield our clients from business risks that can easily be ignored in the capitalist pursuit of profits, but also helps us invest in companies where we see the potential for a triple win—for the customer, the company and society or the environment.

Microsoft is a case in point. The firm's Azure cloud-computing solution frees customers

“Sustainable investing is more than a fad—it is a welcome recalibration of perspective, from a short-term fixation on profits to a long-term view of value creation.”

and developers from intense management of on-premise hardware and software, and helps them drastically reduce energy usage. The company's legacy operating systems and software businesses are stable, but this cloud-computing business is growing quickly and has become a powerful growth driver for the firm overall. Lastly Microsoft has been a 100% carbon-neutral operation since 2012, which we believe creates a clear "win-win-win."

We also like the way Indonesia's Bank Rakyat has found innovative ways to tap into non-traditional growth drivers. Founded in 1896, Bank Rakyat has been partially government-owned since Indonesia's independence in 1950 and has played a critical role in promoting the government's social agenda by advancing subsidized credit for rural enterprises. Indonesia has very low levels of financial services penetration, and thus its rural population is largely unbanked, with no real access to the modern financial sector except through microlending. Bank Rakyat is a crucial lender to the informal economy in these rural regions and leads the Indonesian microfinance market. Through this important role, the company has been rewarded with approximately a 22% return on equity over the past five calendar years (2014-2018). Its rural credit infrastructure, combined with a community-based

approach to lending, has created a difficult-to-replicate formula with low levels (2%) of non-performing loans, that in our view has led to a wide competitive moat. We believe that these are clear wins for society, the customer and the business and we believe that Bank Rakyat is well positioned to produce long-term growth for our clients.

SUSTAINABLE INVESTING IS SMART INVESTING

When companies are smart about ESG, we believe it can help them on "defense" as well as on "offense"—in other words, we are mindful of the way companies are managing ESG risks effectively, capitalizing on sustainable business opportunities, or both. We believe that more investors are coming to view ESG from this perspective, and we see this as a maturation of sustainable investing towards a more holistic and intelligent conception of positive capitalism.

To us, sustainable investing is far more than a fad—it is a welcome recalibration of perspectives that is here to stay. However the field of ESG research evolves in the years to come, we are confident that it is adding value to our investment decisions today. [B](#)

Microsoft

INDUSTRY:

Information Technology

IMPACT THEME:

Sustainable Technology Innovation

SBA:

Revenue Growth; Enhanced Franchise Value

For most of its history, Microsoft has been a nearly universal presence in most of our lives. The company's legacy operating systems and software businesses are stable, while its cloud-computing business is growing quickly and has become a powerful growth driver for the firm overall. Microsoft's Azure cloud-computing solution frees customers and developers from intense management of on-premise hardware and software,

and helps them drastically reduce energy usage. According to the company, moving enterprise workloads from client-side infrastructure to the Azure cloud reduces a customer's energy usage by at least 90% for small deployments, 80% for medium deployments and 50% for large deployments. Microsoft has also been a 100% carbon-neutral operation since 2012, thanks to ongoing energy and emission reduction efforts as well as the

50–90%

Microsoft states that its Azure cloud-computing platform reduced energy usage for large client deployments by up to 50% and by up to 90% for smaller deployments.

implementation of its own innovative carbon fee. Microsoft charges each business unit an internal tax based on estimated energy usage, carbon emissions and prevailing electricity prices. The fees go into a common fund that invests in environmental sustainability/efficiency improvement projects. The initiative currently generates about \$10 million in cost savings per year, and the company expects this to ramp up in the future as improvements stack up over time. The carbon fee has been instrumental in spreading sustainability across the company and embedding sustainable thinking into Microsoft's corporate culture.

Source: Microsoft.



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