

# Book Review

## Investing in a Sustainable World

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According to a study reported in the April 2009 *Journal of Financial Planning*, many investors are interested in “going green” when it comes to selecting their investments. Allianz Capital, a leading global investment firm, found that 64% of surveyed investors considered the environment as the most desirable investment opportunity among 10 investment categories surveyed. The survey also reported a 30% increase in the number of investors who have made environmentally-oriented investments. However, more than two of three (68%) respondents indicated that they would need to consult someone in the financial services industry for help with environmental investing decisions.

What about investors who want to purchase environment-related investments but lack a financial advisor? Enter *Investing in a Sustainable World*, an extensively well-researched and clearly written 300-page book that explores this topic from every conceivable angle. The author, Matthew Kiernan, is founder and Chief Executive of Innovest Strategic Value Advisors, Inc., the top-ranked sustainability investment research firm in the world. Dr. Kiernan previously served as Director of the World Business Council for Sustainable Development and has spoken several times at the prestigious World Economic Forum in Davos, Switzerland. In the book’s introduction, he introduces readers to environmental and social (ES) or “sustainable” investing, noting that ES factors are “absolutely and increasingly critical to the competitiveness and financial performance of both individual companies and the broader economies and societies in which they operate.” Kiernan also describes six “fundamental truths” about ES investing and provides a roadmap to the book.

Chapter 1, “Welcome to the Sustainable Investment Revolution!,” begins with encouraging news for ES investors: major Wall Street investment banks (many of which subsequently collapsed or were merged out of existence as the book was in press) were starting to write reports about climate change, water scarcity, human rights issues, “and a host of other topics they have been studiously avoiding.” Moreover, in less than 18 months, the United Nations Principles for Responsible Investment attracted more than 380 signatories, and a global investor coalition attracted supporters with \$55 million of assets within 6 years. Kiernan notes that “the Sustainable Investment Revolution is driving a worldwide industrial restructuring, radically changing the very basis of competitive advantage for companies and, therefore, investors.” He further notes that sustainability issues now matter to many companies, citing successes such as the Toyota Prius hybrid car. Chapter 1 also discusses factors that are driving the sustainable investing revolution, distinguishes ES investing from more commonly known socially responsible investing (SRI), describes key environmental and social issues, and outlines the “four pillars” of ES investing: environment (e.g., minimizing adverse impacts), human capital (e.g., employee retention and innovation capacity), stakeholder capital (e.g., interactions with external stakeholders), and strategic governance (e.g., how companies handle ES issues).

In Chapter 2, “What’s Taken Us So Long?,” Kiernan attributes the slow appreciation of ES factors in investment decisions to both “individual intellectual inertia and collective organizational inertia” and cites a number of specific

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examples as well as six enduring myths about sustainable investments (e.g., “addressing sustainability factors is irrelevant or even injurious to risk-adjusted financial returns”). He also describes Wall Street analysts’ fixation with “making their quarterly numbers” (which downplays concern about the future financial potential and true competitive risks of a company) and fleshes out the four pillars of sustainability, noted above.

“Perverse Outcomes and Lost Opportunities” is the title of Chapter 3, which builds on the previous chapter and focuses on “real world” examples of the results of a lack of attention paid to sustainable (ES) investing factors. Five categories of case study examples of institutional asset owners are profiled as examples of inactivity and resistance to sustainability considerations: multilateral financial institutions (e.g., the UN Joint Staff Pension Fund and the World Bank), public sector pension funds (e.g., the state of Connecticut), foundations and endowments (e.g., the Gates Foundation and the Yale Endowment), environmental nongovernmental organizations or NGOs (e.g., the Nature Conservancy), and organized labor (e.g., the AFL-CIO). Kiernan also notes that “company pension funds have so far stayed away from the Sustainability Revolution in droves,” including, ironically, companies that have given this a high priority in their business operations. Perhaps the most notable of these descriptions was Kiernan’s observation that the \$40 billion Gates Foundation has refused to even consider sustainability investing or research, even if its own investment activities could be undermining all of the good work that it does on the grant-giving side.

Academic research about ES investing is the focus of Chapter 4, “But What Does the Evidence Really Say?” Kiernan begins by describing a meeting where he was rebuffed by a leading Wall Street firm by stating: “In the 21<sup>st</sup> century, environmental and social issues are becoming more and more important to companies’ competitive success.” He then describes how a meta-analysis of 99 studies of the performance of traditional SRI funds found strong evidence for the existence of a positive relationship between environmental management quality and financial performance. Findings from several specific studies are then reviewed as well as “real world evidence” from a European asset management firm. Kiernan concludes the chapter by noting that “the weight of evidence argues heavily in favor of the sustainable investment thesis, not against it. At the very least, it should convincingly call into question the blithe dismissal of the thesis by its many critics.”

Chapter 5, “Toward a New Postmodern Sustainable Portfolio Theory,” begins with an applicable quote from Warren Buffett: “Certain perils that lurk in investment strategies cannot be spotted by the use of the models commonly employed today by financial institutions.” It goes on to explain that these perils include sustainability-driven financial risks and makes the case that “traditional methods of investment analysis have proven woefully inadequate.” Topics such as behavioral finance and the Adaptive Markets Hypothesis are explored, as well as the need to capture “intangible value” (e.g., ideas, brands, innovation capacity, strategic alliances, and unique work processes) in the valuation of companies. In short, quarterly earnings reports are inadequate because they do not reflect companies’ long-term viability. Integrating sustainability factors into investment analyses “provides a fuller, more comprehensive, and more forward-looking understanding of both the risk profiles of companies and their future ability to create competitive advantage and investor returns.”

The major environmental and social challenges of our time are described in Chapter 6, “Why Does It All Matter Anyway?” This was the most frightening chapter of the book by far because it describes, not only the detrimental effects of environmental and social factors run amok upon investors’ portfolios but, more importantly, their impact on the future health and well-being of everyone living on planet Earth. As noted by Kiernan, “current environmental and social conditions-and forward-looking trends-should be enough to give all investors pause.” He continues, “unless these trends can be halted or reversed, there will be relatively little point in investing: we will simply not have the sort of world in which anyone would want to work, raise children, or spend their retirement.” What follows is a detailed, and often scary, review of 11 major sustainability challenges (population growth and urbanization, poverty and social inequality, climate change and energy, human rights, water scarcity and quality, air pollution, human health, waste and waste management, soil degradation and loss, deforestation and deterioration of forests, and biodiversity loss or the destruction of interrelated ecosystems). This is followed by an equally detailed, and even scarier, discussion of the impacts of these issues, as well as bulleted lists of associated risks and opportunities for investors. One example of an opportunity is that “pure-play renewable energy providers in the solar, wind, geothermal, and biofuels subsectors will be attractive.” An example of a risk is “persistent poverty obviously precludes literally billions of people from becoming either customers or productive employees.”

Just when *Investing in a Sustainable World* starts to get downright depressing, describing one planetary health and/or investment risk factor after another, the tone of the book changes significantly. Chapters 7 to 12 are much more uplifting and optimistic and provide specific examples of work that is being done, or could be done, to avert the gloomy scenarios that were described in Chapter 6. Chapter 7, “Sustainability and Competitive Advantage,” describes specific examples of companies that are attractive to sustainability investors because they are creating a competitive advantage. Included here are some well-known corporate names (e.g., Honda, HSBC bank, and drug manufacturer GlaxoSmithKline) as well as relatively unknown overseas firms.

Chapters 8 through 10 form a three-part series that focuses on “Game Changers,” i.e., “cutting edge organizations and individuals who are currently leading the Sustainable Investment Revolution.” Chapter 8, Part I: “Collective Initiatives,” focuses on a number of examples of collaborations among large and diverse groups of investors and other stakeholders including the United Nations Environment Program’s Finance Initiative, the Coalition for Environmentally Responsible Economies or CERES, and the Carbon Disclosure Project. In Chapter 9, Part II: “Individual Owners of Capital,” Kiernan profiles individual asset owners such as pensions, endowments, and foundations that are integrating ES factors into investment strategies. Examples include APG in the Netherlands, the U.K. Environment Agency, and the large California public retirement plans CalPERS and CalSTRS. Chapter 10, Part III: “The Service Providers,” describes other types of sustainable investment leaders including consultants, advisors, researchers, and money managers. Quite noticeable was the fact that much of this leadership is coming from abroad from companies such as Sustainable Asset Management in Switzerland.

Kiernan pushes the “optimism envelope” even further in Chapter 11, “Making It Happen,” which provides “how to” advice on the mechanics of sustainable investing. The chapter begins with “10 Commandments of Sustainable Investment” (e.g., “Do not use sustainability research in isolation: always combine it with more traditional fundamental and/or quantitative investment research”). It then discusses appropriate responses to common objections raised with respect to the cost and use of ES investing and how to build a “sustainability enhanced” portfolio. The chapter ends with a discussion of climate change which

Kiernan calls “the mother of all sustainability issues,” noting “few environmental issues pose as real, significant, and widespread a financial threat to investors as climate change.” He further explains that this risk is impacted by the time horizon of investors and is, understandably, of more concern to those with longer holding periods.

*Investing in a Sustainable World* concludes with Chapter 12, “Some Final Thoughts.” Again Kiernan reiterates that the Sustainable Investment Revolution, while underway, is admittedly not yet in full swing. Like any other information-based investment strategy, ES investing will eventually lose its unique edge when it becomes more widespread, thereby undercutting its value. Kiernan believes that this will not happen anytime soon, however. The chapter concludes with a description of the ES potential of so-called sovereign wealth funds (SWFs). These are huge blocks of investment capital controlled at a national level by public or quasipublic agencies. The largest SWF is controlled by the Emirate of Abu Dhabi on the Persian Gulf.

At the end of the book are four appendices that further explain how companies are rated on ES factors. Specific examples of reports about companies from Innovest Strategic Value Advisors and a list of the “Global 100 Most Sustainable Companies” are included. The appendices are followed by extensive chapter-by-chapter endnotes that describe the sources of information referred to within the book and a list of references. *Investing in a Sustainable World* is extremely well researched, and readers will learn a lot about both investing and the multitude of environmental and social challenges facing everyone who inhabits this planet.

Kiernan is an authority on sustainable (ES) investing and his expertise was evident throughout the book. In many places he presented opposing points of view about ES investing, thereby providing a balanced presentation. A few places were especially technical but even they were clearly explained. In summary, *Investing in a Sustainable World* cannot help but make readers more astute investors. Even those who consider themselves socially responsible investors will learn new things because ES investing strategies encompass so much more. As Kiernan states in the last sentence of the book, “we can predict one thing with complete confidence: twenty-first century investors who understand, embrace, and harness the power of the [Sustainable Investment] Revolution will outperform those who do not.”