ESG analysis instrumental in a company's long-term performance

Integrating environmental, social, and governance (ESG) analysis into the overall investment decision-making processes made for better investment decisions and also more sustainable returns for companies.

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"From a fixed income perspective, ESG matters are very relevant in assessing credit risk as part of our fundamental credit analysis process," says Angelique Kalam, who is responsible for sustainable investment practises at Futuregrowth Asset Management.

"The key motivating factor for us is to understand the risks associated with a transaction, in order to price and mitigate for that risk appropriately. We see ourselves as a long-term funding partner and, as such, we view sustainability as key to understanding risk. Fiduciaries representing pension fund interests have to take this responsibility seriously, and understand the importance that ESG risks pose to clients' investments," Kalam explains.

Baseline assessment

Futuregrowth has developed a proprietary ESG scorecard that provides a baseline assessment of a borrower. In addition, drawing on substantial sector knowledge and its analysts' fundamental credit analysis, Futuregrowth is able to obtain deeper insight into any potential credit (including ESG factors) risks.
"ESG indicators do improve the analysis of all investments by promoting improving standards of practises," she says. "But they represent only one of the many credit risk tools that form part of our holistic credit process."

Futuregrowth's credit strategy promotes independent and in-depth analysis on borrowers and applies a variety of internal risk measures to price for risks and negotiate rates and covenant terms. For private (unlisted) debt, it uses a range of criteria during the credit analysis process to analyse, screen, identify, and price for any potential risks to ensure that the risk-reward trade-off is appropriate.

Practical example

"An example of this in South Africa is that increased water scarcity in some regions will affect the agriculture sector by increasing operating costs and creating other operational disruptions, ultimately affecting on-going profitability and the future cost of funding. We consider these risks, mitigating where possible in our loan terms and conditions, and price for them accordingly," says Kalam.

All asset managers have a responsibility to manage their clients' funds in a sustainable and responsible manner that considers the appropriate risk-reward pay-off. However, there is no standardised framework for analysing companies on sustainability issues.

"The materiality of ESG issues is reliant on judgement by the Futuregrowth analyst and will differ from sector to sector and between borrower types. The end result is to provide sustainable risk-adjusted returns that contribute to our client's long-term return objectives," says Kalam.