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INTERVIEW WITH MASSIMILIANO CAGLIERO

“There’s no doubt about it, ESG firms have better returns”

By Sergio Luciano

BANOR FOUNDER: “THE BEST DECISIONS COMBINE ESG RATINGS WITH FUNDAMENTAL ANALYSIS CRITERIA”

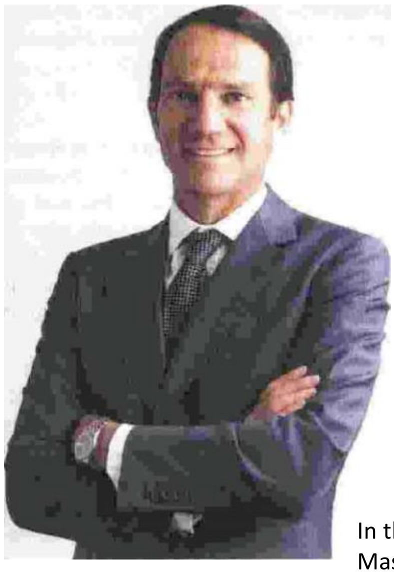
Businesses with higher ESG ratings obtain significantly better returns than others. In particular, the stock market seems to reward companies which adopt good practices across all three elements (environment, social and governance) rather than just one. These are the findings of a study conducted by Professor Giancarlo Giudici from Politecnico di Milano in collaboration with a team of researchers from Banor SIM. Important to note is that the study was based on Stoxx® Europe 600 index data and considered the period between 2012 to 2017, before ESG principles were all the rage. Is it possible, then, to confirm that the correct and conscious management of social, environmental and governance factors is a competitive advantage for companies? “Here at Banor, we are convinced that the answer is yes, but the study also shows that the best investment strategies combine ESG ratings with considerations relating to fundamental analysis,” responded Massimiliano Cagliero, founder and CEO of Banor. “In particular, the price-to-earnings ratio per share remains an essential indicator, further demonstrating the advantages achieved by an integrated approach to asset allocation”. A detailed analysis of the performance factors of the industrial securities on the index reveals that businesses with high ESG ratings were more effective in increasing turnover, improving profit margins (generally negative for other companies) and increasing dividend yield. This evidence is consistent with the theory that the adoption of good ESG practices can prove to be a long-term competitive advantage.

So when evaluating an investment, is the best approach to combine value-oriented management practices with ESG criteria?

Yes, the incorporation of ESG valuations in asset allocation may potentially improve the quality of value-based analyses. Understanding the link between competitive advantage, profitability and good practices in the environmental, social and governance fields is therefore useful for companies, which will be able to better communicate with all their stakeholders and increase the value of investments in good ESG practices, as well as for investors, who are increasingly more selective in stock picking. And I think it is important for everyone to pursue a commitment to ESG issues on a substantive and economic sustainability level.

Are you concerned that this factor drives inflation and therefore distorts the very concept of ESG management?

First of all I’d like to note that, historically, a focus on social issues and good governance has always been appreciated and, more recently, environmental sustainability has become the subject of greater focus. Nonetheless, many people were surprised when Blackrock CEO Larry Fink stated that his group would no longer invest in companies that don't apply ESG criteria. I think this announcement is very positive in the medium and long term. In the short term, we will see plenty of hypocrisy and greenwashing. It costs less to organise an evening to talk about ESG than it does to effectively change business processes. But the path forward has been set and, with some ups and downs, will be followed. Naturally, much depends on the performance of the global economy and the resources it will generate which could be directed towards ESG investments. And the impetus of green political movements on the global stage will also play a part.



In the photo: Massimiliano Cagliero

Indeed, let’s stay on the topic of politics. Many experts wonder if it is possible and sustainable for a western business to comply with ESG principles and remain competitive with businesses in countries that don't comply with them, as we’ve seen among many of the economic powers in the Far East. What do you think?

This is a very important and real concern, but a more general one. It doesn't just apply to ESG and the limitations that a policy of ESG compliance can place on certain companies, and not on others. The same could also be said of fiscal dumping in certain counties or of certain tax breaks which businesses get in certain markets as compared to others. This problem, the current lack of a certification body at global level, needs to be tackled politically.

"REDUCING THE WORKFORCE TO INCREASE CAPITAL RETURNS IS UNACCEPTABLE"

Do you think we could apply special tariffs to goods produced in countries that don't respect ESG principles?
Yes, in principle. Conceptually, the use of tariffs could be an acceptable solution. However, it would be extremely difficult to put into practice in the absence of an objective method for measuring ESG criteria. And even if we did find a way to apply them, it wouldn't be sustainable in the long term. It is consumer mentality that truly determines a business' success or failure.
Let's go back to social psychology, and trends. Is there something fanatical and, therefore, transitory about this wave of interest in ESG criteria?
I don't think this is a passing trend. What we are witnessing is a very rapid shift in mentality. My generation was the last one to not focus instinctively on ESG principles. Today, as asset managers, we are under considerable pressure to do so. This will become most evident at the start of the next recession: this is the moment when businesses will really feel the weight of ESG topics. When things are going well, like in the last ten years, it's easy to act like kings. Moreover, I believe we can be optimistic and expect to see a strengthening of the collective awareness of these values. New generations are very conscious of them.
You have praised the managerial approach adopted by Warren Buffett. However, he has recently weighed in on the ESG debate with the view that a business' job is to generate profits legally, and nothing more.
Warren Buffett may have said that, but his actions tell another story. He often writes that the management quality of the businesses he invests in is of paramount importance. What he is referring to—and on this I agree—is profit allocation. Companies should maximise profit generation in an ethical way. When shareholders receive the profits, it's up to them to use them in the way they see fit. But to maximise this profit, now and in the future, they will have to concentrate on ESG criteria.
And what about businesses that preach water but drink wine? What about those that dare to announce to the market the increase in planned profits and dividends while at the same time making cuts to the workforce?
The act of making redundancies, particularly in a fluid market like in the US, is not necessarily contrary to the idea that the same company practices social responsibility. It is different in more rigid contexts, like the European market, where, in fact, mass redundancies are much less common than in the United States. It's true that the employment factor is going through a turbulent phase that will require intensive re-skilling, which could eventually result in significant transformation, but perhaps in the course of a generation. Rationalising the workforce to protect the surviving workforce, that I can understand. Rationalising it to increase the share premium is unacceptable.
So don't you think that CEO-capitalism, which focuses on maximising stock market prices, is counter to the development and respect of ESG principles?
Absolutely not. In fact, the application of ESG criteria, over time and with ups and downs, will be the key to maximising companies' stock market value. We can see this from the Banor-Politecnico study. And it is also clear from the results of our asset allocation management approach based on ESG principles.
Let's finish by talking about Italy. How do you think we're doing in this field?
We are in the first stage of adopting these principles, which means lots of announcements, lots of conferences, and a good deal of greenwashing. But while, whether through convenience or conviction, people have embraced the issue and however quickly and pervasively this can affect standards, much still depends, as I said earlier, on how the economy performs. As long as things are going well, growth will continue. But it will be Italy's extraordinary entrepreneurs who will apply ESG principles in a more effective and pervasive way than any other entrepreneurs across the globe!