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Examining Investment Companies' ESG Data to Determine Investment Efficiency

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ABSTRACT

Environment, Social, and Governance (ESG) investing is a crucial topic in modern society. Every day, new government regulations and incentives fuel sustainable investing by requiring robust corporate ESG disclosures. As companies become more aware of their societal and environmental impacts, investment companies such as Blackrock and Vanguard also learn to reshape their capital allocation decisions to benefit their customers. In this paper, we examine the S&P 500 equity holdings of some of these significant asset managers with a specific focus on the ESG scores of the companies they invest in. Through the compiled data, we see that the ESG scores of asset managers are ultimately very similar. Additionally, we derive that asset managers tend to base their decisions on several other factors, including the expected returns, as most investors also demand profit. As the ESG investing landscape continues to evolve, we determine that investors approaching their investments in an ESG-conscious manner may prefer to make their investments based on their independent analysis until the birth of more ESG-conscious investing strategies.

Introduction

Environment, Social, and Governance (ESG) investing is a strategy focused on screening investments based on the companies' willingness to improve their ESG performance. Primarily, the environment portion of ESG includes a company's carbon footprint, direct and indirect greenhouse gas emissions, ability to abate or mitigate toxic chemicals in its manufacturing process, waste management, biodiversity, the company's resilience against climate risks like flood, fire, climate change, and sustainability in its supply chain. Second, social defines a company's relationships with the stakeholders, including human capital management, diversity, equity, and inclusion (DEI), workplace conditions, pay parity, the company's impact on the communities, and extending social impact expectations to supply chain partners. Finally, governance focuses on transparency, accountability, and compliance. These include internal controls promoting transparency, board composition and structure, transparent and accurate accounting methods, leadership accountability to shareholders, alignment of leadership incentives to stakeholder expectations, and avoiding illegal activity.

The surge of ESG considerations within investment strategies has captured substantial attention within the financial sector. Announcements from leading financial institutions and asset managers frequently emphasize an escalated commitment to integrating ESG principles into their investment portfolios. Based on this growing discussion, we conduct a critical examination of the accuracy of such claims: Is there obvious evidence to uphold a significant shift in capital allocation towards ESG-compliant enterprises? We believe assessing the tangible growth of ESG-aligned investments bears profound implications for the marketplace and society. An increase in ESG investment would not only reflect a reorientation of financial flows towards sustainability but would also predict a transformative impact on the global economy, with potential ripple effects that reinforce the broader objectives of sustainable development.

Background

Over the past couple of years, ESG has emerged from investment philosophies focused on sustainability and changed the nature of capital allocation decisions made by the world's largest financial services firms and asset managers. It has resulted in an increasingly socially responsible investing system and has led to investment approaches beyond pure risk and opportunity management. In the future, the Paris Agreement's climate commitments, many countries' and companies' net-zero targets, and Sustainable Development Goals (SDGs) will surely continue to alter the ESG and, therefore, investing landscape.

Many investors have been integrating environmental, social, and governance (ESG) issues into their investing decisions across the globe, fueled by client demand, a desire to make an impact, and reputational concerns. Equities are the most popular asset class gaining exposure to ESG, and retail investors and pension savers are increasingly demanding products that deliver both a financial and sustainable return. The concerns about greenwashing and investment returns remain a significant challenge for asset managers.

Global governments and large companies increasingly aim to reach net zero emissions by 2050. According to the forecasts by Bloomberg, ESG assets are expected to exceed $53 trillion and construct one-third of global assets under management (AUM) by 2025. The World Bank estimates the total value of outstanding green, social, and sustainability (GSS) bonds would have reached $3.8 tn at the end of 2022. According to Jessica Alsford at Morgan Stanley's Institute for Sustainable Investing, "Assets under management (AUM) for sustainable equity and fixed-income funds reached a record 7.9% of global total AUM in the first half of 2023."

With such a surge in ESG investing, many large financial services firms and asset managers are choosing to invest more in ESG-conscious assets. We examine several asset managers' equity breakdowns, specifically focusing on the S&P 500, to make our intracompany comparisons to see if there is a genuine connection between asset managers' ESG investments and advertising efforts.

Data

We chose Blackrock Inc., Vanguard Group Inc., Guggenheim Partners, State Street Global Advisors, and Northern Trust Co. (the "firms") to make our comparisons. Our list includes a mix of the world's well-known asset managers and investment advisors who manage money for institutional clients and provide investment solutions for personal investors. We found their equity profiles and picked their investments in S&P 500 companies' equities. Then, for all companies in the S&P 500, we gathered Environment, Social, and Governance risk scores and total ESG risk scores (a sum of Environment, Social, and Governance risk scores), with a lower total risk score meaning a more ESG-compliant company. We collected all our data from Yahoo Finance during August of 2023 to keep the information more consistent, and the website did not list the ESG risk scores of some smaller companies, so we excluded them from the calculations.

Methods

As a first step, the respective weights of all equity holdings of the firms were calculated. The various companies' market capitalizations were determined by adding up all the market capitalizations of each equity based on their respective weights within the investments of each firm. Blackrock's market capitalization stood the highest at $638.21 bn, Northern Trust's followed at $621.35 bn, then leading to State Street at $615.68 bn, Vanguard at $611.96 bn, and Guggenheim at $609.44 bn, as seen in Table 1.

Table 1. Market capitalization of the firms' Equity Holdings

	Market Capitalization of Equity Holdings ($ bn)				
	Blackrock	**Vanguard**	**Guggenheim**	**State Street**	**Northern Trust**
Market Cap ($ bn)	638.21	611.96	609.44	615.68	621.35

These weights were then used to separately derive the weighted average of Environment, Social, Governance, and total ESG risk scores of the firms' equity holdings. A company is deemed more ESG-conscious when the risk scores are lower.

1. Blackrock: Blackrock's equity holdings' total market capitalization is $638.2 bn, while the weighted average Total ESG score is 21.35. The weighted average Environment ESG risk score is 4.08, weighted average Governance ESG risk score follows it with 7.54, and the weighted average Social ESG risk score comes next with 9.73, as seen in Tables 1 and 2.

Table 2. The weighted average ESG risk scores of Blackrock Inc., as of August 2023.

	Weighted Average ESG Scores
	Blackrock
Total ESG	21.35
Environment ESG	4.08
Social ESG	9.73
Governance ESG	7.54

2. Vanguard: Vanguard's equity holdings' market capitalization is $612 bn, and their weighted average Total ESG risk score is 20.84. The weighted average Environment ESG risk score of Vanguard is 3.93, the weighted average Governance ESG risk score is 7.38, and the weighted average Social ESG risk score is 9.52, as seen in Tables 1 and 3.

Table 3. The weighted average ESG risk scores of Vanguard Group Inc., as of August 2023.

	Weighted Average ESG Scores
	Vanguard
Total ESG	20.84
Environment ESG	3.93
Social ESG	9.52
Governance ESG	7.38

3. Guggenheim: Guggenheim's market capitalization of equity holdings is $609.4 bn. The weighted average Total ESG risk score stands at 21.27, the weighted average Environment ESG risk score is 4.02,

the weighted average Governance ESG risk score is 7.56, and the weighted average Social ESG risk score is 9.70, as seen in Tables 1 and 4.

Table 4. The weighted average ESG risk scores of Guggenheim Partners, as of August 2023.

	Weighted Average ESG Scores
	Guggenheim
Total ESG	21.27
Environment ESG	4.02
Social ESG	9.70
Governance ESG	7.56

4. State Street: State Street's market capitalization of equity holdings is $615.7 bn, while the weighted average Total ESG risk score is 21.21, the weighted average Environment ESG risk score is 4.00, the weighted average Governance ESG risk score is 7.53, and the weighted average Social ESG risk score is 9.68, as seen in Tables 1 and 5.

Table 5. The weighted average ESG risk scores of State Street Bank and Trust Co., as of August 2023.

	Weighted Average ESG Scores
	State Street
Total ESG	21.21
Environment ESG	4.00
Social ESG	9.68
Governance ESG	7.53

5. Northern Trust: Northern Trust’s market capitalization of equity holdings is $621.4 bn. The weighted average Total ESG risk score is 21.24, while the weighted average Environment ESG risk score is 4.00, the weighted average Governance ESG risk score is 7.55, and the weighted average Social ESG risk score is 9.69, as seen in Tables 1 and 6.

Table 6. The weighted average ESG risk scores of Northern Trust Co., as of August 2023.

	Weighted Average ESG Scores
	Northern Trust
Total ESG	21.24
Environment ESG	4.00
Social ESG	9.69

Governance ESG	7.55

The percentages of S&P 500 equities in total equities owned by the firms and the respective Total ESG risk scores are depicted in Figure 1. The sizes of the bubbles indicate the total market capitalizations of the equities, and the location of the bubble represents the percentage that equity represents of the total assets and its total ESG risk score.

The firms invest in companies with single-digit total ESG scores to a score of 50, while total ESG scores between 10 and 40 constitute a significant majority of the investments. The total ESG scores between 20 and 30 are the range including most of the equity investments within the charts. The weighted average total ESG scores of around 21 is primarily due to the higher weights of some equities with lower total ESG scores.

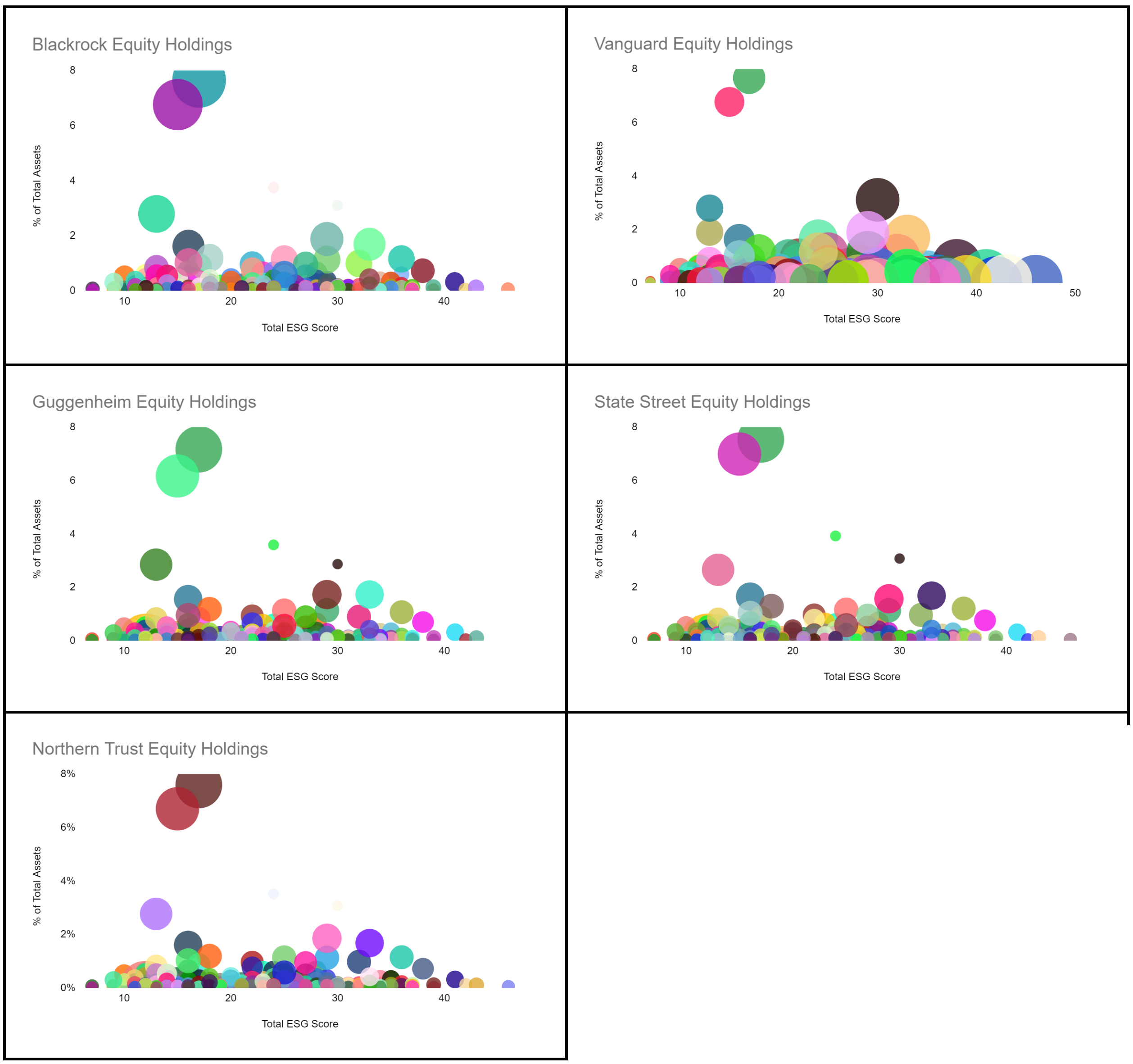

Figure 1. Equities as a percentage of total assets per Total ESG scores of S&P 500 equities held by Blackrock Inc., Vanguard Group Inc., Guggenheim Partners, State Street Global Advisors, and Northern Trust Co., as of August 2023.

Results

The analysis depicts that Blackrock, Vanguard, Guggenheim, State Street, and Northern Trust have similar market capitalizations regarding their S&P 500 equity holdings, with the largest difference being between Blackrock and Guggenheim at $28.77 bn, as of the date the data was taken. These firms are similar in terms of size, the S&P 500 equities chosen, and their ESG-conscious investing approaches. The weighted average Total ESG scores of the equity holdings are extremely close, with all but Vanguard deviating from the average of 21.18 by less than one standard deviation.

Furthermore, the similarities in the bubble charts indicate that all of the investment companies approach their investing in a similar fashion since the percentage of total assets per total ESG score stays mostly consistent throughout. The two bubbles at around 15 total ESG risk score and 7% of total assets represent Apple (AAPL) and Microsoft Inc. (MSFT) and are consistently present across all five bubble charts with mostly similar sizes. These investments impact the weighted average total ESG risk scores favorably.

Overall, the data demonstrates that the firms have very similar ESG-investing approaches, without a granular difference to detect among them, regardless of their advertisement intensity of ESG-conscious investments.

Discussion

The similarities in the total ESG risk scores of their equity holdings demonstrate that Vanguard, State Street, Blackrock, Northern Trust, and Guggenheim do not differ in the ESG-consciousness of their investment approaches. The similarities in their market caps, the companies that they choose to invest in, and the weighted average total ESG risk scores demonstrate that they have similar strategies in terms of purpose and returns. The returns may be satisfying for the investors; however, there is room for growth in targeting lower ESG risk score companies. The asset managers will be forced to invest more in ESG-compliant companies as ESG-conscious investing becomes more of a norm and the investors demand more ESG-focused investments. Additionally, they will need to actively engage with the companies in which they invest to encourage companies to create long-term value for their clients.

Individuals demanding more ESG-conscious investments targeting lower total ESG score companies may need to invest themselves until ESG-investing themes become more structured, and new asset classes or funds addressing these concerns are introduced.

Conclusion

ESG investing is gaining more ground as investors demand a sustainable future. Asset managers worldwide are gearing primarily towards a socially and environmentally responsible system beyond pure risk and opportunity management. Global governments and regulators are also facilitating the change in environmental, social, and governance frameworks for a more sustainable future.

Slowly but surely, companies are also beginning to become more sustainable. Nevertheless, asset managers still have a lot of room for improvement in terms of focusing on building more ESG-conscious portfolios. For ESG investing to reach maximal effectiveness, it is imperative that asset managers bridge the gap between ESG-conscious investing and pure risk and reward investing, which will eventually happen due to the demands of investors, especially the millennials, and the worldwide efforts to create a more sustainable future for the next generations. However, until ESG investing reaches a more efficient sweet spot, investors targeting pure ESG-conscious investments should prefer making their investments based on their own judgments. An individual investment strategy will provide them with a lower total ESG risk score since they will be able to pick their equities and not be limited by the investment companies' funds or other asset classes. Moving on, ESG investing will be more prevalent with more asset classes and thematic options, but for now, individual investors should stick to their own plans for sustainable investing to maximize ESG-conscious efforts.

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