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A More Impactful Strategy for Sustainable Investing

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A More Impactful Strategy for Sustainable Investing

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Summary. The effectiveness of sustainable investing has been challenged, with critics like Tariq Fancy describing it as a mere placebo. Amidst rising skepticism and stricter disclosure requirements, a deeper dive reveals that traditional methods of influencing companies, namely "voice" (shareholder engagement) and "exit" (portfolio screening), are not exhaustive. Through a comprehensive review of over 3,500 research papers, a new approach — "field building" — emerges. This tactic acknowledges the interconnected web of stakeholders around companies, termed "fields", that profoundly influence corporate behavior. By reshaping these fields, investors can indirectly drive sustainable change in firms. Five tactics are

highlighted: (1) Shifting other investors' evaluation of issues, (2) Sharing expertise, (3) Delegitimizing certain business activities, (4) Establishing voluntary standards, and (5) Supporting regulatory changes. While promising, field-building presents challenges like profitability and political exposure. Yet, by embracing this expanded toolkit, investors can magnify their positive impact and appeal to an increasingly conscious investment clientele. **close**

Whether sustainable investors can have a positive impact on business and society has been the center of debate in recent years. One major obstacle holding sustainable investing back from maximizing its impact is that most investors operate with too narrow of an understanding of how impact can come about. Most investors believe they have two primary ways to influence companies. First, there's portfolio screening, often termed "exit." In this approach, investors shift capital from non-sustainable to sustainable companies. The second strategy is shareholder engagement, frequently called "voice." Here, investors directly urge companies to adopt more sustainable practices through means like meetings, shareholder proposals, or voting.

But in our research, we have found that some unconventional investors go beyond the "exit" versus "voice" dichotomy. We have mapped their activities through a systematic review of research for which we screened more than 3,500 research papers on sustainable investing. Based on this review and conversations we've had with practitioners, we put forth a case for a third, potentially more impactful sustainable investing strategy: *field building*.

Field building works because companies are always embedded in fields. The term "fields" is closely related to industries, but broader. Fields encompass both companies (e.g., oil and gas companies) and the stakeholders with which companies interact most frequently (e.g., investors, regulators, or media). Through these interactions, actors within fields develop assumptions, norms, and rules that shape the behavior of companies within a field. In short, a field captures those parts of the external

environment of a company that have the most direct influence on a company. Field building means that investors influence companies by changing the (1) stakeholders and (2) assumptions, norms, and rules that surround companies, thereby exerting their influence on companies indirectly.

We have found five tactics for field building that sustainable investors can use to increase their impact.

Shifting other investors' evaluation of issues

As a first tactic for field building, investors can shift other investors' evaluation of environmental and social issues. By publicly and continuously highlighting these environmental and social issues, an investor can raise attention to environmental and social issues among other investors and thereby motivate these other investors to influence companies.

This tactic is particularly relevant for investors that do not have enough assets under management or status to directly influence companies. By influencing larger investors with more direct influence on companies, investors can change the fields in which companies operate in ways that expose companies to more pressure for corporate sustainability.

The Dutch shareholder "FollowThis" has used this first tactic very successfully since 2014 to influence oil and gas companies. FollowThis submits shareholder proposals on behalf of over 10,000 individuals who have bought shares of oil and gas companies. While FollowThis has neither the assets under management nor the elite status to be taken very seriously by oil and gas companies themselves, their approach has been very successful in influencing big Dutch pension funds. Some pension funds followed suit after their initial refusal to support FollowThis led to protests from beneficiaries and negative media attention — including ABP, the largest Dutch pension fund with over 500 billion Euro assets under management.

Sharing expertise with other investors

A second tactic for field building is to share expertise with other investors. Investors that are new to sustainable investing often struggle with the inherent complexity of environmental and social issues, and know neither what demands are realistic nor how to raise their demand in ways that make business sense for companies. By making private information publicly available, investors can empower other investors to influence companies. When other investors know more about sustainability, this creates additional pressure for corporate sustainability within the fields in which companies operate.

The international asset manager Robeco has used this tactic since August 2022, when it made its SDG framework openly accessible. This framework assesses the degree to which over 2,900 companies advance or undermine the 17 sustainable development goals (SDGs). Having used the framework internally since 2018, Robeco's decision to make their SDG framework open access not only establishes Robeco as a leader in that space. Access to this framework can help less experienced investors incorporate sustainability into their investment decisions.

Delegitimizing certain business activities

A third tactic for field building is to delegitimize business activities that are particularly harmful for the environment and society. Companies can only operate in fields in which key stakeholders — such as policymakers, consumers, suppliers, or the media — see their activities as legitimate. If these stakeholders start to see certain business activities as illegitimate, it can create existential problems for companies. Given these dynamics, investors that publicly problematize certain business activities can play a key role in changing widely shared assumptions about whether these business activities are legitimate or not.

Investors within the fossil fuel divestment movement have used this tactic very successfully. Since 2012, over 1,500 investors have publicly announced they would divest from fossil fuel companies, including the city of Chicago in 2022 and the Church of England in 2023. Proponents of the divestment movement make clear that, "Divestment isn't primarily an economic strategy, but a moral and political one." They realize that their main influence does not come from increasing the cost of capital of fossil fuel companies in the short term, but by gradually changing public opinion about fossil fuel companies. Research shows that the divestment movement has influenced the views and actions of important stakeholders, including banks that have withheld credit from fossil fuel companies and students who have committed to not work for fossil fuel companies.

Establishing voluntary standards

A fourth tactic for field building is to establish voluntary sustainability standards. Voluntary standards have become a central instrument to advance corporate sustainability. They include codes of conduct, certification standards, and reporting standards, and may focus on single fields (e.g., Equator Principles for project financing) or multiple fields (e.g., the GRI reporting standard). Investors have played a major role in establishing voluntary standards, and have thereby reshaped the rules of the fields in which companies operate.

Investors that are active in the "Taskforce on Nature-related Financial Disclosures" have employed this tactic. Biodiversity loss and other nature-related risks are complex challenges, and many companies have little expertise on how to address them. Since 2020, investors have used the Taskforce to develop voluntary standards for corporate reporting on how companies harm nature and how nature creates risks for companies. After extensive stakeholder dialogue, pilot testing, and industry feedback, the

Taskforce will release its final version in September 2023, which we expect will transform the nature-related parts of sustainability reporting.

Supporting regulatory changes

The fifth and final tactic for field building is to support regulatory changes that set mandatory standards for corporate sustainability. Once multiple companies within a field voluntarily engage in a sustainability-related activity, and thereby prove that such activities are technically and financially viable, regulatory interventions may be necessary to force laggard companies to follow suit. Following this logic, the number of laws related to corporate sustainability has almost tripled between 2013 and 2023, from around 300 to almost 900. Given their investments in different types of companies, investors can provide valuable insights to policymakers and regulators about regulatory changes that seek to advance corporate sustainability.

Some investors have used this tactic to shape the upcoming European Sustainability Reporting Standards, which will be mandatory for all companies operating in the European Union from 2028 onwards. While the April 2022 draft of this law contained strict disclosure requirements, the number of disclosure requirements were weakened in a subsequent draft due to pushback from companies. In February 2023, eleven investors and several sustainable investing industry associations wrote a public letter to policymakers of the European Union in which they urged policymakers to go back to strict disclosure requirement to “ensure a level playing field… for companies that already contribute to a nature-positive economy.”

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Each of the five tactics can change the fields in which companies operate, thereby creating additional pressure for companies to become more sustainable. Despite these opportunities for

increasing their impact, two reasons may deter investors from venturing into field building.

One reason is profitability. It can be difficult to make a business case for field building over the short term. Field building mostly generates costs for an investor, while benefits will be captured by other investors, including those in the future. Yet, given that many individuals are willing to accept lower returns if their investments create greater impact, they may seek out asset managers that engage in field building even if higher management fees slightly lower their returns.

Another reason is political exposure. Field building requires that asset managers publicly take a stance on sustainability issues, which could lead to backlash by people with different views — a risk that is higher among asset managers that cater to a wide range of customers. These asset managers can limit this risk by doing field building on sustainability issues for which a broad consensus exists among their customers and that are backed by a strong business case.

By broadening their toolbox of tactics, and mastering field building, investors can better position themselves to have a more positive impact on the environment and society — and, in doing so, attract more individual investors that care about impact.

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