Rewards for ESG-compliant firms point to the future

Capital, contracts and customers will flow to good citizen companies

GILES NICHOLAS
UBS

What will investors look for post-Covid? Clearly, medical science and healthcare businesses, together with technology firms, as the critical importance of these sectors has been highlighted so strongly.

But the focus is also going to sharpen on another long-term trend. Firms with strong environmental, social and governance (ESG) credentials will be at an increasing advantage, with capital, contracts and customers attracted to them.

Investors and other stakeholders are already seeing ESG-compliant firms as less risky than those that are not. They are viewed as less likely to suffer from adverse headlines or social media coverage that could damage their brand and revenues. There is also less chance of them being hit by new regulations that could make them impractically expensive to run.

We are seeing many clients re-evaluating their investment priorities in the light of ESG. Businesses already embracing ESG are likely to find themselves with a first-mover advantage, taking investment and clients from rivals that are slower to adjust. President Joe Biden's commitment to tackling climate change will only accelerate that shift.

For some companies, ESG is central to their business model. One of them is RSK (No 82), which conducts environmental and social impact assessments across the world in sectors such as energy and infrastructure. Founder and chief executive Alan Ryder spoke recently of the firm's culture of "doing the right thing" and wanting its "sustainability credentials to shine". Having made 12 acquisitions in the last 12 months, it is targeting a £1 billion turnover and staff of 10,000 by 2025.

But in most sectors, gaining ESG credentials is about making changes to an existing business model that take greater account of the needs of the planet and communities. An example is Thatchers Cider (No 31), where Martin Thatcher – the fourth generation of the family to lead the business – has invested in a new energy centre that uses solar panels, waste heat and biomass to heat its cider mill. In 2020 it saved 20 million plastic rings from being used for its can packs by switching to recyclable cardboard instead.

These are not the only changes Martin has made at the company: he has also invested in TV adverts and new products such as alcohol-free cider. But the firm's burgeoning ESG credentials are likely to reassure trade clients and consumers alike. Profits grew from £2.4 million in 2016 to £11.9 million in 2019, as sales rose from £73.2 million to £106.6 million.

Martin Thatcher is busy greening the family-owned Thatchers Cider (No 31)

Different kinds of companies are at different stages of their journeys to ESG credibility. Firms in resource-intensive sectors such as mining, oil and gas, and construction often start from a challenging position. For investors considering whether to back them, or potential clients looking to award a contract, it now matters whether they are engaged with ESG or seem to be ignoring it.

Ardent Hire Solutions (No 16) provides customers with excavators, telehandlers and other equipment used in construction. In August, chief executive Jeremy Fish said that "we are totally committed to helping our industry reduce its carbon footprint", adding that the company had paid to offset the 3,500 tonnes of CO_2 produced annually by its heavy goods vehicles, which it uses to deliver plant.

He also unveiled an innovative not-for-profit carbon offsetting scheme for customers that allows them to pay a small surcharge in order to offset emissions produced by the machinery they hire, and receive a certificate. The company's software, Site Manager, also helps customers cut down on unnecessary usage, saving fuel and further reducing greenhouse gas emissions. These green initiatives are helping to differentiate the company, which saw profits grow from £2.7 million in 2019 to £4.7 million last year.

For entrepreneurs selling to consumers, a passion for tackling environmental and social challenges can boost growth – as Susie Ma, the founder and chief executive of London-based Tropic Skincare (No 54), can testify. The firm, which offsets double the carbon produced by its operations and sends no waste to landfill, sells 200-plus vegan and cruelty-free skincare products via a network of 20,000 brand ambassadors. Profits hit £10.7 million last year, up from £3 million in 2017.

Governance – the "G" in ESG – is also a key factor. If a firm is provably well-run and transparent, it helps neutralise a risk that investors increasingly feel they need to consider. For instance, boardroom diversity helps to guard against monoculture and can boost financial results.

Investors recognise that it will take time for companies to improve their ESG credentials. But as economies seek to "build back better" following Covid, and regulation continues to strengthen, the need for companies to take account of ESG is growing more urgent. We should expect that in the years ahead, ESG-compliant companies will become the norm, not the exception.

Giles Nicholas is a managing director of UBS Wealth Management