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Food & Agri-Business Specialists

The Importance of Environmental, Social and Governance Due Diligence in Agri-Investing

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Quick read

- Investment in Environmental, Social and Governance Sustainability, or ESG, has taken on added impetus as businesses and investors look to contribute to fighting climate change, behaving ethically and improving overall performance
- There are financial penalties and reputation damage associated with poor ESG practice, and the risks associated with that make ESG due diligence of potential investments essential
- Surveys show that businesses who immerse in sustainable practices benefit from increased profitability
- Agribusinesses must consider treatment of local people and ecosystems in their processes and strategies and ensure traceability of produce. ESG due diligence is required to make possible pathways for mitigating investment risk

Introduction

Anthropogenic climate change is one of the most pressing issues facing mankind today. Irreversible consequences of planetary warming are fast approaching, impacting the most disaffected parts of the globe the most. People are also becoming more concerned about social injustices, and it is for these reasons that ESG factors are becoming increasingly prominent in today's investment landscape. This is especially applicable to agri-investing, as many environmental and social factors are intrinsically linked to agricultural activities. Not only are there financial penalties and reputational damage for failing to consider ESG risks but incorporating ESG into investments has also been shown to improve performance.

ESG Due Diligence

ESG Due Diligence involves assessment of risks and opportunities relating to the environmental, social and governance implications of an investment. Before undertaking an investment in agribusiness, there are a range of factors to investigate.

Environmental issues to consider include:

- Pollution and resource use
- Biodiversity and ecosystem services
- Climate change
- Social issues to consider include:
- Community health and safety, particularly in underprivileged areas
- Labour practices and working conditions
- Land rights and tenure

Governance issues to consider include:

- Executive pay
- Track record of management
- Shareholder's rights

The benefits of considering ESG factors

The evidence to support the need for ESG Due Diligence is abundant and increasing. Individual investors value ESG stocks more highly than non-ESG and ESG-related shareholder activism is on the rise. This means that a failure to take ESG factors seriously can impinge upon company revenues. Incorporating ESG factors into Due Diligence studies can also alter company valuations, as expressed in a recent global study of private equity partners. 54% had decreased their bid price following ESG studies, and almost one third had increased it. Aside from this, there is no doubting the increasing tilt towards global sustainability. Historically speaking, companies better positioned for the future have had better long-term performance.

Companies who have incorporated ESG matters into their strategy have reaped several rewards, including increased market trust and value for shareholders. According to a global survey by FTSE Russell, more than 50% of asset managers are currently implementing or evaluating ESG considerations in their investment strategy. Another study conducted by Oxford University and Arabesque Partners proved that there is profitability in sustainability. They concluded that:

- 88% of companies with solid sustainability practices have better operational performance
- In 80% of cases, good sustainability practices improved the performance of shares
- Sound sustainability standards lowered the costs of capital in 90% of the companies examined

Agribusiness and ESG

Investment in primary production often carry a far higher environmental and social risk, especially in developing economies. Given the fact that global food production will have to rise by 50% in order to meet growing populations, investment in agriculture will have to increase, especially in currently under-productive emerging countries. The risks associated with these ventures have been demonstrated time and again, with investors facing backlash against land grabs, deforestation and the harmful use of pesticides and fertilisers. The burden of reputational damage can often be harder to shake than any financial loss. Before undertaking such projects, consultants may be required to investigate just some of the following factors:

- How local livelihoods will be affected through the acquisition of the land, even if they have no formal ownership of the land
- Will indigenous peoples or other vulnerable groups be negatively impacted?
- How the water supply required for the project will impact on the area, especially in low rainfall locations
- How development will affect ecosystem services and natural habitats in the vicinity
- Can efficiencies be implemented to increase savings on natural resource use?
- If investing in a company, does management have a history of corruption or neglect of the natural environment?
- Traceability of others involved, including suppliers, buyers or any third parties

Conclusion

The advantages to including ESG considerations in investment decisions are far greater than a sense of personal pride. ESG risks are now, more than ever, financial risks, and the capacity for comprehensive due diligence to mitigate these is pronounced. Failure to shift with the moving tide could result in lost investments and poor performance.

Expert in this Insight

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