Baillie Gifford™

Has ESG reached its expiry date?

May 2025

Our new head of ESG, Siobhan Cleary, and head of the client's department, Nick Thomas, discuss the evolution of ESG, highlighting the challenges of integrating ESG factors into investment strategies and the need for clarity and precision.

Your capital is at risk.

Nick Thomas (NT): The term ESG was first popularised in 2004, I think, by a UN Global Compact report. Yeah, who cares, wins. So how well do you think that concept of ESG has held up over the intervening two decades?

Siobhan Cleary (SC): Well, I think as we all know, the term has become quite politicised, challenging. It's become a little bit of everything and nothing. Over the years, it's become one of those terms that everyone sort of reads into it what they want it to be. And that's created some problems. So in the investment world, it was initially framed as this idea that companies, in order to thrive, had to consider their material environmental or social considerations and factor those into how they conducted their operations. It's a little bit weird that 'G' was in there ever, because in a certain sense, governance underpins effective management of companies generally, including oversight of environmental and social issues.

But I think what's happened over the years has become something that those who don't like the idea of investors looking at environmental and social issues, want to push to one side and say, well, it's got nothing to do with financial returns. And it's become something of an article in faith that people hang on to and say, yes, every issue is financially material in some way. So we're probably at a point now where we've got a reckoning around the concept and a need to just start to be a little bit more precise about what it is we mean.

NT: We'll dig into that a little bit more. So if you think that term of ESG has been quite loaded with conflicting interpretations, is there something we should use instead that would be a more constructive framework?

SC: Actually, I've been going back and forth because obviously my title is Head of ESG, and maybe we'll have to change our view on that. But we don't or shouldn't be ever talking to a company about its ESG performance. We talk to it about how it's managing employee relations, how it's thinking about health and safety and its operations, how it's thinking about supply chain. All of those fall under the header of ESG, but you can talk about the specifics without resorting to jargon and probably should be in any event. So come back to me on the term in six months' time.

NT: Our community, the investment community, is experiencing a lot of polarisation around sustainability. The fundamental debate seems to be really whether should investors at all consider a company's impacts on society or on the environment in matters that do not immediately relate to financial gain and maybe it is a time horizon question. We're finding this difficult. Baillie Gifford is a very client focused organisation, but we have sets of clients who want quite conflicting things. How are we going to navigate this challenge?

SC: So a few things in there. One, I think your point around time horizons is exactly right. If you think about environmental and social factors in the company's performance, there are certain things that will be immediately relevant. So if water is an input into a company's manufacturing, then availability, access to water, and the tensions or otherwise that access creates with communities is going to be a directly relevant consideration. So that's a clear area where this is a relevant factor. But over longer time horizons, the kind of time horizons we invest in, the impact that a company has on an environment, the impact it has on society, might become material even if it's not immediately material. That's where the space we play in. We have to factor in those impacts. We may not make different investment decisions once we've thought about it, but we have to at least think about it.

So that's the time horizon question. When you get into this idea that clients want different things from us, I would suggest that the bulk of clients actually want the same thing, which is to deliver them investment returns in accordance with the mandate that they've given us. We're very clear on that and we understand that. What we do have, however, is some clients who themselves are thinking maybe over even longer time horizons than we are and really thinking about the contribution they can make to addressing some big challenges like climate change, and they really want their managers to help them in regard to that. And then you have some clients at the other side who perhaps have sort of a much narrower framing and much narrower understanding of fiduciary obligation, and they're saying, all we want you to focus on is investment returns. And I think what's really important is just being clear with clients about what their expectations are, and then making sure that you're managing in accordance with that, but also being clear about what your own investment philosophy is and how we think about these things, which I think we have tried to do very much, certainly as long as I've been here.

NT: Well, one phrase I've heard us use internally, which helps to make sense of this topic is social license to operate, which you'll be familiar with. What we're saying there is, you know, our investment time horizon is five to 10 years. We need to think about the negative effects that the company could have on its environment or its stakeholders, and then how that will come back to it and affect its financial performance. So it's saying how you treat people you're involved with affects your own business performance. Does that help?

SC: I'm from South Africa originally, and one of the very clear things in the post-apartheid South Africa in 94, when we moved to this democracy in South Africa, there was a very clear understanding about exactly this idea. We called it a social compact at the time, but this idea that the collective wellbeing of the country was dependent on government, civil society, trade unions and companies working together and recognising the role they had to play for that collective future. And I think you find the same idea and it will play out in different ways, but companies that ignore the impacts that they have on the environment, on society, they're probably not going to be great investments over certainly our time horizons and probably the time horizons of many of the clients we invest on behalf of.

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