ESG Research Helps Reveal Resilience amid COVID-19

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Companies are coping with diverse challenges through the coronavirus crisis. Investors who integrate environmental, social and governance (ESG) factors into their research can gain important insights on how businesses are adapting—and how future return potential might be affected.

The COVID-19 crisis has sharpened the importance of applying ESG analysis for investors. Amid a human and economic crisis of epic proportions, public health issues have become intertwined with corporate policies. Management decisions on an array of ESG issues will affect earnings for many companies. By embedding ESG analysis within security research processes, we believe investors can better determine how corporate behavior through the pandemic will affect future returns.

A responsible investing agenda should focus on corporate responses to the coronavirus for two reasons. First, it's important to ensure that companies are being responsible corporate citizens. Second, investors need a better understanding of the opportunities and threats the pandemic poses for business models.

Coronavirus Tests ESG Commitments

What types of ESG issues have companies faced through the coronavirus? Many have had to make tough decisions about how to protect workers from danger while keeping operations running. Responses range from furloughing employees to providing severance pay, compensation or other means of support. Companies that shifted their workforces into work-from-home mode faced new challenges to maintain data privacy and security standards.

Executive conduct and compensation raise more questions. Was management willing to adjust compensation appropriately at a time when a demand shock was putting severe pressure on profits? What about dividend and buyback policy, especially for companies that are recipients of government aid? And, beyond the immediate challenges, will companies continue to devote capital expenditure to projects that reduce emissions or mitigate the impact of climate change during a recession and through a period of heightened uncertainty about business conditions?

Case Studies: ESG Awareness Matters in a Pandemic

Often, companies that had already internalized strong ESG practices have coped well with the crisis. Perhaps that's because an ESG awareness often signals that a company is forward looking and strategically minded to consider a range of scenarios for their businesses. This can create advantages when quickly adapting technology and operations to remote working, while providing employees and communities the support they need and continuing to deliver products and services to customers.

For example, consider Williams-Sonoma, the US kitchenware and home furnishings company. Even after shuttering its retail stores, the company continued to provide pay and benefits to associates, even redeploying some store staff to provide virtual design advice. Management treated distribution center staff with respect by instituting additional health protections and incremental pay. As a result, Williams-Sonoma has been able to meet increased demand in its e-commerce business, keep employees engaged and attract loyal customers back to its stores as the reopening progresses.

In the utility sector, Enel, an Italian power generator, has been very active in planning for transition to a low-carbon economy. The company has invested in renewable energy while aligning its infrastructure, tools and processes to a changing world.

How did this help Enel during COVID-19? Enel has built sophisticated grid management and IT systems to accommodate the small-scale disbursed nature of future solar and wind power generation. Since renewable energy sources are intermittent, the company also developed real-time demand measurement and management infrastructure. Today, that means Enel can largely run its transmission and distribution operations remotely, without putting thousands of "essential" workers at risk manually operating the grid, reading meters and contacting customers. What's more, Enel's customer monitoring systems have enabled the company to identify customers who are struggling to pay bills and proactively reach out to give those customers relief.

The Integrated ESG Research Model

These types of corporate behaviors often have a direct impact on the bottom line—and on stock performance, in our view. Perhaps that's why stocks with strong ESG scores outperformed during the first quarter of 2020 in the coronavirus downturn.

But finding companies that are ESG leaders is hard work. Third-party ratings are backward looking, and often miss forward-looking changes in a company's behavior that may indicate ESG improvements are underway. For investors, these issues can best be analyzed through an integrated research model. Analysts who cover a company, and have specific industry expertise, are best placed to review a company's pandemic response, and to analyze how that response will affect cash flows, balance sheet and earnings. We believe that this type of ESG integration in fundamental research is the best way to apply a responsible investing agenda to investment portfolios.

To do this effectively requires several ingredients. First, it takes a long-term view of a business strategy and industry environment, especially today when short-term visibility is so cloudy. Second, a global approach is vital in a world where the pandemic has upended global trade and supply chains. Third, engagement with management is needed to get a true sense of how difficult strategic choices are being made to balance the needs of stakeholders from employees to customers to shareholders.

Big Data Can Add Advantages

New approaches to data can also help generate insight into the recovery paths for companies. For example big data techniques can be used in today's environment to analyze complex company supply chains—and even supply chains of suppliers—which can help investors discover how a company is coping with government-imposed shutdowns.

Employee reviews and sentiment can be scraped from the web to find out how well staff and management are adapting to remote-working. Metrics on personal mobility, credit card purchases, factory pollution and restaurant bookings can all be used to provide a research edge on company performance through the crisis in different industries.

COVID-19 has created new ESG challenges for companies and investors. We believe companies that demonstrate a thoughtful commitment to ESG considerations through the crisis will have a better chance of steering to a successful recovery. Similarly, investors who incorporate ESG analysis as a key component of security research will be well equipped to identify stocks and bonds of good corporate actors that are also likely to be strong sources of long-term return potential.

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