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Rainbow washing the SDGs away

The Sustainable Development Goals (SDGs) have been broadly embraced by financial institutions. This is a positive move, and timely too. The 2019 Edelman Trust Barometer[1] indicates that the finance industry remains the least trusted business sector and is often, quite rightly, blamed for failing to address the great social and environmental challenges of our time.

In this environment, the SDGs offer a unique opportunity, some might say life raft, to align the purpose of finance with globally agreed sustainable development objectives. The United Nations (UN) itself argues that finance must play a critical role in closing a funding a gap in developing countries, estimated to be USD2.5 – 3 trillion per year between now and 2030[2].

This shift is supported by client demand, with Morningstar reporting a 'Record-Shattering Year for Sustainable Investing'[3] in 2019. With this has come a proliferation of funds that claim to invest sustainably, with many linking their investment objectives to the SDGs. Indeed, even 'mainstream' investors, like large pension funds and sovereign (state-owned) wealth funds have sought to map their investments to the goals.

> Running hard on quicksand – investors are struggling to validate and articulate SDG contributions

Balancing the positives... with the negatives

The embrace by investors of the SDGs is not without its issues and carries significant risks. Unlike other responsible investment approaches, the SDGs were not designed as a private investment framework, nor are there agreed disclosure requirements or minimum standards. To make matters worse, the information that investors rely on to make decisions related to the SDGs is even sketchier than it is for other environmental, social and governance (ESG) factors, with the Ethical Corporation[4] and Oxfam[5] among others finding that SDG reporting by companies is weak and given to 'greenwashing', or 'rainbow washing'.

There are several issues we have seen with different external fund reporting:

- Lack of balance, where case studies of positive SDG impacts are not balanced with risks and issues the company faces.
- Lack of portfolio disclosure, so clients and stakeholders are left to rely on high level ESG metrics and case studies.
- Simplistic and overly-broad approaches to tagging company contributions which can lead to misaligned and inappropriate stock inclusions.
- A lack of information on the approach and processes, both where qualitative judgments are required or where quantitative approaches fail to acknowledge data issues and gaps.

Nestlé, for example, is a company we believe is moving in the right direction in terms of access to nutrition, supply chains and packaging, but readily acknowledge risks from bottled water, plastic packaging and responsible sourcing. We often say that there is no such thing as a perfect company, but too often we see the positives expressed without the negatives for large, complex and evolving companies like Nestlé.

It is one thing to have omissions from disclosures that are properly addressed through the investment process. However, we have also seen instances where companies are included in SDG labelled funds when we believe they do not deserve to be. For example, pharmaceutical companies like AbbVie who have faced criticism for drug pricing and rate poorly in the Access to Medicine Index[6] across most areas. The company has also faced controversies over elaborate kickback[7] schemes for doctors and engaged in extensive litigation to prevent competition from generics for their Humira drug, which is technically, although not practically, off-patent.

Companies like AbbVie are sometimes simplistically tagged with SDG 3 – Good Health and Well-being. However, as this example shows, it is important to look deeper at a company's business practices.

Examples like these also underline the importance of focusing on the 174 targets rather than take a broad view on the 17 goals, which in some applications can capture the majority of companies. Even socially useful and ethical companies should not be tagged with SDGs if they do not in fact contribute to the underlying targets.

The critique in this article is not about individual fund's investment choices, but rather the inability for clients and prospective clients to understand what choices are being made and why. Even well intended approaches in this regard risk a fund's reputation and further reducing public confidence in the whole industry.

What can fix this problem?

We believe that a principles-based framework is required - one which can help improve the credibility of SDG-related claims while allowing for the diversity of reasonably held beliefs and approaches to sustainable investment.

To achieve this end, we have developed and started to apply principles for our own SDG claims. We believe these principles have broader application, both by asset owners wishing to test the claims made by asset managers, and asset managers wanting to ensure the credibility of their own products. The principles are as follows:

SDG claims should:

- Demonstrate a clear link to SDG targets, especially where developing countries are differentiated from developed.
- Be meaningful and relevant for the company (not corporate philanthropy) either as:
    a. a revenue/growth driver
    b. strategic initiative backed by research and development (R&D) and capital expenditure
    c. a function of deep culture and 'how they do things' e.g. for gender equality targets
- Make a real and preferably recurring difference to target outcomes by being demonstrable (not necessarily measurable) and deliberate.
- Recognise and be transparent about negative impacts from the company, including contradictions and risks of perverse outcomes – with claims only being made where disclosure is balanced and comfort can be drawn that negatives are being addressed.

Additionally, investors should be clear about what type of contribution an investee company is making, recognising that not all directly to the SDG targets with companies noted as either providing:

- Direct contributions to targets
- Enabling/supporting activities
- Sustainable and socially useful products and services, but not directly relevant to a target

By extension, applying these principles would require full portfolio holdings disclosure.

Principles in practice - examples of how companies are contributing to sustainable development

Examples of companies we have so far categorised this way include, a Japanese drug store dispensary that has been the clear leader in distributing generic medications through a large retail network, making these medicines more accessible for rural and low-income populations. This is particularly important with Japan's ageing population. We believe the company makes a direct contribution to:

SDG target 3.8: Achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality and affordable essential medicines and vaccines for all.

A US multi-physics engineering and software company is providing supporting activities which has created the world's leading engineering and product design software. The company is supporting a move towards a circular economy (SDG 12.2 and 12.5) as its software virtually tests performance of products and processes, with the ability to evaluate energy efficiency, greenhouse gas emissions and water usage. The technology reduces development time 9x and overall product cost 4x. While we are concerned that their software is used by the defence and oil and gas industry, these represent relatively small proportions of revenue at around 1% each.

Lastly, an example of a company whose products are sustainable and socially useful, but not directly linked to an SDG target, is a Japanese baby-care company, which manufactures and distributes best-in-class infant feeding products, including bottles and breast pumps, but also health and hygiene products for the elderly.

In our attempts to apply these principles, we have developed a microsite and interactive map that provides full portfolio disclosure and relevant SDGs across strategy holdings.

Standards for claims made about the SDGs across the industry must improve, lest trust be further eroded and the all-important real world impacts fail to materialise. Transparency is a critical feature of building trust, as is the ability to demonstrate that companies are making a meaningful and enduring impact on sustainable development through their core business activities and conduct. As we look to improve our own disclosure, we invite other investors to join us on this journey.

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[1] Source: 2019 Edelman Trust Barometer. The Edelman Trust Barometer is an annual trust and credibility survey, measuring trust across a number of institutions, sectors and geographies. The 2019 Barometer surveyed more than 33,000 respondents across 27 countries.

[2] Source: https://www.un.org/sustainabledevelopment/wp-content/uploads/2019/07/EXEC.SUM_SG-Roadmap-Financing-SDGs-July-2019.pdf

[3] Source: https://www.morningstar.co.uk/uk/news/199190/record-shattering-year-for-sustainable-investments.aspx

[4] Source: http://globalsustain.org/files/The%20Responsible%20Business%20Trends%20Report%202019.pdf

[5] Source: https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620550/dp-walking-the-talk-business-sdgs-240918-en.pdf

[6] The Access to Medicine Index analyses how the world's largest pharmaceutical companies are addressing access to medicine in low- to middle-income countries for various diseases, conditions and pathogens.

[7] A kickback is an illegal payment intended as compensation for preferential treatment or other improper services. The kickback may be money, a gift, credit, or anything of value.

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Investment terms

View our list of investment terms to help you understand the terminology within this document

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