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Active Shareholder Engagement is Essential for Balanced Growth

Is sustainable investing activist? In June, the Dutch House of Representatives argued that pension funds should stop engaging in "activist investing" aimed at sustainable goals, emphasizing that returns should come first. Cardano agrees, as returns are indeed the leading principle for a pension fund. But the question is: returns over what timeframe? Maximum economic growth cannot occur without affecting the environment—and vice versa. How do you calculate returns if the damage to people and the environment is not factored in?

September 2024

Green growth is ultimately the pinnacle. This means jointly ensuring optimal economic activity within the planet's boundaries while considering a social foundation. It requires an integrated approach and an understanding of multiple sustainable transitions, as well as active involvement from both the government and pension funds.

Expert

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When investing for pensions, achieving good returns must be a guiding principle. Excluding companies based on various sustainability criteria could potentially jeopardize this objective. At the same time, investing in themes such as climate change, biodiversity loss, and pollution may yield better short-term financial returns, but on a longer-term horizon, it could contribute to larger systemic risks that have far-reaching and irreversible financial impacts. Pension funds, especially those with investment horizons stretching up to 40 years, are uniquely focused on the long term.

Two Key Questions

This long-term obligation, along with the duty of care it entails, raises two key questions. The first is from a risk/return perspective: The costs of ignoring negative impacts are enormous. Various studies cite astronomical annual losses caused by environmental destruction. Can a long-term investor contribute to this capital loss while also increasing the risk of disruptive interventions in production methods and products in the future? The "profitable" investments of today could become the "bleeders" of tomorrow. What is the risk to the value of these investments when the impact on people and the environment is accounted for? What stance should one take in this regard?

The second aspect concerns the moral question. Ultimately, a pension fund wants its participants to enjoy their pensions. Good health and a livable world are fundamental to this.

The European Commission stated the following in "The Business Case for Biodiversity" as part of the Green Deal: More than half of the world's GDP—around €40 trillion—depends on nature. The loss of biodiversity and the collapse of ecosystems are among the greatest threats to humanity over the next decade. The economic and social costs of inaction would be enormous. Between 1997 and 2011, an estimated €3.5 to €18.5 trillion in ecosystem services were lost annually worldwide, while land degradation results in an estimated €5.5 to €10.5 trillion in losses each year. Biodiversity underpins food security in both the EU and globally.

The loss of biodiversity threatens our food systems and is closely linked to, and exacerbates, climate change. This loss leads to reduced crop yields, lower fish catches, increased economic losses from floods and other disasters, and the disappearance of potential new sources of medicine. Globally, average yields of rice, maize, and wheat are expected to decrease by 3% to 10% per degree of warming above historical levels. The services provided by ecological systems and the natural capital they generate are crucial to the functioning of Earth's life-supporting systems. They directly and indirectly contribute to human well-being and thus form part of the planet's total economic value.

Investing in companies that focus on short-term profits is at odds with these challenges. It is neither the role nor the expertise of politicians to make investment decisions for pension funds or influence their investment policies. In fact, completely ignoring sustainability may lower relative risk compared to a benchmark, but it increases absolute risk in terms of value in euros.

Returns or False Returns?

In short, higher financial returns are often achieved in the short term because the damage to people and the environment is not included in the cost price. This leads to higher short-term profits but shifts the negative consequences to the future, increasing the long-term risk profile. The burden is thus passed on to future generations. As a result, sustainable investing may sometimes seem to come at the expense of short-term returns, but this return is actually false—since the true costs have not been accounted for.

Excluding Harmful Companies?

Should pension funds then exclude all companies that currently produce (partially) harmful products? And only invest in the most sustainable companies? Cardano believes the answer is no. Many pension funds do not do this either. Moreover, the number of companies that already operate perfectly sustainably is too small to create a sustainable society.

Simply excluding entire sectors or activities is a blunt tool that can negatively impact both financial and social returns. This risks excluding companies that are willing and able to transition to sustainable operations. These are precisely the companies that should be supported by shareholders during their transition. Collectively, these companies can significantly accelerate the transition—and that is exactly what is needed. We are heading in the right direction, but far too slowly. We must accelerate the transition to a sustainable society together.

New Classification

Cardano classifies companies based on their ability and likelihood to contribute to the transition to a sustainable society, as well as the sustainability of their operations. This specifically concerns topics that are financially material to a company. If a company can (or is willing to) adapt, investing in it can be a wise choice, provided risk and financial return frameworks are met. But if adaptation is too big a step, posing an unacceptable risk to investment portfolios and having a negative societal impact, avoidance or exclusion is a logical next step.

Activist or Active Shareholder?

To maximize the chances of success in the necessary transitions, investors must make their expectations clear. Passively following developments is not enough. Stewardship plays a central role here. As large shareholders, pension funds—or their designated investors like Cardano—actively engage in dialogue with the companies they invest in and vote at shareholder meetings. The "engagement topics" during such conversations vary by company and can cover financial, organizational, and sustainability opportunities and risks. For investors, failing to consider these sustainability risks is a risk in itself. If these risks materialize and are not adequately mitigated, participants will certainly take action.

So, does this make one an activist or an active shareholder? Expressing expectations, with well-founded justification, fits an active role—especially when it concerns long-term risks and associated company performance.

Engagement and Voting as Powerful Tools

Within its stewardship activities, Cardano highlights the risks and opportunities arising from ongoing transitions. Our stewardship approach is closely aligned with the Cardano Sustainability Framework—as outlined in our Sustainable Investment Policy—to ensure that our investments help companies contribute to and thrive in a sustainable future. Engagement and voting are our active, powerful tools, and they interact with each other. Divestment is Cardano's last resort, used when a company consciously decides to abandon or significantly delay its transition.

This approach results in a portfolio of companies that already operate sustainably and companies that contribute to the transition to an economy with healthy growth, within planetary boundaries. In other words, green growth.

Required: Active Shareholding, Vision, and Leadership

Pension funds, investors, governments, and humanity must collectively ensure a good life for both current and future generations. Economic growth is necessary for this, but it must occur within planetary boundaries and with consideration for a social foundation. This requires thoughtful investing, with an integrated approach to multiple sustainable transitions happening simultaneously. Alongside active shareholding, this also demands vision and leadership from politics and the House of Representatives.

Read more about Cardano's stewardship:
https://www.cardano.nl/en/stewardship/