INTEGRATING SUSTAINABILITY IN INVESTMENT ANALYSIS

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PREFACE

During the past ten years, most Nordic institutional investment companies have developed systematic frameworks to ensure responsibility in their investment decision making. These frameworks assess multiple sustainability issues, and increasingly include a degree of forward-looking analyses (such as the adequacy of investees' plans for transition to a low carbon economy). More ambitious investors are starting to systematically analyse sustainability-related impacts from the perspective of valuation.

Reflecting these two connected but different perspectives, the newly proposed EU Corporate Sustainability Reporting Directive (CSRD) seeks to define new standards to improve corporate sustainability disclosures. These standards will direct companies to report according to the "double materiality" principle—identification and elaboration of material sustainability exposures from both responsibility and financial perspectives. Crucially, the proposal introduces the requirement that these sustainability disclosures should be audited (to reduce scope for selective or misleading reporting). The current aspiration is that these standards should be applied in annual reports by 2024. This increased disclosure will likely influence investment choices—a clear incentive for us all to continue to develop our competencies in integrating sustainability issues into our financial analyses.

Portfolio managers, sell-side financial analysts, and investor relations departments are all engaged in the challenge of sustainability integration in investment analysis. This report investigates not only how each of these communities view the status of integration, but also how they are interacting with one another. The status check is enlightening, not least with regard to the almost universal view that focus on sustainability integration will continue to increase for many years. Both investors and sell-side analysts appear in agreement that sustainability analyses can identify investment opportunities, given linkage between sustainability exposure and financial returns. The report also reveals that there are significant differences in priorities and understanding between the communities. The implication is that the pace of sustainability integration could be accelerated if these differences could be mitigated.

So, how should we narrow the gaps in understanding? The report concludes with some useful ideas and pointers. A key recommendation is that all three communities need to improve communication with each other regarding what information and analyses are most useful. Another key recommendation is that all three communities need to invest further to build relevant skills and knowledge—understanding of how sustainability issues could impact companies directly and indirectly will not only increase the relevance of research insights, but also will clarify which information and data are required to enable those insights.

Swesif would like to thank all thirty portfolio managers, analysts and investor relations officers who contributed their time, expertise and insights to this study. A special thanks to those who contributed further through participation in the mid-study round table, which further enriched the study's findings and interpretations.

It was a pleasure for Swesif's ISIA project team (Julian Beer, Åsa Moberg, Anna Strömberg) to work with the Misum team. Once again, they have delivered a high-quality insight into the financial community's journey to enable successful sustainability integration.

Julian Beer
ISIA Project Manager
Board Member, Swesif

Susanne Bolin Gärtner
Chair of Swesif

EXECUTIVE SUMMARY

Many investors and companies around the world now agree that sustainability can directly influence the evaluation of companies' current and future financial performance. For this reason, it has become central to understand how sustainability—or environmental, social and governance (ESG) issues[1]—can be integrated into financial analysis. This is a task not just for financial analysts, however, but also for the portfolio managers who buy such analysis from sell-side researchers, as well as the officers who handle investor relations at the listed companies that are the target of financial analysis and investment. It is therefore important to study the interaction between these three actor groups, in order to better understand the drivers of and challenges for integrating ESG issues into financial analysis.

This report extends the results of a 2019 study by Swesif, Stockholm School of Economics (SSE) and the Stockholm Environment Institute (SEI) on the theme of integrating long-term perspectives into financial analysis.[2] Both reports include all three actor groups. While the first study was survey-based, and addressed ESG only implicitly through its focus on long-term issues, this report provides more context by using interviews to document how the different actors view the integration of sustainability into their work. To this end, we draw on 30 interviews with Swedish financial actors: 10 from the sell-side, 10 from the buy-side and 10 from the corporate side.

Our study makes four main contributions:

- First, our study indicates that there has been a notable increase in sell-side analysts' focus on sustainability in the past two years. We identify three major drivers of this change: investors' growing interest in ESG issues, the EU taxonomy on sustainability activities, and the increased attention paid to and understanding of the financial relevance of ESG.
- Second, while previous studies have emphasised that financial analysts' short-termism may have spurred markets to overlook sustainability risks, we found that participants in our study did not view short-term pressures as a major impediment. They do however highlight the need to balance short-term and long-term issues in order to better integrate ESG issues. The quarterly earnings call is a typical setting where companies often struggle to frame ESG issues in a financial context.
- Third, quantifying ESG aspects is perceived as a major challenge when integrating ESG issues into financial analysis. Our results show that initial progress has been made as some financial actors do factor either ESG scores or materiality assessments into their financial valuations. The EU taxonomy and the harmonisation of other reporting standards are perceived as important tools for further supporting these advances. Many interviewees, however, insisted that there is also ample room for qualitative assessments of ESG issues in financial analysis.
- Lastly, our findings highlight the importance of access to sufficient and high-quality ESG-related skills and resources. Most of our interviewees rely on an important variety of sources for ESG information, but largely learn how to make use of these sources "on the job". We find that dedicated ESG teams and the involvement of companies' sustainability officers provide important support, especially in the early phases of a learning curve.

1 In this report, we use the terms sustainability and ESG interchangeably. ESG is, in other words, not limited to scores, but a broader concept.

2 Setterberg, H., Sjöström, E. & Vulturius, G. (2019) Long-term perspectives in investment analysis. Report published by Stockholm Sustainable Finance Centre and Swesif.

FINDINGS	The key drivers of the sell-side's increased focus on ESG are: • Buy-side demand • The EU taxonomy • Financial relevance of ESG	Separate ESG teams or staff help make the conversation between the three groups meaningful and relevant, which ultimately aids ESG integration. ESG is often learned on the job.	Quantifying ESG is a major challenge for its integration into financial analysis. Finding suitable formats for balancing short- and long-term perspectives linked to ESG is sometimes a challenge.
RECOMMENDATIONS	Financial actors should anticipate the breadth of the transformation to a sustainable economy. This involves moving from an end-market to a value-chain view, and understanding financial risk in relation to Earth system and societal interlinkages. Sell-side houses should consider making it mandatory for analysts to integrate material ESG issues.	Financial market actors should spend resources to build stronger ESG-related skills and expertise through staff recruitment and training.	The three actor groups should consider how to better match their demand and supply information, for example through quarterly disclosure of corporate ESG metrics and key performance indicators.

Snapshot of main findings and associated recommendations.

Our findings show that the notion of *ESG integration* has different meanings across financial actors, ranging from applying ESG scores to conducting a materiality assessment to inform and modify financial valuations. We offer a schematic mapping of this in the report (Table 2).

To support a broad and ambitious understanding of ESG integration, we make three recommendations. On an overarching level, we recommend that financial actors: first, anticipate the breadth of the transformation to a sustainable economy; and, from this perspective, second, build ESG expertise and skills. Third, these three actor groups must find ways to increase the quality and relevance of their communications with each other. These recommendations are expanded on in the final section of the report.

Finally, our findings have implications for policymaking. Our interviewees highlighted the challenges that different reporting standards represent for them. We recommend that policymakers work to harmonise ESG standards. In addition, we recommend that policymakers support the pricing of negative externalities to ensure that critical ESG issues for society are material for financial analysis and ultimately for investment decisions.

INTRODUCTION: UNDERSTANDING THE ANALYST/PORTFOLIO MANAGER/ COMPANY INTERACTION

The financial markets are showing a growing interest in environmental and social sustainability issues, such as climate change, biodiversity, human rights and fighting corruption. Sustainability refers to our ability to not only preserve the Earth system, but also improve the functioning of human societies. From a corporate perspective, this entails creating long-term value for societal stakeholders and not generating profits at their expense, future generations included.

Many investors and companies around the world now agree that sustainability can directly influence companies' current and future financial performance. For example, a recent academic survey found that institutional investors believe that climate risks have financial implications for their portfolio firms, and that these risks have already begun to materialise.[3]

According to the 2020 Global Sustainable Investment Review, the share of total assets under management that is subject to a sustainability strategy has been growing steadily for many years and currently stands at *c.* 36 percent globally.[4] More than 12,000 companies have committed to the ten sustainability principles in the UN Global Compact and a recent KMPG survey found that 96% of the world's largest 250 companies (the G250) are reporting on their sustainability performance.[5]

While the capital market conversation seems increasingly to be taking sustainability into account, the integration of sustainability per se into financial analysis remains a challenge. Financial analysis usually refers to the process through which any business-related venture—e.g. a project, a company, a stock or a bond—is evaluated in order to determine its financial performance and inform investment decisions. Previous studies have identified three main barriers to embedding sustainability within this process. First, they have emphasised that the market's short-termism can prevent attention being paid to sustainability issues, as these tend to be long-term in nature (for a multidisciplinary review of this matter see Belinga and Sjöström, 2021[6]). A study by The 2° Investing Initiative and The Generation Foundation asserts that non-cyclical, non-linear risks that only materialise after the forecast period are likely to be missed by analysts, and that sustainability risks often fall into this category.[7] The authors make an analogy with *black swans*, or unexpected risks with a low probability. Some sustainability risks may be mistaken for black swans, but in reality be white swans hiding in the dark that you can only see if you put your long-term headlights on. From this perspective, it is interesting to note that, according to one survey, sell-side analysts spend only 12 percent of their time researching companies' prospects beyond a 12-month horizon.[8] Second, the literature highlights the issue of materiality—or the ability to connect sustainability issues to financial prospects in a relevant way.[9] Not every sustainability aspect has financial relevance. Third and finally, even if investors extended their time horizons and were able to determine the extent to which a certain industry is exposed to sustainability risks, they might not find meaningful and comparable indicators across companies.[10]

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3 Krueger, P., Sautner, Z. & Starks, L.T. (2020) The importance of climate risks for institutional investors. *The Review of Financial Studies*, Volume 33, Issue 3, March 2020, Pages 1067–1111, https://doi-org.ez.hhs.se/10.1093/rfs/hhz137

4 The Global Sustainable Investment Alliance (2021) Global Sustainable Investment Review 2020. http://www.gsi-alliance.org/trends-report-2020/

5 KPMG (2020) The time has come: The KPMG survey of sustainability reporting 2020. https://home.kpmg/xx/en/home/insights/2020/11/the-time-has-come-survey-of-sustainability-reporting.html

6 Belinga, R & Sjöström, E. (2021) Long-termism, climate change and financial markets: current literature and implications for policy. MISUM Report.

7 Naqvi, M., Burke, B., Hector, S., Jamison, T., & Dupré, S. (2017) All swans are black in the dark: How the short-term focus of financial analysis does not shed light on long term risks. 2° Investing Initiative, Tragedy of the Horizon Programme

8 Aviva Investors (2016) Investment research: Time for a brave new world? Aviva Investors Report.

9 Eccles, R. G., Krzus, M. P., Rogers, J., & Serafeim, G. (2012). The need for sector-specific materiality and sustainability reporting standards. Journal of Applied Corporate Finance, 24(2), 65-71.

10 Ibid.

ACTOR GROUP	DEFINITION	WORKS FOR	ROLE IN FINANCIAL ANALYSIS
Sell-side analysts	Sell-side analysts provide research on companies' listed securities. They generally follow a small number of companies from the same industry and assess their financial performance over the coming year. On this basis, they issue "buy", "sell" or "hold" recommendations to investors.	A sell-side analysis institution, often a bank	Sell-side analysts both carry out and sell financial analyses. To do so, they examine quarterly earnings reports, attend quarterly earnings calls and meet regularly with companies.
Buy-side analysts	Buy-side analysts are portfolio managers who invest in financial markets on behalf of their beneficiaries or clients. They generally invest in a large number of companies.	An asset management firm or another institutional investor such as a pension fund, an insurance company or a hedge fund	Buy-side analysts buy financial analysis from sell-side analysts, and also carry out their own analyses. To do so, they meet with sell-side analysts and companies, and sometimes attend quarterly earnings calls.
Investor relations officers	Investor relations officers oversee communications with their company's investors. They write the annual report and quarterly earnings report, and organise quarterly earnings calls, as well as other meetings with investors.	A listed company	Investor relations officers communicate financial information, which provides the inputs for the sell-side's and the buy-side's financial analyses.

Table 1: The respective roles of the sell-side, the buy-side and investor relations in financial analysis

The existing research however is mostly focused on the role of *investors* in the integration of sustainability issues into financial analysis;[11] but a variety of financial actors are involved in the process of producing financial information on companies and their assets, and influencing investors' decision-making. In particular, financial analysis largely rests on the interactions between three groups of actors: sell-side analysts do research on companies and their stock to provide regular analysis and investment recommendations to investors; portfolio managers (or the buy-side) purchase analysis from the sell-side to input into their own analysis and to make investment decisions about companies; and companies—specifically the investor relations function—communicate much of the information on which financial analyses are based, as they are the subject of investors' investment decisions. The involvement of sell-side analysts and investor relations in sustainability issues therefore also deserves further scrutiny. For instance, Eccles and Serafeim (2013) argue that to be "taken seriously", sustainability should be discussed in quarterly earnings calls—the regular financial conversations between companies' investor relations, on the one hand, and sell-side analysts and investors, on the other.[12] Understanding how the sell-side, the buy-side and the corporate side exchange and discuss sustainability information is therefore crucial in order to capture how such issues are—and could be—integrated into financial analyses.

11 Liang, H., & Renneboog, L. (2020) Corporate social responsibility and sustainable finance: a review of the literature. European Corporate Governance Institute–Finance Working Paper, (701).

12 Eccles, R. G., & Serafeim, G. (2013) A tale of two stories: Sustainability and the quarterly earnings call. *Journal of Applied Corporate Finance*, 25(3), 8-19.

In this report, we examine all three actor groups and document how they view the integration of sustainability into their work. We draw on 30 interviews with Swedish financial actors: 10 from the sell-side, 10 from the buy-side and 10 from the corporate side.

Extending *Long-term Perspectives in Investment Analysis* (Setterberg, Sjöström & Vulturius, 2019)

This report is a follow-up to a study that was published jointly by Swesif, Stockholm School of Economics (SSE) and the Stockholm Environment Institute (SEI) in 2019, *Long-term Perspectives in Investment Analysis*.[13] It outlined the perspectives of Sweden-based investor relations officers, buy-side portfolio managers and sell-side analysts. The report focused on long-term perspectives rather than ESG, but ESG was sometimes implicit since it is often seen as a long-term issue. Among the main conclusions of the 2019 report were:

- Short-termism was perceived to be a problem by all three actor groups. Notably, 51 percent of sell-side analysts agreed that "sell-side research has a detrimental short-term focus".
- The sell-side stated that it would always seek to deliver what the buy-side asked it to do, while at the same time there was some hesitation from the buy-side that the sell-side would be able to deliver on a request for more long-term perspectives, and thus there was no point in asking—in other words, a chicken and egg situation. At the same time, there was a discrepancy between and within the three actor groups on what constitutes a long-term perspective, something which might affect how the sell-side interprets buy-side demands for "long-term analysis".
- Sell-side analysts did not think that corporations included long-term issues in their story of value creation to the same extent as investor relations officers thought they did. This indicates that companies might need to adjust how and to what extent they communicate long-term issues to better fit analysts' information needs.
- The study was survey-based and while it provided highly relevant insights, we launched the present interview-based study to provide rich qualitative data to enable us to contextualise the results and drill deeper into the "how and whys" of the findings.

While sell-side analysts, portfolio managers and investor relations staff have all made significant progress in integrating ESG issues, we found that these three actor groups still struggle with "how" to integrate them. For instance, to embed ESG into financial analysis, both buy-side and sell-side analysts need to determine the materiality of the ESG information communicated by investor relations. This assessment requires the ability to prioritise sustainability and long-term issues, and to quantify ESG-related issues, as well as access to the right expertise on the matter.

13 Setterberg, H., Sjöström, E. & Vulturius, G. (2019) Long-term perspectives in investment analysis. Report published by Stockholm Sustainable Finance Centre and Swesif.

METHOD: HOW WE CONDUCTED THE STUDY

This research was conducted as a collaboration between Sweden's Sustainable Investment Forum (Swesif) and the Mistra Center for Sustainable Markets (Misum) at the Stockholm School of Economics. While the Misum researchers worked independently, Swesif supported them by providing access to interview participants from its wide network, by giving feedback on the interview grids based on expertise and practical experience of financial analysis and ESG, and by being an active speaking partner during the crafting of the report.

DATA COLLECTION

We carried out semi-structured interviews with ten portfolio managers, ten sell-side analysts and ten investor relations officers, a total of 30 interviews. This allowed us to triangulate the different perspectives of the main actor groups involved in financial analysis, which regularly interact with each other. We chose to focus on listed equity (as opposed to for example private equity or fixed income instruments) since this is the asset class where the largest amount of assets under management reportedly applies an ESG perspective in Sweden.[1] Anecdotally, it is also the asset class in Sweden where most progress has been made on ESG.

Swesif assisted by selecting interviewees from its broad network. On the company side, all the investor relations personnel represented large-cap companies listed on the Nasdaq Nordic stock exchange. All the interviewees were based in Sweden.

INTERVIEW QUESTIONS

Before the interviews, we determined and discussed with Swesif specific interview grids for each category of actor (see the appendices). We first ask the interviewees about their background and their work in their respective institutions, their beliefs with respect to sustainability issues in finance, and their interactions with the other two categories of actors. While our research project is informed by the notion of sustainability, we use the term ESG in this report, which is short for Environment, Social and Governance, as this is commonly used in the financial industry when referring to sustainability.

DATA ANALYSIS

The interviews were held between April and June 2021. Each lasted for approximately one hour and was recorded and transcribed. In September 2021, Swesif and Misum hosted a roundtable with two representatives of the sell-side, three portfolio managers and three investor relations officers to jointly reflect on what had emerged from the interviews. The discussion was captured by a notetaker and fed into our main pool of data. All the data was coded into NVivo qualitative analysis software. Each author of this reports separately coded the interviews and compared their codes to ensure the robustness of the analysis. This analysis provided key themes.

The remainder of this report presents and reflects on the four key themes that emerged from our data:

- **Trends and drivers of ESG issues and financial analysis;**
- **Time horizons;**
- **Quantification; and**
- **Internal organisation.**

1 Eurosif (2017) European SRI Study 2016, page 53.

1. TRENDS AND DRIVERS FOR INTEGRATING ESG IN FINANCIAL ANALYSES

There are many signs at the global level that ESG-related issues are gaining increased attention from financial market actors and companies. This trend is reflected in our interviews. Our respondents largely agree that there has been an increased focus on ESG issues in the capital market conversation in recent years, but that it is only in the past two years that there has been a notable increase on the sell-side.

> *I would say that the focus, especially on ESG and sustainability, has shifted materially from just two or three years ago from being an appendix to much of the material presented to investors, to being an integrated and fundamental part of every management meeting, company meeting, analyst meeting, etc.*
>
> **(BUY-SIDE 06)**

> *It* [the increased ESG focus] *is happening all the time. It has happened in the last one to three years and it will continue to happen in the next one to three years, I think. So, it's a developing process in that it will continue to change. It will continue to grow in importance, I think.*
>
> **(SELL-SIDE 05)**

> *Equity investors have a lot of* [ESG] *focus now. And it's very clear that after this year's AGM season, a lot more investors are actually thinking about and want to understand how our company is really thinking about ESG.*
>
> **(INVESTOR RELATIONS 06)**

Some sell-side research houses have even invested in dedicated ESG teams—something that we address further in Section 4. At the same time, according to portfolio managers and investor relations officers, there seems to be some variety within the sell-side group in terms of the quality that they deliver:

> *I think I've only seen two meaningful longer reports on ESG from analysts. Or, that was the case until six months ago, when everything exploded, and I now its instead maybe only two analysts who have not written anything on this topic yet.* **(INVESTOR RELATIONS 06)**

> *They have really improved over the last couple of years. But of course, there's a huge difference between those that are good and those that are not good.* **(BUY-SIDE 07)**

In terms of the key drivers identified by the interviewees of the increased focus on integrating ESG issues into financial analysis, three main themes emerge from our data: (a) sell-side analysts are motivated by increased client demand; (b) the EU Taxonomy has presented an opportunity for the sell-side to deliver value for the buy-side in the ESG space; and (c) the financial links to ESG are becoming increasingly clear.

KEY DRIVER 1: BUY-SIDE DEMAND FOR ESG SELL-SIDE RESEARCH

Sell-side analysts repeatedly told us that they are in a service business and will deliver what the client wants. Hence, the growing ESG focus by the sell-side is a natural response to strong buy-side demand. According to several interviewees, this demand has increased in recent years.

> *And the whole thing with ESG, why ESG has become big on the sell-side in the past one, two years, is the push that we get from our clients; that's what's driving the sell-side. It's not the corporations. It's not. It's because we think we can make money by serving our clients.*
>
> **(SELL-SIDE 01)**

> *They* [sell-side analysts] *have had a bit of a brutal awakening, I would say, and they are now starting to see that their clients—I mean, if you go back just one, two years, they never asked a question about ESG at all because they said, well, our clients, the investors, they actually don't care about that. They want the brutal facts from the quarterly report and give forecasts and all that, just financially. But then all of a sudden, they hear their clients asking questions about ESG and then they have to really ramp up that research, and some of that really quickly and impressively.*
>
> **(INVESTOR RELATIONS 01)**

One sell-side analyst explained that his clients would previously have relied more heavily on consultancy services such as Sustainalytics, and not expected sustainability-related analysis from the sell-side, but this has now changed. One reason, according to the interviewee, is that consultancy firms do not have deep knowledge about each individual company, unlike the sell-side equity analyst.

RANKINGS AND REWARD SYSTEMS

Portfolio managers' demands for ESG integration are sometimes directly but more often indirectly reflected in sell-side analysts' rankings. Buy-side organisations will typically use structured evaluation models for their research suppliers, and this is often a standalone topic for the larger ones. This means that if you want to be top ranked by a Swedish fund, you will probably have to do well on ESG issues. Even when it is not an explicit evaluation criterion, many agree that to get a high ranking today a sell-side analyst needs to do well on ESG integration.

> *I mean, most of the clients we talk to now, they care so much about ESG. So, if I'm not credible there, I would lose ranking and, you know, lose my value as an analyst.* **(SELL-SIDE 08)**

> *You have to sort of incentivise people. So, again, it has to come into broker reviews or external rankings as a weight. Otherwise, people won't bother.* **(SELL-SIDE 10)**

However, the buy-side's rankings criteria are not always transparent, and it might not be clear to individual sell-side analysts how the bank-wide rating relates to their own work.

> *It's not a lot for the individual, but for the group, I would say for the bank, it's important. But it's hard to get personal feedback in ESG rankings in the same way as I get in individual or sector rankings.* **(SELL-SIDE 03)**

Portfolio managers will often have an open dialogue with sell-side analysts about what they are looking for. The importance of ESG can therefore be conveyed in more informal ways than evaluations and rankings. Furthermore, it is a common business model for portfolio managers only to reward the research that they are satisfied with, which is another mechanism that incentivises sell-side analysts to integrate ESG issues if that is what the client wants.

> *Each quarter, we evaluate all the* [sell-side] *companies that we have agreements with, and then we give the company points. So, we pay them for analysis and one factor is ESG. So, if we are not happy with their ESG work, they don't get paid, and the* [sell-side] *companies know that as well.* **(BUY-SIDE 02)**

> *So, we're both voting on them and giving them feedback, but also paying them. So, it's pretty crystal clear how we* [incentivise them]. **(BUY-SIDE 05)**

One portfolio manager pointed out that it is important that the sell-side response to increased client demand for ESG-inclusive research and analysis is anchored at the top, so that sell-side analysts get enough resources to meet the demand. They might, for example, have to hire new staff.

KEY DRIVER 2: THE EU TAXONOMY FOR SUSTAINABLE ACTIVITIES

The EU's classification system for environmentally sustainable activities, often referred to as the EU Taxonomy, was repeatedly highlighted by our respondents as having accelerated sell-side research in the ESG domain in the past one or two years. The EU Taxonomy, which came into force in July 2020, seeks to define which investments make a substantial contribution to at least one of the EU's climate and environmental objectives, and do not significantly harm these objectives. Its purpose is to help steer capital in an environmentally sustainable direction and to prevent greenwashing. During the development of the Taxonomy, there was both controversy and confusion about the eligibility of some activities. The disclosure regime has still not taken effect at the time of writing. Portfolio managers are under pressure to assess how taxonomy-compliant their portfolios are, while

at the same time many companies are struggling to collect the relevant data in order to estimate how taxonomy-compliant their business is. This has led the buy-side to ask the sell-side for input and guidance, thereby propelling sell-side researchers to deep-dive into the topic.

> *The taxonomy: it's quite hard to get a grip on. So that's a typical subject that we have been discussing with sell side analysts now.* [...] *I think that the* [sell-side] *company who is good at explaining how they view the taxonomy and that is early in providing us with figures on how much* [companies'] *revenues and CAPEX are taxonomy-aligned, they would have huge benefits now.* **(BUY-SIDE 02)**

> *But it's also like now with the EU taxonomy. So, then people want to understand: 'OK, I have a portfolio. How is that portfolio screening, which are the EU taxonomy cases where we will have more than 50 percent alignment, which are the ones where people might get disappointed? Where might we get the positive surprises?' So sometimes it's of that nature. It's not like they really care, but they care about other systems and people's perceptions. Because if people were expecting a company to be 50 percent aligned, then it comes out to be eight to 10 percent aligned; well, that's a disappointment.* **(SELL-SIDE 01)**

One sell-side analyst described how his co-authored report on how the taxonomy might impact different companies in a certain sector received more client attention than anything else he had written that year. It generated a lot of opportunities to discuss these matters with investors. Notably, the analyst added that "nobody had expected us to write the report", which indicates that sell-side analysis that proactively integrates ESG issues is not only appreciated, but also a differentiating factor for sell-side institutions. One buy-side respondent also said that it seems that some sell-side houses have seen the need to staff up to meet the demand for increased research on the EU taxonomy.

From a company perspective, several investor relations officers in our interviews reported that the taxonomy has contributed significantly to greater ESG-related interest from the sell-side.

> *It's shifted drastically and rapidly in just the last year, I think, with this taxonomy and then all of that coming into play.* **(INVESTOR RELATIONS 01)**

One respondent noted that a degree of regulation can play a similar role to the taxonomy in driving the integration of ESG issues into financial analysis, and that the sell-side has an important role in helping the buy-side to understand business impact. One example is the single use plastic directive and what it means for the suppliers of restaurants, and the like. The same respondent pointed out that these conundrums arise from the fact that sustainable investment is no longer just about excluding things, but now more about risk monitoring. Investors need to understand the business impact, which in turn increases demand for ESG integration into sell-side research. This leads us on to the next key driver: the business case for ESG.

KEY DRIVER 3: THE FINANCIAL RELEVANCE OF ESG

Some of our interviewees explained their inclusion of ESG in financial analysis by the simple fact that it makes financial sense: If there is a business case for ESG, it should make it into the equity research and the valuation model.

> *You realise at a certain point that if you're not on top of some of these factors, you're going to miss out on either potential significant value creation in the company or value destruction.* **(SELL-SIDE 02)**

> *I talk to Atlas Copco, one of my biggest holdings in the fund. It's so obvious that they need to be at the forefront when you talk about climate and everything; otherwise, they will not be in the game in, say, five years. So, it's really, really important today: not only because you want to be a good company, but to actually make profits.* **(BUY-SIDE 10)**

According to one investor relations officer, the realisation that there is a financial link with the opportunity side of ESG, not just with risk, has spurred more investor attention on ESG issues.

> *From a financial perspective from the investor side, I think when investors really started to realise that this is not just a risk, but an opportunity; obviously you can price or try to price the risk of missing out on, in our case, the electrification race or you can sort of also price the opportunities that are out there.* **(INVESTOR RELATIONS 08)**

Several investor relations officers pointed out that sustainability is an integral part of their business, so it would be difficult to do a financial evaluation of the company that does not include ESG issues. One investor relations officer was even puzzled as to why ESG-related activities should be labelled as such, rather than just business continuity and business improvement. In his view, this is how analysts see it too.

> [Analysts] *don't say 'now I have an ESG question', they ask me 'now I have a business question: how is the cleantech business in the energy transition performing?'*
> **(INVESTOR RELATIONS 05)**

The idea that ESG is an integrated part of business and therefore qualifies for inclusion in the financial analysis was also discussed by a portfolio manager:

> *If you're talking about fossil fuel-free transportation and the opportunities: Would you consider that ESG or not? Well, at least to me, you do have an ESG linkage about that, but it's just telling us about the company's ability to transport.* **(BUY-SIDE 01)**

While the business case for sustainability is still disputed in academia,[14] our findings show how this increasingly widespread rationale facilitates the integration of ESG issues by financial actors. The financial relevance of ESG-related issues could, however, depend on the time horizon considered in the financial analysis. Many crucial ESG sustainability issues might only become financially relevant in the long run.

MAIN FINDINGS: TRENDS AND KEY DRIVERS

- There has been a notable increase in the sell-side focus on ESG issues in the past two years but, according to the buy-side, the extent of the increase varies between houses.
- The sell-side's ESG focus is largely driven by buy-side demand, and amplified by investors' need to better understand the implications of the EU taxonomy on sustainable activities.
- Integration of ESG issues into financial analysis is also driven by the perception and understanding that it may have financial relevance.
- The buy-side feels that its reward system for sell-side ESG integration is clear, while the sell-side finds that at times it is opaque.

14 See for example: de los Reyes Jr, G., & Scholz, M. (2019). The limits of the business case for sustainability: Don't count on 'Creating Shared Value' to extinguish corporate destruction. *Journal of Cleaner Production*, *221*, 785-794 ; Crane, A., Palazzo, G., Spence, L. J., & Matten, D. (2014). Contesting the value of "creating shared value". *California Management Review*, *56*(2), 130-153.

2. TIME HORIZONS

A focus on ESG and sustainability issues often requires a long-term perspective as, by definition, sustainable development takes the well-being of future generations into account. ESG risk management sometimes aligns with long-term shareholder interests, for instance, to anticipate the financial impact on future regulations of climate policies or diversity requirements, avoid increased stock price volatility from scandals such as child labour in the supply chain or simply prevent the additional costs of physical risks such as flooding near a factory. At the same time, however, financial analysis and investment can have a variety of time horizons, from day-trading to months or years, depending on the investor mandate and other such factors. In addition, the different actor groups on which this report focuses are often not aligned: sell-side analysts typically focus on a 6–12-month time horizon while many portfolio managers focus on the coming three to five years, pensions funds might even have a 30-year investment horizon, and the focus of publicly listed companies might span anything from quarterly results to sustainability goals set for distant decades. We were therefore interested in better understanding how the various actors balance the different time horizons and how this might affect ESG integration.

SHORT-TERM PRESSURES: DO THESE HINDER ESG INTEGRATION?

Quarterly capitalism has been described as pressure from the capital market on publicly listed corporations to continuously deliver short-term financial results. A quest for quick wins, the argument goes, could in part be driven by sell-side analysts' lack of focus on financially material sustainability issues.[15] While some of the sell-side analysts in our interviews agreed that there might be some truth in the statement that the sell-side pushes companies towards short-term thinking, many respondents were more cautious. Portfolio managers argued that companies with a strong quarterly focus would not remain profitable over time, and that most companies have the integrity to withstand any such pressure. Some also referred to a short-term focus as being "part of a game" that companies—at least the large ones—know how to play but would not be influenced by:

> *The big companies, they don't care. I mean, they are big, and they know the game.*
> **(BUY-SIDE 08)**

> *I can assure you that that means nothing in how we run our business.* **(INVESTOR RELATIONS 05)**

Investor relations officers explained that while the conversation with the financial market is often short-term oriented, this does not prevent the company from having a more long-term focus internally, on business plans, strategy and long-term ESG-related issues. Furthermore, respondents pointed out that companies with a strong main owner might be less concerned about quarterly fluctuations and more concerned with how sustainability issues might affect their investment in the long run. Respondents noted, however, that while it would be detrimental for business to only have a short-term focus, it would be equally problematic to only have a long-term focus: companies, investors and analysts need to strike a balance.

BALANCING SHORT-TERM AND LONG-TERM

Most of our interviewees end up working with different time horizons and/or interacting with financial actors with different time horizons. Managing these different timeframes, and balancing the short term and the long term therefore becomes an important part of integrating ESG issues. For instance, sell-side analysts explained how they adjust to different types of clients: for state pension funds it might be more important to write "a bigger piece" on understanding what will happen to a certain industry in five years, in order to provide insights into whether it is an industry that the fund would like to be exposed to. Thus, while the sell-side tends to have a shorter focus overall, it is ultimately about catering to client demand, which includes an interest in long-term ESG-related issues.

15 Aviva Investors (2017) Brave New World. https://integratedreporting.org/wp-content/uploads/2017/10/research-brave-new-world.pdf

> *I think that it has also been pushed from our side that the sell-side cannot focus too much on the short term because it's not in the interests of most people.* **(BUY-SIDE 03)**

> *I think it's a big shift that people are not caring so much about the quarterly numbers anymore; and I have to adapt and just think, you know, that if no one is going to pay me for having expertise on the quarterly—I mean, very few people—I just have to adapt and look more longer term. To be honest, I think it's actually quite a healthy development.* **(SELL-SIDE 08)**

One investor relations officer told how, in the light of sustainability targets typically being long term, the company was currently making an effort to move its financial targets more towards the long-term story.

Another aspect of balancing different time horizons, and one which could potentially impact the extent to which ESG is integrated into financial analysis, is the tension between the goals of the fund and how portfolio managers are evaluated. Pension funds would typically have long investment horizons of maybe as long as 30 years but, as the interviewees noted, the focus of an individual portfolio manager will be shorter:

> *A lot of them* [pension funds] *say they are long term* [but] *you* [the portfolio manager] *still have to think about your job (...). So, someone may urge you to think about the next three to five years and then you have two years of shit performance and out you go. Maybe your stocks will ride for the three to five years, but if you underperform dramatically for a short period, maybe, you know, someone loses their temper with you anyway.* **(SELL-SIDE 10)**

> *I try to be really long-term in my thinking and my decisions, but I also know that my bosses are seeing how I'm doing each day, each month, each quarter, so I would lie to you if I said that I only think about the long term.* **(BUY-SIDE 10)**

One setting where there appears to be a struggle to balance short- and long-term perspectives on accounting with longer term ESG-related issues is the quarterly earnings call. This is a meeting where the Chief Executive Officer and the Chief Finance Officer present the financial results of the past three months and share their views on the coming quarter, which is followed by a question-and-answer session. It is largely attended by sell-side analysts but some investors will join too. Quarterly earnings calls are one of the most important interfaces between company management and the financial markets.[16] By definition, the earnings call is focused on the short term, but it has been argued that if ESG factors are to be viewed as a strategic commitment, they merit the same attention in the earnings call as other strategic initiatives, such as major R&D programmes or expansion into new markets.[17]

Our respondents expressed mixed views on whether ESG-related information should be discussed in these calls: some said yes while others said no, but many agreed that it is becoming more prevalent. This seemed largely to be related to sector. For those companies where climate-related issues are especially material, such as transport or heavy industry, it appeared more often to be a natural part of the earnings call. We also probed analysts and portfolio managers about whether they raised ESG-related questions in the question-and-answer session. Again, this differed by type of respondents: most sell-side analysts seemed not to do so while for some buy-side respondents, it was a way not only to gather information but also to get a feel for the level of commitment among company management.

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16 See for example a survey published in Brown, L. D., Call, A. C., Clement, M. B., & Sharp, N. Y. (2019). Managing the narrative: Investor relations officers and corporate disclosure. *Journal of Accounting and Economics, 67*(1), 58–67. doi:10.1016/j.jacceco.2018.08.014.

17 Eccles, R. G., & Serafeim, G. (2013). A tale of two stories: sustainabililty and the quarterly earnings call. *Journal of Applied Corporate Finance, 25*(3), 66–77. doi:10.1111/jacf.12023

The most obvious difficulty with getting ESG issues into the call is the different time horizons:

> *Should we follow up on the environmental or sustainability targets that we have? Perhaps, but again, environmental targets are typically five, 10 years out. So, does it matter if we report it on a quarterly basis? We know we report on it on a monthly basis internally; I don't know if it makes sense to do it externally on a quarterly basis. Perhaps it will start to come. I don't know. All I know is that if the world asks for it, we will do it because we have the data.*
>
> **(INVESTOR RELATIONS 05)**

> [Interviewer: Would you ask questions about ESG in the quarterly earnings call?]
> *Not really. And that's a good point actually because, on the earnings calls, it's assumed, if not spoken, that it's about the quarter; it's about the quarter that has passed and the quarter that is coming up. So, I would say extremely little about sustainability in the quarterly calls.*
>
> **(SELL-SIDE 01)**

One sell-side respondent pointed out that even if ESG issues make it on to the call, this might not be framed in a quarterly context. Instead, it might be about trying to connect something that is happening in the quarter to a longer structural trend that could be ESG-related.

Many, however, expect that there will be more ESG-related information in these calls in the future.

> *Maybe one year from now, I wouldn't be too surprised if the PR people had convinced company managements to have a distinct sustainability section in the quarterly calls.*
>
> **(SELL-SIDE 01)**

One likely major challenge, therefore, is to present it in a quantitative way that is useful for sell-side analysts' valuation models, a topic that is addressed in chapter 3.

MAIN FINDINGS: TIME HORIZONS

- A short-term focus is not perceived as hampering ESG integration to the extent that has been claimed in other studies, but the buy-side still sees a need for the sell-side to become less short-term oriented.
- The three actor groups are making continual efforts to balance short- and long-term perspectives linked to ESG issues.
- There were mixed views on whether the quarterly earnings call is a relevant forum for raising ESG issues, but this is expected to become more common. The capital markets day is generally viewed as a more suitable venue.

3. QUANTIFICATION

While all the interviewees recognised the importance of integrating ESG issues into their work, most indicated that quantifying ESG issues is still a major challenge. Quantification refers to the process by which ESG issues can be measured, compared and priced. This last part—monetizing ESG—is often the most difficult. Portfolio managers and sell-side analysts emphasised that quantification would help incorporate ESG issues into financial analyses as they could become part of Discounted Cash Flow calculations or other valuation tools that drive investment decisions. The burden of quantification falls first on companies, as they report on ESG issues, select the information that investors will deem material or just attempt to increase interest in their sustainability work.

Quantifying [ESG] *is really the biggest challenge that we see. How can we present this information in a way that is relevant for the buy-side and the sell-side? We are struggling and trying to find a way.*

(INVESTOR RELATIONS 09)

MATERIALITY AND VALUATION TOOLS

While the quantification of ESG issues is their measurement, materiality is an assessment of whether ESG-related issues are likely to have a significant effect on financial performance or valuation.

With respect to financial analysis, when one or several ESG issues are deemed material, they can be factored into the valuation process, e.g. into the calculation of Discounted Cash Flows (DCF). DCF is a valuation method based on an investment's expected cash flows. Financial analysts forecast expected free cash flows from a certain investment and "discount" them to determine a "present value". While analysts might integrate long-term cash flows (e.g. 10 years out) into their analysis, these are discounted more heavily than short-term cash flows.

Quantification of ESG issues is still an immature component of financial analyses, but our interviewees highlighted the efforts that have been made in this direction.

EARLY PROGRESS TOWARDS QUANTIFICATION

Several financial analysts are already factoring ESG issues into their valuations. For instance, some analysts apply an ESG score to each company and alter their DCF calculations correspondingly. These scores might compare, for instance, how well a company is doing on ESG issues against the average ESG score for the industry. This approach assumes that companies with better than average ESG scores will deliver better performance in the long term, whereas the others will see their equity value decrease, and some sell-side analysts therefore include a risk premium to reflect this.

To avoid the shortcomings of ESG scores, other sell-side analysts try to directly assess the materiality of ESG for the companies' financial statements. They include this in their DCFs by providing estimates of the costs or benefits of sustainability over the years.

I have companies involved in wood-based contract construction materials, and the pitch here is that they can take market share from cement or steel. Construction materials have huge carbon issues; the cement industry is one of the worst industries in the world and so is the steel industry, by the way. Whereas, if you build houses with wood, you can store carbon for 50 or 100 years, depending on how old the tree. It's based on a renewable resource; and you will store carbon for a very long time. It's a very long cycle material, and then you can, for instance, if you want to quantify, you can say... that they will each and every year take one percentage point of market share; and you can quantify that. You can identify that this is the market, [so] *one percent market share is worth that much.* **(SELL-SIDE 01)**

Making these estimates requires analysts to understand the end market of companies, their long-run strategies and how sustainability can drive or decrease value. Portfolio managers and investor relations officers, however, indicated that these attempts are not always accurate, and can even misrepresent firm-specific sustainability information.

> *I think they ask the right* [questions]*, but then they're not sure what to do, how to use the* [ESG] *information they get and put it into a financial model. That's not easy. Some have tried it and then we have had some really tough discussions with some sell-side analysts about how wrong they have been in their assumptions and their conclusions. So there has been… some catastrophic first analysis coming out that… was almost embarrassing for that institution.* **(INVESTOR RELATIONS 01)**

In addition, most interviewees agreed that it was possible to try to quantify environmental issues, but the quantification of social issues was as yet undeveloped.

> *Our ambition is always to try to put numbers on it; and you end up with a correlation, massive correlation matrix* [into] *which you're feeding all the data, where you can sort of see gender equality and whatnot. And you look at the company's performance over time and then you might end up with something showing that it's probably a good thing if there's equal representation of men and women on the board and top management. But there are also studies showing that, no, it doesn't matter. […] So, I just want to say it's been easier to focus on the environmental factors, if you have an ambition to put numbers on it. Whereas some of the other* [factors] *are much more difficult; it's more that it's good or it's bad, which has value. […] Hopefully we'll be able to do more on that side.* **(SELL-SIDE 02)**

Sell-side analysts therefore refer to quantification as largely a "guessing game". There is a risk in getting the estimates wrong—including for their own careers. Some noted, however, that financial analysis has always been about looking into the future and making estimates, and that they are already working with non-financial information when it comes to business models, governance issues and even litigation risks. Most of our interviewees were hopeful that the quantification of ESG will be fully developed in time, not least thanks to the harmonisation of ESG reporting standards.

> *I think that it's also a question of time. Everything will be quantified very soon. I mean, you have the EU taxonomy regulations coming out. So, all this will be a reality very soon.* […] *There was the same thing with employees before and well-being and so on. It's all in the figures now. So, I think that it's going to come…* [for] *sustainability in the broad definition as well.* **(INVESTOR RELATIONS 04)**

Doubts remain, however, on whether ESG standards can deliver on their promises, and whether even standardised metrics can or should be used to assess the materiality of ESG issues. We now turn to the promise of ESG standards for quantification.

THE STANDARDISATION OF ESG

While some expect that the skills and information required for quantification will soon be developed and become routinised in financial analysis work, the sell-side and buy-side analysts still considered the ESG information provided by companies difficult to compare from one company to another, and thus difficult to make sense of in the context of financial analysis. Most interviewees therefore regard the European taxonomy as valuable for standardising information and facilitating quantification.

> *Historically, yes* [it has been difficult to quantify ESG]*. I think with the EU taxonomy regulations this will be resolved because you report according to certain standards; and then it will be much easier to compare. And when you can compare things, you can actually put it in the Excel spreadsheet and use it to some extent. So, I think that it will make life easier for everyone when you have common practices and standards that you need to report according to.* **(INVESTOR RELATIONS 06)**

While other investor relations officers also welcomed the taxonomy, they signalled that companies are under a lot of pressure from investors to cope with various—and time-consuming—standards from the EU taxonomy for European investors to the Global Reporting Initiative (GRI), the Sustainability Accounting

Standards Board, the Taskforce on Climate-related Financial Disclosures, and the Carbon Disclosure Project, among others.

Companies are calling not only for the alignment of these various standards, but also for better recognition of their transition efforts towards a low-carbon economy. Many investor relations officers, portfolio managers and sell-side analysts highlighted that some high-emitting companies do not qualify as EU taxonomy compliant even though they have made significant investments in climate mitigation and transition. The steel company SSAB, for instance, was mentioned on several occasion as a company that would be judged negatively according to the taxonomy, despite its long-term climate strategy for producing fossil-free steel. Others signalled that the taxonomy does not fit well with the challenge facing service industries or multinational goods companies.

> *As with this taxonomy, it's very EU centric. Of course, it's the EU that is putting it out.* [...] *So how will that fit into the EU taxonomy if you sell trucks globally? I mean, try to sell an electric truck to a developing country in Asia or Africa: there's no infrastructure. You won't be able to sell an electric truck there for a decade or so. So that's another challenge for the companies operating globally. But I think from an investor point of view as well, if you're the world's best company that produces trucks, they will struggle to get close to, say, 70 percent of sales that are ESG compliant because they* [sell in] *markets that will take at least a decade to catch up with the rest of the world. Probably longer.*
>
> **(SELL-SIDE 04)**

Even if they were to be aligned, however, ESG standards such as the taxonomy would still generate new issues and biases for both companies and their investors. Some of the interviewees therefore argued that qualitative information is still needed to overcome the shortcomings of ESG quantification.

BEYOND QUANTIFICATION: MAKING ROOM FOR QUALITATIVE INFORMATION

Not all the interviewees agreed that ESG issues can or even should be quantified. In particular, several portfolio managers insisted that some aspects of ESG analysis cannot be reduced to a cost or price.

> *You can't quantify reputational risk. An example of that is H&M. They have been banned from apps in China due to what they have said about the cotton area in...*[Xinjiang]. *But then H&M said that it wanted to be friends with China, and it wanted to be friends with their customers. And it's hard to quantify the value if China were to ban H&M forever. And it's harder to quantify if customers choose to go elsewhere to buy clothes due to the fact that they buy cotton from this region. It is impossible to put a price on that. So that's why I don't think that you can use the same format for all companies when doing your ESG analysis.* **(BUY-SIDE 02)**

Some of our interviewees explained how they integrate "soft issues" into their investment decision-making process beyond valuation calculations. For instance, they qualify the extent to which they rely on DCF estimates and other valuation tools, and they suggested that this was already common practice in financial analysis.

> *You could compare to how we did it in the old days where we typically only looked at the G* [Governance]. *I mean, how is the management, how's the board, how's the compensation, how's their vision of the culture, how's the DNA of the company.... That was also kind of, you know, a bit fluffy, but still, we couldn't put it into the DCF models. But it would be an area we should have to check regularly. So again, even though the ESG part is still not material because we don't have the standards and so forth, we still have to do estimates in a more qualitative way. Will this be a company at the forefront, or will they be among the losers? And as I said before, I think SSAB will be at the forefront while a competitive steel producer might be one of the losers. But*

> *putting that into a DCF model... I'm still OK with not being able to do that because I hope I will in the future.* **(BUY-SIDE 08)**

Similarly, many portfolio managers emphasised that they consider the "trustworthiness" of the management of companies in their investment decisions.

> *But* [electrification] *could also be a huge opportunity for* [Volvo]*. And, again, we're not going to know that in five years' time. So, it's difficult to put a number on it. But then it comes down again to what we feel about the company's management and* [how] *trustworthy they are. And if they're actually committed to doing what they say they're doing. It comes back to our discussions about management.* **(BUY-SIDE 03)**

Some of our interviewees therefore believed that progress with the quantification of ESG issues does not make qualitative data obsolete. Some ESG issues that have yet to be quantified can be discussed in qualitative terms. Others might always remain qualitative, as investors preserve a qualitative evaluation of companies on top of quantitative financial valuations. More generally, the discussion of quantitative and qualitative analyses of ESG issues means that financial actors will have access to sufficient ESG-related information and the skills to produce and interpret such analyses.

MAIN FINDINGS: QUANTIFICATION

- The quantification of ESG issues, and their translation into spreadsheets for corporate valuation models, is seen as a major challenge for integrating ESG issues into financial analysis.
- Early progress has been made with quantification as some financial analysts are either integrating ESG scores into their valuation models or making financial estimates of the impact of ESG issues on valuations.
- A lack of standardised ESG data, however, is hampering the communication of relevant ESG data from companies to analysts.

4. ESG-RELATED SKILLS AND RESOURCES

The integration of sustainability into financial analysis requires new sets of skills not only from companies and portfolio managers, but—perhaps more importantly—also from sell-side analysts. Companies and portfolio managers have long been exposed to sustainability issues, but the rapid increase—in only a few years—in interest is pushing a better understanding of the financial implications of ESG issues. Still new to this topic, sell-side institutions are building up the skills and experience needed to address the challenge of materiality.

One sell-side analyst mentioned having taken a course, but most of the sell-side interviewees have had few opportunities for retraining. They reported "learning on the job", mostly thanks to their own reading, but also through interactions with their own ESG teams and the companies that they follow.

ESG INFORMATION

Both sell-side analysts and portfolio managers discussed using the services of ESG ratings agencies such as Sustainalytics or MSCI, as well as doing their own research on sustainability. This research generally comprises reading company sustainability reports, industry reports and new regulatory information. One interviewee detailed how sophisticated but time-consuming this work can be:

> *We have come quite a long way. If I look at a new company, for example, we have a captive quant. model. Basically, it's web-based, you plug in a ticker and apply maybe four or five peers, you press a button and then it scrapes, I don't know, 10, 15 larger sources from* [ESG data] *companies like MSCI, RepRisk or SASB, whatever, and I get a big—image-wise—overview of their ESG work. Basically, you get a couple of charts, a z-score, depending on their position or the quality of their work in relation to the industry globally; and we start with an SASB exposure to see what's relevant in this sector; but we also have it for all sectors. We have sort of gone through all these different risk areas and put our own weighting on those where we think they are more relevant than others. Because not all these exposures are relevant to our sectors, the job is to go out and say: what is the data showing?* [It] *scrape*[s] *it, we draw conclusions* [using] *the machine and I get an output. And I can also compare that with all the peers. So you get a pretty good view as a starting point. Then we go in to read all the company policies and the reports; we meet with sustainability, investor relations and company management, we check their policies* [and do] *follow-ups. We look for areas of engagement, we look for incidents and we document everything in a standard template; then we rate every pillar, and we also see areas of improvement, and so on. We try to include the effect on the evaluation as well, and then we suggest a rating. This work could take three to four weeks.* **(BUY-SIDE 04)**

Sell-side analysts mentioned focusing on information related to macro-trends and market transformations on environmental and social issues. Most of the interviewees emphasised the importance of electrification to many companies' business models and consequently to financial analysis. Information can come from a variety of sources, such as newspapers, magazines, industry reports, governmental reports or even trade fairs.

> *Of course, I need to know about the business models and the products that the companies I cover produce, and I know what kind of end market those products are going to. Then what I do is that I read a lot about the different end markets. And I mean, with electric vehicles, you can read a lot about batteries, and you have a lot of data and estimates on how this market will develop going forward. And what I'm doing as well is that I attend different trade fairs where I meet with the suppliers and producers of different components and products. Then at some point during this research process, you understand that, oh wow, this could have a big impact on the earnings potential for this or that company.* **(SELL-SIDE 06)**

Companies also invest in several tools to meet investors' interest in ESG issues and their financial implications. Some investor relations officers for instance spoke about using the SASB materiality map in their annual reports.

DEDICATED ESG TEAMS

Most sell-side analysts and buy-side portfolio managers reported that their ESG work was supported by their organisation's—and sometimes departmental[18]—dedicated ESG team. On the sell-side, ESG teams appear to have been constituted more recently, and some analysts mentioned being in the middle of a recruiting process. Sell-side analysts can mobilise their ESG teams to write reports where ESG is particularly significant for companies, but also to keep up with client demands for information on the ongoing development of ESG issues, regulations and standards.

> *I think our ESG team is doing quite a good job trying to keep us up to pace at least. And they are doing a lot of the calculations when it comes to ESG metrics, etc. […]. When* [a buy-side analyst] *wants to discuss ESG issues related to a specific name, say, Atlas Copco, which is a company that I cover, she would probably go to* [Name], *who is head of our ESG team, instead of going to me because* [Name] *knows Atlas Copco much better from the pure ESG perspective. So, when it comes to ESG, she would talk to* [Name] *and then she would talk to me about Atlas Copco and the products and the competitiveness and the end markets…* **(SELL-SIDE 06)**

Some also said that their ESG teams contribute to their sustainability training. ESG teams help bring new concerns to their attention that should be included in the financial analyses.

> [Our ESG analyst] *is the person who is the most dedicated to only ESG-related questions. So she's a guarantor. You know, she ensures that the quality of our ESG work on a company-level basis is good. We do it all ourselves so that's some kind of internal training, but also forcing the rest of the analysts to follow her advice or tick the boxes that need to ticked.* **(SELL-SIDE 10)**

Portfolio managers also remarked that the integration of ESG-related issues into sell-side research has really benefited from having ESG specialists on board at sell-side institutions.

> *I think the* [sell-side] *companies that have done best have specific ESG analysts. Those that try to incorporate ESG analysis by the normal sell-side analyst who has been covering the company for five or six years, when they integrate ESG analysis, they do it just with their left hand. It's not really from the heart. So the companies that do it the best have a separate ESG department.* […] *Because the ESG questions are quite difficult sometimes. We have specific ESG analysis that we do for all companies that we own or that we have lent money to on the bond market. But that's a sheet with 50 different questions. And it's hard to do that because companies have different opportunities within ESG and different risks. No company is like another. So, I think it's better to do it case by case. Some sell-side firms have ESG analysts who, when something occurs in the company,* [assess] *how this would affect the company's reputation, the P&L* [profit and loss], *and so on. I think they succeed better than* [the others]. **(BUY-SIDE 02)**

On the buy side, dedicated ESG teams seem to be more common practice. Many publicly listed companies also have their own "ESG teams" in the form of Corporate Social Responsibility departments and sustainability officers.

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18 As some organisations offer both asset management and sell-side analysis services, some of our interviewees explained that their ESG team was specific to their department. The other side (buy/sell) had their own.

CORPORATE SUSTAINABILITY OFFICERS

Corporate sustainability officers are another important resource for integrating sustainability issues into financial analyses, especially when they attend investor relations meetings with the buy-side and the sell-side. They can provide additional information, and meet independently with the portfolio managers' and the sell-side's ESG teams.

All of our interviewees from investor relations indicated working closely with their firms' sustainability officers. Their explanation for this was that investors have increased their interest in ESG, but also that it was a way to drive increased—and better informed—attention on their companies' work on environmental and social issues.

> *Already back then* [in 2015] *we had a wonderful sustainability manager (...). And the two of us, we could kind of, you know, force brokers to arrange ESG roadshows. And we both went, standing on the stage, presenting the company with all the sustainability included. Sometimes people don't know what's good for them. So maybe by educating them, they will learn how to* [look at] *the more interesting topics as well. Yes, it's about being a teacher in a way, working in investor relations.*
>
> **(INVESTOR RELATIONS 09)**

This involvement of sustainability officers helps to better connect the company information output to investors' expectations and concerns about the materiality of ESG issues. When the sustainability and investor relations functions work closely together, it seem to ameliorate the discussions on the reported ESG metrics.

MAIN FINDINGS: ESG-RELATED SKILLS AND RESOURCES

- Financial analysts have a variety of ESG information sources at their disposal but largely have to learn on the job—rather than through training—how to make use of them.
- Dedicated ESG teams or staff, as well as a company's sustainability officers appear helpful for the three actor groups to have a meaningful information exchange about ESG, which can feed into financial analysis.

5. DISCUSSION & RECOMMENDATIONS ON THE FURTHER INTEGRATION OF SUSTAINABILITY INTO FINANCIAL ANALYSES

Our results show a general perception, at least among the members of this group, that the sell-side, the buy-side and investor relations have all made significant progress with integrating ESG issues into their communications with each other. ESG issues have a more prominent place in financial analysis today than just two years ago. These efforts are driven not only by portfolio managers' increased focus on ESG, which has spilled over to the sell-side, but also by the highly anticipated EU taxonomy for sustainable activities, as well as a growing awareness of the financial materiality of ESG issues.

We found, however, that the three actor groups still struggle with "how" to integrate ESG. "ESG integration" is not well-defined. Based on our interview material, it could mean: (a) adding a section on ESG-related risks to a template for mainstream financial analysis; (b) modifying a financial valuation based on an ESG score; (c) including a price estimate for one or several ESG issues in the earnings forecast based on a materiality assessment; or (d) moderating an investment decision based on a qualitative judgment of ESG risks.

The term integration, which is defined in dictionaries as *uniting* different things, is sometimes used in the ESG context to mean "adding" or "connecting". This might be because ESG issues are often referred to as "non-financial", connoting that they are something different than the usual financials, and thus more of an add-on than *part of* the regular financial analysis. It is also clear from the bi-yearly Eurosif report on different ESG-oriented investment strategies that ESG integration in asset management is not well defined.[19] **We would therefore suggest that the industry itself and future academic research discuss and explore what "true" ESG integration could and should entail.** That said, to achieve a higher degree of ESG integration (in some shape or form) into financial analysis, we have derived three broad recommendations from our interviews.

LEVEL OF INTEGRATION	LOW	HIGH
Quantitative	Use of ESG scores to modify financial valuation	Use of materiality assessment of ESG to modify financial valuation
Qualitative	Separate section in financial analysis	Use of qualitative assessment of ESG to modify investment recommendation/ decision

Table 2: Different levels and types of ESG integration

19 Eurosif (2019) European SRI Study 2018.

RECOMMENDATIONS

THE FINANCIAL INDUSTRY AND ACADEMICS SHOULD DISCUSS WHAT ESG *INTEGRATION* TRULY MEANS

ANTICIPATE THE BREADTH OF THE TRANSFORMATION TO A SUSTAINABLE ECONOMY

- Analysts should extend ESG analysis from end markets to the entire value chain.
- Analysts and portfolio managers should reflect on the concept of financial risk in relation to Earth system and societal complexities and interlinkages.
- Sell-side research managers should consider making it mandatory for sell-side analysts to integrate material ESG issues.

BUILD SKILLS AND EXPERTISE

- Sell-side, buy-side and investor relations should consider separate ESG or sustainability functions or teams to better inform financial analysis on ESG issues, especially in the early phases of a learning curve.
- Sell-side, buy-side and investor relations should spend sufficient resources on training: on sustainability (including identifying metrics and conducting materiality analysis) for financial analysts and other finance functions, but also training on finance for sustainability experts.

FACILITATE COMMUNICATION BETWEEN THE THREE ACTOR GROUPS

- Listed companies should consider publishing ESG key performance indicators in quarterly earnings reports.
- The buy-side should make its criteria for rankings explicit and communicate to sell-side institutions the specific weight of ESG integration.

IMPLICATIONS FOR POLICYMAKERS

- Harmonise ESG reporting standards.
- Explore how negative externalities can be priced.

1. ANTICIPATING THE BREADTH OF THE TRANSFORMATION TO A SUSTAINABLE ECONOMY

Integrating material ESG issues into financial analysis is central not only to a correct assessment of the business implications of sustainability issues, but also to the ability to respond to a more general societal transformation. While most of our interviewees emphasised client demand as a key driver of the sell-side integrating ESG issues into financial research, many also described ESG as a "macro-trend" driven by societal expectations, investor interest, technological development, such as the electrification race, and regulation. This macro-trend is supported by a proliferation of international ESG reporting standards, of national or regional climate and sustainable finance policies (e.g. the EU taxonomy) and of ongoing working groups on sustainable finance, which could have implications for financial analysis.

It is notable that the European Union, the United Nations and ESG framework initiatives such as the GRI are using the concept of *double materiality*.[20] Assessing double materiality would require analysts to consider both companies' impacts on the Earth system and human societies, and the effects of ESG on companies' financial valuations. This perspective on materiality is already embedded in the EU's new sustainable finance disclosure regime for financial firms and corporates, and we expect that it will be necessary for financial analysts to be able to translate what this means for their own work in the years to come.

To further consider the broader impacts of the business world on sustainable development, financial

20 Adams, C. A., Alhamood, A., He, X., Tian, J., Wang, L., & Wang, Y. (2021). The Double-Materiality Concept: Application and Issues. GRI white paper.

actors might also increasingly be required to **adopt a value-chain perspective on ESG**. We note that most of our sell-side interviewees emphasised the importance of ESG for end-markets but tended to overlook companies' entire value chain. ESG issues in the supply chain or other internal business operations are part of sustainable development, and also subject to wider societal expectations of business and finance.

On the theme of broadening the scope, it might be advisable for financial analysts to **reflect on the notion of the financial risk** linked to the sustainability transformation and the interlinkages involved: Academic researchers have highlighted a cognitive disconnect between environmental and financial risk in financial risk frameworks.[21] A broader conceptualisation of financial risk that considers the non-linear aspects and complex interactions of key parts of the Earth system would arguably drive a more accurate assessment. For example, while deforestation resulting from the beef and soy industry may pose reputational risk in the short term, it may also have long-term negative effects on the region's capacity to generate its own rain, which in turn would hamper rain-fed agriculture. Deforestation may therefore become a physical risk that affects the valuation of companies in the agricultural sector. Such interlinkages will only be visible if ESG is not limited to isolated issues but viewed in a systems context. This is no easy task but financial analysts who manage to do this will get a head-start in a competitive environment in which the more sustainability-savvy investors start to demand it.

We recommend that financial actors anticipate—to a much larger extent than today—the breadth of change towards a socially and environmentally sustainable economy and broaden their scope when integrating ESG.

Furthermore, if one accepts the premise that ESG will become a strategic direction in which sell-side analysis needs to move—whether to meet client demand, anticipate future regulation or help make better predictions—it would make sense for sell-side institutions to **mandate their analysts to integrate ESG**. This suggestion was also made by some of our interviewees, who indicated that mandates would be helpful to increase analysts' attention on ESG issues. To avoid the risk of incentivising tick-box behaviour, however, sell-side firms that mandate ESG also need to spend resources on developing internal ESG expertise and ensuring that all sell-side analysts are trained to assess the financial implications of ESG in their sectors.

2. BUILD SKILLS AND EXPERTISE

Sustainability is a complex area that will require new skills and competencies to operationalise a systems perspective or a broader conceptualisation of financial risk. We therefore think it paramount that those who carry out financial analysis build both more extensive and deeper subject knowledge, and draw on in-house ESG expertise—at least during the learning phase.

STAFFING ESG EXPERTISE

In order to integrate ESG into financial analysis, whether it is best to have a dedicated ESG staff or to task each analyst with developing ESG expertise is open to debate. While a separate ESG function appears contradictory to a fully integrated approach, it appears valuable at least in the early stages of a learning curve. In our interviews, several people indicated that it had been beneficial to the increased focus on—and ultimate integration of—ESG to have access to in-house ESG expertise. This person or team seemed to fulfil an important support function and to help their colleagues "raise their game", rather than do the work for them. This was the case not only for sell-side analysts but also for the key functions they interacted with. For example, several investor relations officers described how they often bring the sustainability officer into meetings with analysts and investors in order to have a more meaningful conversation, and portfolio managers talked about the value they see in having the ESG team as a speaking partner. At the same time, however, those interviewees who had long experience of working with sustainability, notably portfolio managers with

21 Crona, B., Folke, C. & Galaz, V. (2021) The Anthropocene reality of financial risk. *One Earth*, Volume 4, Issue 5, 21 May 2021, pp. 618–28.

a sustainability mandate, did not feel the same need to draw on in-house ESG expertise.

We therefore recommend that organisations that are **in an early phase** of ESG integration explore whether separate **ESG or sustainability functions or teams**, working closely with the analyst, investor relations officer or portfolio manager could be a viable option for achieving better informed financial analysis on ESG. Importantly, the ESG function would need to be financially literate in order to fully support the integrated perspective. Some respondents pointed out that the "sustainability people" in the organisation do not focus much on "the numbers", and that there might sometimes be a disconnect between them for this reason.

TRAINING

The notion of a learning curve leads on to our next recommendation, which is **to spend enough resources on training**. Many of our interviewees stated that they are primarily learning on the job. Since ESG issues and sustainability require subject expertise related, for example, to climate change, biodiversity, labour issues and human rights, it might be difficult to make the link to financial analysis in the absence of such knowledge, and it might not be sufficient to just learn by doing. Moreover, as standardised ESG integration methods are developed—for instance, for the quantification of ESG—mastery of new tools, frameworks and techniques will be required in the years to come.

Previous research has identified three learning goals for professional training on ESG integration:[22] integrating ESG issues into financial calculations; understanding and applying measurement techniques for ESG; and designing financial instruments or financial deals for resolving ESG issues. The offer from ESG investment courses and training, however, is still nascent. To help financial institutions and companies assess such offers, we recommend that network organisations such as Swesif or the Swedish Association for Financial Analysts, and their equivalents in other countries, **list available training and learning opportunities**. While some companies might want to develop in-house training, they would still benefit from comparing similar programmes or drawing on the expertise of an industry-wide network as they build their own. In addition to financial institutions, investor relations departments might also benefit from further training on both sustainability and its implications for financial analyses and their financial interlocutors.
These training programmes should encompass the transformation to a sustainable economy and develop practical knowledge on how to adopt and incorporate a systems perspective into financial analysis. To do so, they could draw on—and expose their trainees to—not just industry reports and regulatory information, but also academic research and the grey literature of civil society organisations, while also maintaining an active dialogue with such knowledge-oriented institutions.

3. FACILITATING COMMUNICATION BETWEEN ALL THREE ACTOR GROUPS

Our findings illustrate the importance of formal and informal communication between the sell-side, the buy-side and investor relations. Annual reports, quarterly earnings reports/calls, capital markets day, ad hoc meetings, rankings, and every opportunity to exchange information both frame and enable the integration of ESG issues. In this regard, when companies disclose ESG issues, they should not only assess the materiality of their business activities for financial valuations, but also consider how this is presented, so that it clearly links to financial materiality and can be effectively brought into the sell-side analysts' spreadsheets—even if there will always also be a need for qualitative information.

On this note, we join several of our interviewees in recommending that companies explore whether they can **disclose ESG KPIs in quarterly earnings reports** in a meaningful way. This might help analysts and investors assess progress on ESG—some of our interviewees pointed out that the long term is the sum

22 Belinga and Morsing (2020) "Teaching Sustainable Finance". Misum Report

of many short terms—while also helping to hold companies accountable for their ESG goals. It might also help draw short-term investors' and sell-side analysts' attention to ESG. Quarterly ESG KPIs would undoubtedly represent challenges for companies, as they would need, first, to identify which metrics are relevant on a quarterly basis and then devise an internal process for gathering these metrics and ensuring their quality. Our interviews indicated that some companies are already putting such systems in place. We also acknowledge that quarterly ESG KPIs would not be enough to inform financial analysis, and that exchanges on non-quantifiable information would still be needed. While quarterly earnings reports could emphasise quantifiable information, analyst meetings and capital markets days would provide dedicated time and space for qualitative ESG information.

Finally, to support ESG integration by sell-side analysts, we recommend that **the buy-side make their criteria for rankings explicit and communicate to sell-side institutions the specific weight of ESG integration** not only in individual rankings, but also in the bank-wide ranking, as this is not clear enough to many sell-side analysts today.

IMPLICATIONS FOR POLICYMAKERS

Our findings can also help to inform policymaking. First, the **harmonisation of corporate reporting standards** on ESG issues appears crucial to support both the integration of ESG into financial analysis and financial communication on ESG issues. The EU taxonomy is one answer, even if its scope is currently limited to six environmental and climate-related objectives. Future endeavours could try to make up for the taxonomy's shortcomings, by for instance also rewarding not currently environmentally sustainable companies that are on a pathway to align with a low-carbon economy. Initiatives such as the International Sustainability Standards Board (ISSB)[23] should also be supported.

Second, since (the lack of) financial materiality appears to be a core challenge for increasing the focus on ESG issues in financial analyses, it will be key for policymakers to further support **the pricing of negative externalities** through, for instance, a carbon tax or other sustainability-oriented taxes and subsidies. This clearly is not a new issue.[24] It can be controversial—like the debate on quantifying the value of ecosystem services—and lack of political will is well known to have been an obstacle to achieving such pricing. Nonetheless, it will be necessary to pursue this ambition if the market mechanisms that could link ESG issues to companies' future earnings are to come fully into play.

23 In November 2021, the IFRS Foundation Trustees announced the creation of a new standard-setting board—the International Sustainability Standards Board (ISSB). It aims to deliver a comprehensive global baseline of sustainability-related disclosure standards for information about companies' sustainability-related risks and opportunities.

24 See e.g. the work published in 1968 by economist Erik Dahmén, "Sätt pris på miljön" [Put a price on the environment], Stockholm: SNS.

APPENDICES

INTERVIEW GRID A: SELL-SIDE ANALYSTS

1. YOUR WORK

- Can you describe your work?
- How many companies are you following, and in which sector(s)? Has this stayed the same during your time here/during your career?
- What other type of work do you do that is not financial analyses and report writing/marketing? How much time do you spend on it?

2. ANALYSIS: QUALITY, RESTRICTIONS, FORMAT, RECOMMENDATIONS

- How much discretion do you have over the analysis and the recommendations that you write?
- Does your analysis have to follow a certain format/content, or are you free to change it? Do your analyses always have to conclude with a focus on financial value impact?
- What is the balance between analyses of issues that are expected to impact financial performance in the short term (less than 12 months), medium term (1–3 years) and long term (beyond 3 years)? How far do you look in order to do your (6–12 month) analysis?
- The sell-side is often associated with pushing companies towards short-term thinking—what is your view on that? Is there also merit in short-term perspectives?

3. SUSTAINABILITY/ESG ISSUES

- Do you include sustainability/ESG perspectives in your research? What is the main reason for doing so? Is there a difference now compared to five years ago in how much you and your colleagues focus on sustainability/ESG; if so, what do you think has driven that change?
- Where/at what stage of your analysis do you include sustainability perspectives? Is there a specific format/structure in your analysis to take sustainability issues into account?
- How do you determine which are the relevant/material sustainability/ESG issues for the companies that you follow? Do you look at them from a responsibility perspective, an impact perspective, or a financial performance perspective?
- Some say that non-financial issues are more difficult to quantify, and that it may be difficult to "get them into the excel sheet". What is your view on that? Do you feel that it is ok to spend analysis time on a factor where the effect on corporate financial performance is difficult to quantify? (Social issues for example).
- Which ESG issues are most often considered in your analyses? Of the ESG-focused analyses that you have done, have the issues that you focus on changed? Or the type of analyses of those issues, e.g. more financial than reputational?
- What type of support to you get internally to address sustainability in your analysis? What actions could your managers take to enable you to further integrate ESG issues into your analyses?
- In your opinion, what structural changes would be needed to promote more sustainability/ESG oriented and long-term research?

4. INCENTIVES

- How is your incentive package designed? Do you have a non-fixed part? What is it based on?
- Does your incentive system reward or hinder long-termism? A sustainability/ESG perspective?
- Does the ranking of analysts incentivise spending time on ESG-centred analyses?
- Do your clients overall incentivise you to produce ESG-related analyses?
- Do you think any type of policy, regulatory or financial incentive measures would be helpful to generally steer towards more long-term and sustainability/ESG-focused equity research activity? If not, why not?

5. BUY-SIDE, SUSTAINABILITY/ESG AND LONG-TERM PERSPECTIVES

- How often are you in contact with the buy-side? How do you communicate and interact with the buy-side? What are the main interfaces?
- In what ways do your clients use your analysis? What do you think the buy-side appreciates most in your analysis?
- Among your clients, is there any variation in the time horizon that they have on their investment? What would you say is their average investment horizon?
- Do you perceive that the buy-side is asking for sustainability-/ESG-oriented and long-term research?
- How large a share of your client contacts are hedge funds? How interested are they in sustainability/ESG or long-term issues?
- Do you feel that you have a meaningful conversation about corporate long-term value creation and sustainability/ESG issues with the buy-side? What is easiest to communicate to the buy-side: a non-financial factor that will influence the company in the short-term or a financial factor (quantifiable) that influences the company in the long term?
- Are you evaluated in any formal way by the buy-side? Do sustainability/ESG issues come into play there?
- Some buy-side representatives say that they are doubtful that the sell-side can deliver high-quality research on sustainability/ESG issues; what is your view on that?

6. COMPANIES/INVESTOR RELATIONS

- How often are you in contact with representatives of the companies that you follow? Is it only investor relations or also other functions?
- How do you maintain good relations with investor relations? Is it important to do that? Why?
- How does investor relations react to negative analyses?
- How often do you discuss sustainability/ESG issues with investor relations? On what occasions? Is it at their or your initiative?
- What are the main types of ESG issues you discuss with them? Do you ever discuss major transformative ESG issues with them?
- Do you feel that you have meaningful discussions about sustainability/ESG and the company's long-term strategy and value creation? If yes, can you describe in which contexts these discussions are happening? If no: why do you think this is?
- Do you feel that you have access to the sustainability/ESG information that you need from companies? Through which channels do you collect sustainability/ESG information that you can use in your research? What format does it take?
- Do you ask questions about sustainability/ESG issues in earnings calls? If not: why not? Do others ask such questions? What do you think about it? If yes: what types of questions do you ask? Do you tie the questions to the earnings perspective or pose general questions? Do you get meaningful responses?
- Do you attend capital market days, and is that a place where meaningful sustainability/ESG information is shared by the company?

INTERVIEW GRID B: PORTFOLIO MANAGERS (BUY-SIDE)

1. YOUR WORK

- How long have you had this job? Can you describe your work?

2. SELL-SIDE

- How often are you in contact with the sell-side?
- How much do you rely on sell-side analysis in your own work?
- In what ways are you using sell-side research? What is the main use you have for sell-side analysis—knowledge center, investment ideas or stock picks?
- What aspects can sell-side research add that the company cannot?
- Do you feel that sell-side research currently has a good balance between short- and long-term perspectives?
- Do you feel that the analysis from the sell-side currently includes sustainability/ESG perspectives in a satisfactory way?
- Is the quality of sell-side research in terms of the sustainability/ESG component good enough for your purposes?
- Have you explicitly asked sell-side analysts for more or different sustainability/ESG perspectives in their research? If yes, can you tell us more about this? If not: why not?
- What are the main types of ESG issues you discuss with the sell-side? Do you ever discuss major transformative ESG issues with the sell-side?
- What would you do if you were not happy with the quality of the research?
- Do you (your firm) formally evaluate the sell-side analysts? If yes: is sustainability/ESG and/or long-termism a parameter?
- The sell-side is often “accused” of pushing companies towards short-term thinking—what is your view on that?

3. COMPANIES/INVESTOR RELATIONS

- How often are you directly in contact with the companies that you have holdings in? Who do you talk to?
- Do you discuss ESG issues with companies? What are the main types of issues? Do you ever discuss major transformative ESG issues with them? Do you always connect these to a financial case?
- Do you get good enough information from the companies to do the sustainability- and/or ESG-inclusive and long-term analysis that you want to do?
- Do you ask questions about sustainability/ESG issues in the earnings calls? If not: why not? Do others ask such questions? What do you think about this? If yes: what types of questions do you ask? Do you tie the questions to the earnings perspective or pose general questions? Do you get meaningful responses?
- Do you get—or ask for—sustainability-/ESG-related information at the capital markets day? Do you think this is the right forum for the company to share sustainability-related information?

4. SUSTAINABILITY AND TIME HORIZONS

- Do you have a mandate to include sustainability/ESG perspectives in your analyses/portfolio management?
- In general, through which channels do you collect information about sustainability/ESG that you can use? What format does it take?
- Do you feel that your company would pay more for long-term and broader, non-financial, analyses?
- Some say that non-financial issues are more difficult to quantify, and that it may be difficult to “get them into the excel sheet”. What is your view on this? Do you feel that it is ok to spend analysis time on a factor where the effect on corporate financial performance is difficult to quantify? (Social issues for example).
- Short-termism is often portrayed as a big problem. What is your view on that? Are there also advantages with short-term perspectives?
- Do you think any type of policy or regulatory measure would be helpful to generally steer towards more long-term and sustainability- and/or ESG-focused financial market activity?

INTERVIEW GRID C: INVESTOR RELATIONS OFFICER (CORPORATE SIDE)

1. YOUR WORK

- Can you describe your work?
- What are your interactions internally with e.g. sustainability officers, the Chief Finance Officer, legal, etc?

2. YOUR WORK AND SUSTAINABILITY

- What is your view on the relation between sustainability/ESG issues and companies' financial performance?
- Can you give an example where you think these matter in your company? In your view, what are the main types of ESG issues for your company?
- How has the type of ESG issue and its link to financial perspectives evolved over time? Do you discuss ESG or long-term perspectives (and their challenges) with your peers at other companies? What do you discuss?
- How do you determine what are the relevant/ material sustainability- and/or ESG-related issues for your company to communicate on?
- Do you do materiality analysis? If so, which standards do you use (e.g. SASB)? Do you use consultancy services for this?
- Do you consider it more important to communicate on responsibility/reputational issues rather than on ESG issues that could affect financial performance?
- Are there any tensions between long-term intentions and short-term activities in the company, such as long-term sustainability/ESG goals and short-term sales goals? How does that influence your conversation with analysts?
- What might be the consequences for you if your investment analysis is too short term? What might be the consequences if investment analysis generally took more of a long-term view?

3. SELL-SIDE & BUY-SIDE AND SUSTAINABILITY

- How often are you in contact with sell-side analysts?
- Do you feel that you have meaningful conversations with the sell-side about the company's sustainability/ ESG work, and its long-term strategy and value creation? Can you tell us more about these? Have they changed over time? What types of questions are you asked?
- How often do you have direct contact with the buy-side? When/why/how?
- Do you feel that you have meaningful conversations with the buy-side about the company's sustainability/ESG work, and its long-term strategy and value creation? Can you tell us more about these? Have they changed over time? What types of questions are you asked?
- Do you think that analysts focus enough on sustainability/ESG issues? Or would you like them to focus more on these? Which ESG topics would you like to see more focus on?
- Does your Sustainability Officer join in with your conversations with the analysts?
- Do analyst meetings give more and newer information compared to the annual report, with respect to ESG?
- Do you talk about sustainability/ESG issues in the earnings calls? Why/why not? Do you tie this to the earnings or is it more high-level information? What has been your process in going from not talking about it to talking about it? Do you get questions from analysts about sustainability/ESG issues in the earnings call? What types of questions?
- What is the capital markets day, how does it work? What do you want to achieve from it? Do you talk about sustainability/ESG issues on the capital markets day? How interested are the analysts? How often do you address ESG issues from a financial impact perspective? How often to you address ESG issues that affect your company negatively?
- How do you know that you are giving relevant information for analysts to incorporate into an ESG or longer-term perspective?
- Some say that non-financial issues are more difficult to quantify, and that it may be difficult to "get them into the excel sheet". What is your view on that? Do you feel that it is ok to spend corporate resources on a factor where the effect on corporate financial performance is difficult to quantify? Social issues for example.
- Which time horizon(s) do you generally have in your work? What is the longest time horizon that you work with?
- Do you feel that the sell-side has the same time horizons in their work as you do? Is it the same for the buy-side? Why might there be a discrepancy?
- Short-termism is often portrayed as a big problem. What is your view on that? Is there also some merit in short-term perspectives?

4. INCENTIVES

- What roles do incentive structures play in your focus on sustainability/ESG issues and short- or long-term perspectives?
- Is there anything that the company can do to incentivise the inclusion of sustainability/ESG issues in financial analysis?
- Do you think any type of policy or regulatory measures would be helpful to generally steer towards more long-term and sustainability- and/or ESG-focused financial market activity?

MISTRA CENTER FOR SUSTAINABLE MARKETS (MISUM)

Mistra Center for Sustainable Markets (Misum) is an interdisciplinary research center at the Stockholm School of Economics focused on sustainability with competences in economics, finance, sustainable development, business leadership and innovation. Its aim is to develop rigorous knowledge around how markets may best be advanced to support the transition towards sustainable development.

SWEDEN'S SUSTAINABLE INVESTMENT FORUM

Sweden's Sustainable Investment Forum (Swesif) is an interest forum aimed at disseminating information, engaging the community and raising awareness about investments for sustainable development. Our members are mainly asset owners and asset managers. We are also offering associate membership to service providers and consultants who share Swesif's purpose.

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