The Frontier Line

Responsible investment issues for universities

Key takeaways from Frontier's university roundtable

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About us

Frontier Advisors has been at the forefront of institutional investment advice in Australia for almost thirty years and provides advice on around $700 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Our purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

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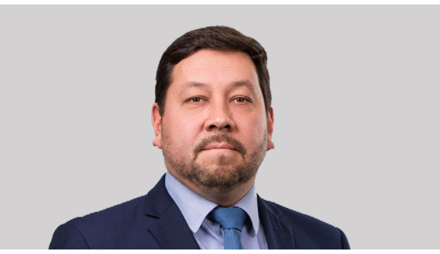

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Introduction

At Frontier Advisors, we believe in promoting collaboration, knowledge-sharing and open dialogue to assist asset owners with their investment strategies.

One of the ways we achieve this is by gathering groups of asset owners with similar needs or interests to share how they are dealing with key challenges and opportunities in their investment portfolios.

In June, we hosted a group of representatives from major Australian universities to share how they are approaching responsible investment (RI) in their endowments. Topics addressed included decarbonisation/net zero, divestment and stakeholder engagement. Frontier invited UK based Deirdre Cooper, Head of Sustainable Equity at Ninety One, to facilitate discussion by drawing on her knowledge and global experience in responsible and impact investing.

While our discussion focussed on the particular needs of university endowments, many of the key takeaways are just as relevant to any asset owner type.

Four key takeaways

Key takeaway 1

Divestment and exclusion
- a nuanced view

Key takeaway 2

The need for internal agreement
on RI requirements

Key takeaway 3

Stakeholder engagement
– reconciling views

Key takeaway 4

A holistic approach to RI
and sustainability

Key takeaway 1:
Divestment and exclusion - a nuanced view

The roundtable discussion highlighted the importance of taking a nuanced approach to divestment and exclusion as part of an organisation's RI strategy.

Divestment and exclusions are common methods through which organisations can express and implement values in their portfolio. This typically involves selling off and avoiding holdings the investor deems not to be aligned with those values. Despite its apparent simplicity, divestment can have unintended consequences.

Limited sustainability impact

Divestment from a company may not materially incentivise genuine positive change within that company, which is obviously counter to the intentions of stakeholders who may be pushing asset owners to divest. For example, public equity investors trade in secondary markets, meaning the asset owner is buying and selling a security to/from another investor. Divestment therefore does not necessarily impact the flow of capital to the underlying company that is deemed by the investor to be undesirable. Someone else ends up owning the company, and that other entity may not have the same desire to effect positive change in the world. Ultimately, divestment can end up kicking the can down the road.

Engagement for greater impact

An increasingly accepted industry view is that asset owners can have a more significant positive influence by retaining exposure to, and engaging with, companies with unsustainable practices. While this approach may initially result in a higher portfolio carbon footprint, for example, when retaining ownership of an energy company, it may ultimately lead to longer-term positive changes within the company by supporting it through a transition to renewable energy, aligning with the organisation's long-term RI goals. Divesting from a company significantly limits the potential for asset owners to engage and work collaboratively to achieve the outcomes sought by the organisation's stakeholders. A strict divestment approach could result in asset owners ultimately missing out on investing in companies that will likely have the most impact on curbing global carbon emissions.

Curtails diversification and replication

Divestment can unintentionally lead to a concentration of investments and risk in specific sectors. For example, divesting from the energy sector often ends up resulting in an over-allocation to sectors such as technology. There may be a large initial impact in reducing the investor's carbon emissions for example, but further large reductions may then not be achievable in the future.

Our discussion underscored the importance of a well-defined RI strategy that prioritises engagement, alongside divestment when engagement has been ineffective. In many cases, organisations can drive the positive real-world change sought by their stakeholders through targeted and active engagement, as opposed to divestment.

Key takeaway 2:
The need for internal agreement on RI requirements

A theme explored at the roundtable was the potential for disconnect between university leadership and endowment investment teams regarding a university's RI objectives.

It was broadly observed that universities (as with other large and complex institutions) are sometimes at risk of imposing unrealistic RI requirements on internal investment and treasury teams without sufficient consultation with them up front. This unilateral approach can result in unintended outcomes3

Wasted resources

Investment teams can expend excessive energy in figuring out how to implement the imposed RI requirements, which may include unnecessary friction between different stakeholders.

Cost increases

Implementing onerous RI requirements in a portfolio can incur additional costs, which could impact a portfolio's ability to achieve its return objectives on a risk-adjusted basis.

Greenwashing risks

Rushed implementation and lacklustre communication can lead to superficial changes being made that do not sufficiently reflect the stated representations on social or environmental impact. This increases the risk of accusations of greenwashing.

Implementation considerations

The size, internal resources and appetite for complexity can impact how readily specific RI needs can be implemented in a portfolio. Investment teams or an investment consultant can provide a practical understanding of the investment and implementation challenges of the RI policy being considered.

Our discussion highlighted the importance of a collaborative approach that facilitates agreement and understanding of purpose and actions across all departments. Promoting dialogue between stakeholders, including investment teams, the organisations' leadership team, and other stakeholder groups, allows everyone to contribute valuable perspectives and minimise the costs and inefficiencies of miscommunication. In Frontier's experience, training programs and moderated workshops are highly effective tools in facilitating these discussions. A collaborative approach can lead to efficiency gains for the organisation, ultimately yielding better outcomes across social responsibility, financial performance and risk management.

Key takeaway 3:
Stakeholder engagement – reconciling views

The role of stakeholder activism influencing universities' RI policies, as well as their endowment portfolios, was a key point that resonated around the table.

There was broad agreement that organisations, such as universities, have many and varied stakeholders including students, staff, donors, suppliers and the community at large, whose views all need to be considered. Some stakeholders may have strongly held views, with more vocal advocates having significant influence over an organisation's investment decision-making, which may not necessarily be aligned with the views or interests of other stakeholders. As such, a critical factor highlighted in our discussion was the benefit of educating and aligning different stakeholders on the complexities of RI constraints and requirements.

Impactful education

Organisations are strongly encouraged to educate their stakeholders on the WN strategies available and the potential benefits and consequences of each approach. This education fosters well-informed decision-making and helps stakeholders understand the nuances of balancing their specific wants with the objectives of the broader organisation and investment performance.

Beyond superficial impact

Excluding a company or industry does not guarantee the underlying social or environmental issues will be addressed. A comprehensive RI strategy should also incorporate engagement. Educating stakeholders on the effectiveness of various approaches empowers them to contribute meaningfully to the conversation.

Stakeholder alignment

Although investment teams, investment committees and an organisation's leadership may agree on the RI requirements of the portfolio, they are in a very real sense ultimately beholden to their stakeholders. Should there not be reasonable alignment between different groups of stakeholders, decisions will likely fail to materialise into action.

Investing in the development of a stakeholder engagement and education strategy was considered a worthwhile tool to facilitate a constructive dialogue between stakeholders to navigate the complex world of RI.

Key takeaway 4:
A holistic approach to RI and sustainability

The roundtable discussions emphasised the need for an organisation-wide approach to sustainability that is consistently applied across time, and which incorporates the views of all stakeholders.

Alignment with organisational goals

Achieving long-term sustainability requires an organisation-wide effort. This includes aligning key business activities. For example, in a university this would involve embedding sustainable practices in research activities, funding sources, course offerings and building and campus development. Promoting cross-departmental collaboration ensures a unified approach to environmental and social responsibility goals.

Navigating the energy transition

The transition to a net-zero future requires investment in emerging technologies. However, the rapid pace of innovation can make it challenging to set rigid long-term investment targets, particularly when the decision makers of today will be unlikely to fully experience the outcomes of emergent technologies and their investment targets. Organisations should allow for adaptable and flexible RI strategies that can adjust to accommodate evolving technologies within the energy sector. This adaptability ensures the portfolio remains positioned to capitalise on opportunities across time that align with the organisations' sustainability goals.

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The final word

The informative and collaborative discussions at Frontier's university roundtable highlighted the dynamic and evolving landscape of responsible investing for universities, with learnings applicable to many organisations with an investment portfolio.

A collaborative approach, ongoing education, and a strategic, organisation-wide commitment to RI are essential for navigating this critical area effectively.

Learn more

Frontier Advisors is committed to promoting a supportive community for our clients and the wider asset owner universe. We invite you to join us in future roundtable discussions to share your experiences, learn from your peers, and collaborate in improving investment outcomes for your organisation.

If you have an idea for a topic you'd like to discuss with other like-minded investors in a roundtable environment, please contact your consultant at Frontier Advisors.

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Frontier Advisors is one of Australia's leading asset consultants. We offer a range of services and solutions to some of the nation's largest institutional investors including superannuation funds, charities, government / sovereign wealth funds and universities. Our services range from asset allocation and portfolio configuration advice, through to fund manager research and rating, investment auditing and assurance, quantitative modelling and analysis and general investment consulting advice. We have been providing investment advice to clients since 1994. Our advice is fully independent of product, manager, or broker conflicts which means our focus is firmly on tailoring optimal solutions and opportunities for our clients.

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