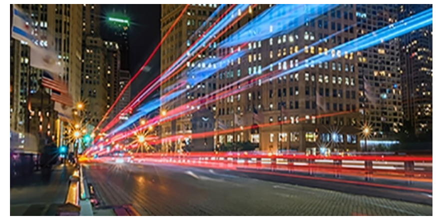
masuda funai



News & Types: Client Advisories

It Pays in the Market to be ESG… and More

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Practices: Corporate, Finance & Acquisitions

In recent years, there has been a clear and noticeable trend in the market to push companies' goals to address environmental, social and governance (ESG) issues, with both investors and companies responding under mounting pressure to meet this demand by shaping their strategies to be more ESG-focused. While the debate on the true value-creation mechanism of ESG is still ongoing, recent empirical studies have consistently shown strong empirical evidence that companies with high ESG scores incur lower costs of capital than companies with poor ESG scores. Further supporting this, MSCI, a leading provider of financial indexes, has found that companies with lower ESG scores, upon improving their ESG rating, experienced reduced costs of capital.

Skeptics of ESG do point out the weak empirical link between ESG and other financial performance measures, as well as the potential for "greenwashing," a practice of creating a false public perception that a company is ESG-friendly to attract conscious investors. Such criticisms have triggered a regulatory response in the U.S., with the SEC recently vowing to provide close guidance for more consistency and transparency in ESG disclosures made to the market. As the regulatory framework improves, the degree to which the market will reward companies implementing genuine ESG-conscious strategies with access to cheaper capital will likely only increase in the future. In short, the practice of "doing good" could pay off even more in the form of lower cost of capital necessary for pursuing valuable projects.

While large public corporations have traditionally been the forerunners of ESG initiatives, the effect of ESG on cost of capital can be captured more easily by private companies with a narrower range of stakeholders. Therefore, for many Japanese companies seeking to expand to the U.S. or Japanese-owned U.S. subsidiaries looking to grow, making ESG-conscious business decisions now while keeping a keen ear to the changing regulatory framework could prove to benefit their growth strategies in the coming years.