

# ESG & FMCG: A critical view

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1. What is ESG & Why is it popular?
2. Do engaged parties really care about ESG?
3. FMCG: ESG issues and a roadmap to sustainability
4. Is ESG something special after all?

- **ESG are metrics to assess the sustainable profile of a company**
- **‘E’ for Environmental:** How do the operations of a firm affect the environment
- **‘S’ for Social:** How a company treats employees, clients, supply chain, relation with society
- **‘G’ for Governance:** How a company is governed
- **Sustainable finance:** *Transparency of risks* related to ESG factors & *Mitigation* of such risks.

- **ESG ratings differ substantially across vendors**
  
- **→ Is this a real problem? No**
  - Investors need to work harder, yet diversity is not new in finance
  
- **The real problems:**
  1. ESG ratings are disconnected from the intentions of firms to improve
  2. Incentive structure of ESG raters
  3. Carbon emissions: You cannot capture all
  4. AI can help (Faccini et al., 2023, Politis & Skiadopoulos, 2024, Skiadopoulos & Xue, 2024).

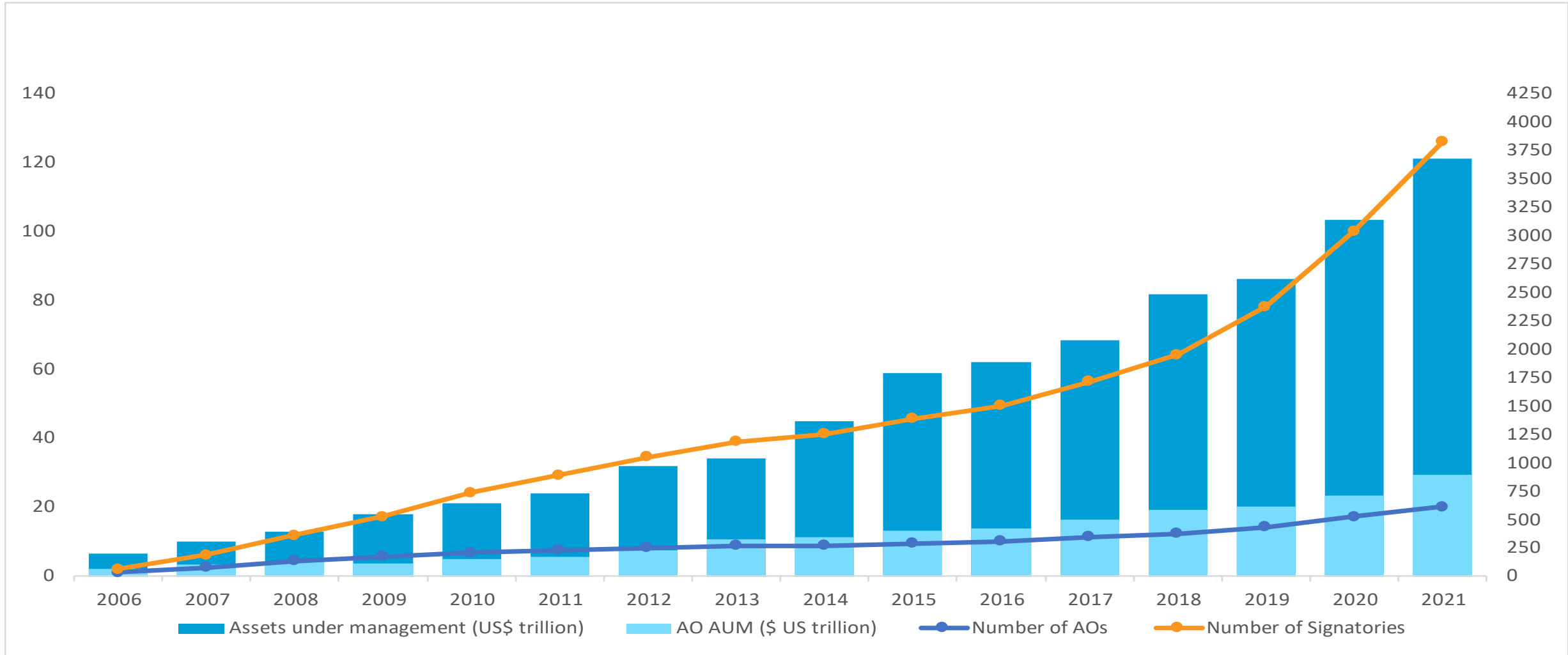
- **Discount rate channel**
  - Divestment is not like boycotting, yet it may affect the cost of capital
  - The empirical evidence is mixed (Skiadopoulos and Xue, 2024)
  
- **Cash flow channel**
  - Demand for the product may change, thus affecting revenues
  
- **End-result:** Depends on the fraction of 'green' investors/ consumers.

# ESG: Why has it become 'popular'?

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- Climate change
- Societal changes: Diversity and Equality, #Me Too
- Investors are looking for opportunities
- Socially-conscious investors are being more vocal: They engage with the firms they invest to
- Stricter regulation globally – Pressure from regulators
- Change in consumers tastes
- Specific events: Covid-19, George Floyd

# Do investors care about ESG? PRI growth



# ESG redefines practices (?) Mixed signals



*“After 25 years in the financial sector, there is always a **madman** who tells me about the end of the world...**but what bothers me about this is the amount of work these people have me do, the amount of regulation coming through the pipes, the number of people on my team and at HSBC who are dealing with financial risks from climate change.***

*“...**Who cares if Miami is six meters underwater in 100 years? Amsterdam has been six metres underwater for ages, and that’s a really nice place. We will cope with it”**, **Stuart Kirk**, **Head of Responsible investing, HSBC, May 19, 2022 (suspended May 23, 2022)***





**Multinational XYZ is facing an investigation by the UK government's Competition and Markets Authority (CMA) concerning its environmental claims**

*“Certain statements and language used by XYZ appear vague and broad, and may mislead shoppers regarding the environmental impact of those products*

*... XYZ's use of colours and imagery – such as green leaves – may create the overall impression that some products are more environmentally friendly than they actually are”,*  
CMA

- **Companies greenwash, investors greenwash, even countries greenwash!**

- **Faccini, Matin, & Skiadopoulos (FMS, 2023)** provide **first-time evidence** on which types of market-wide climate change risks are reflected in U.S. stock prices
- Novel measures of climate change risk. U.S. investors
  - Do **not** care about natural disasters & Global warming
  - Do **not** care about international summits
  - *Care only when the discussion reaches the political arena/regulator intervenes*

- **Of interest to investors, firms & policy makers**

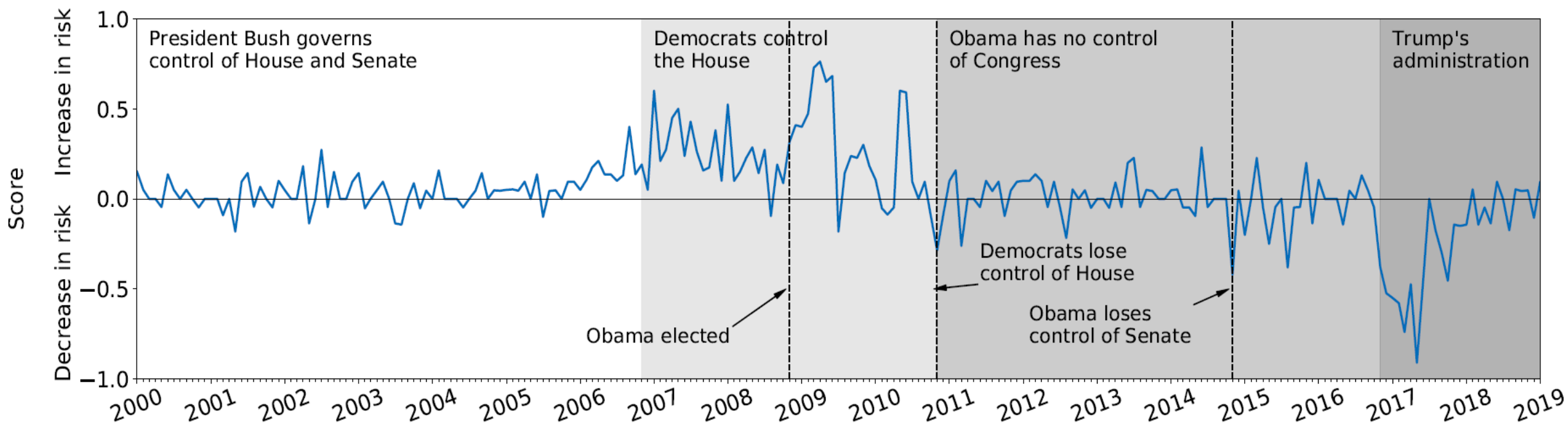
[Sustainable Finance: How AI can help account for Climate Risks](#), EU40 & European Parliament's STOA event [Video](#)

Presented at EIOPA, EBA, ESMA

Included in OECD [report on Climate-resilient Finance and Investment](#) & Financial Stability Board [Annual Report](#)

Featured in [Columbia Law School's Blue Sky Blog](#), [Investments & Pensions Europe](#)

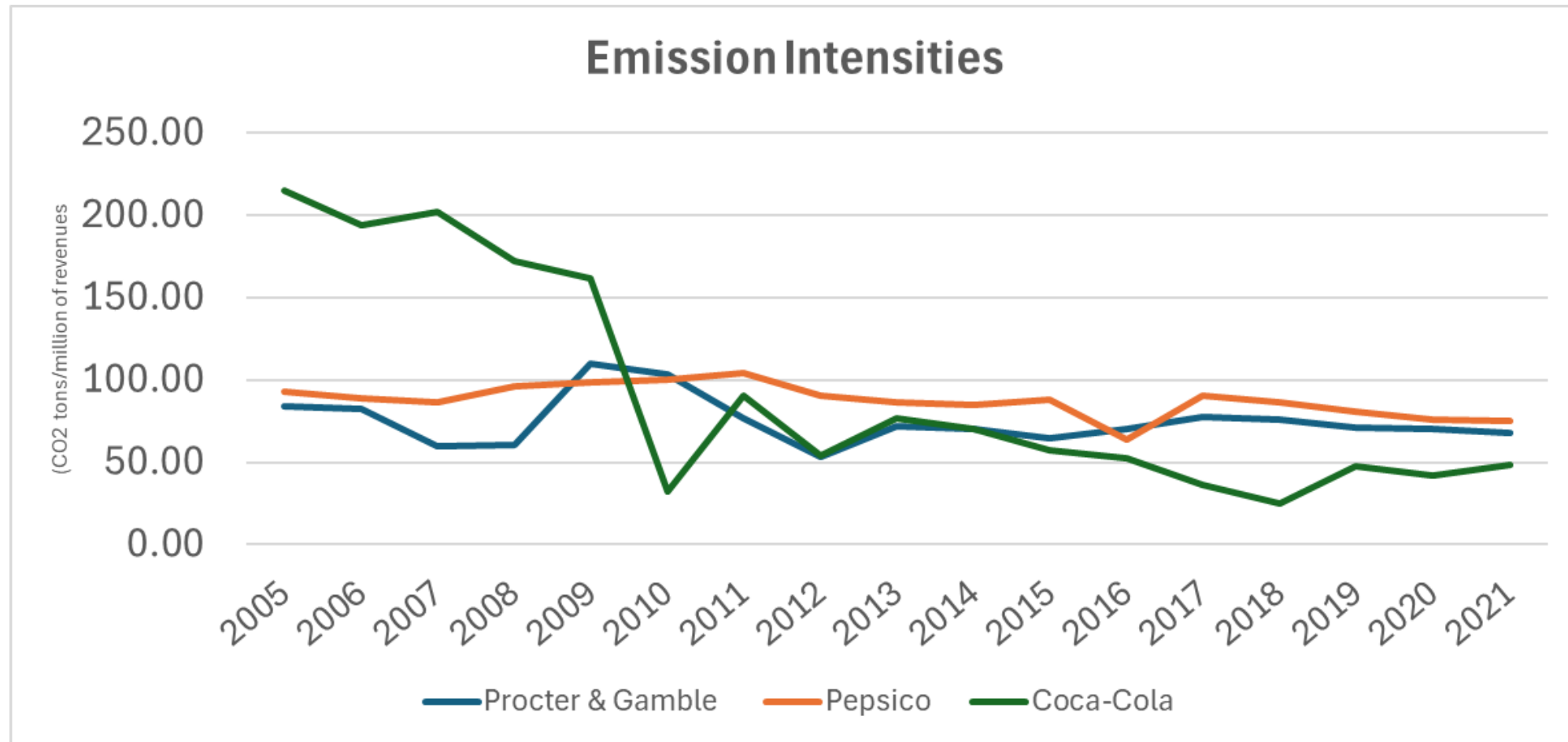
- Decreases (increases) signal a decrease (increase) in U.S. transition risks



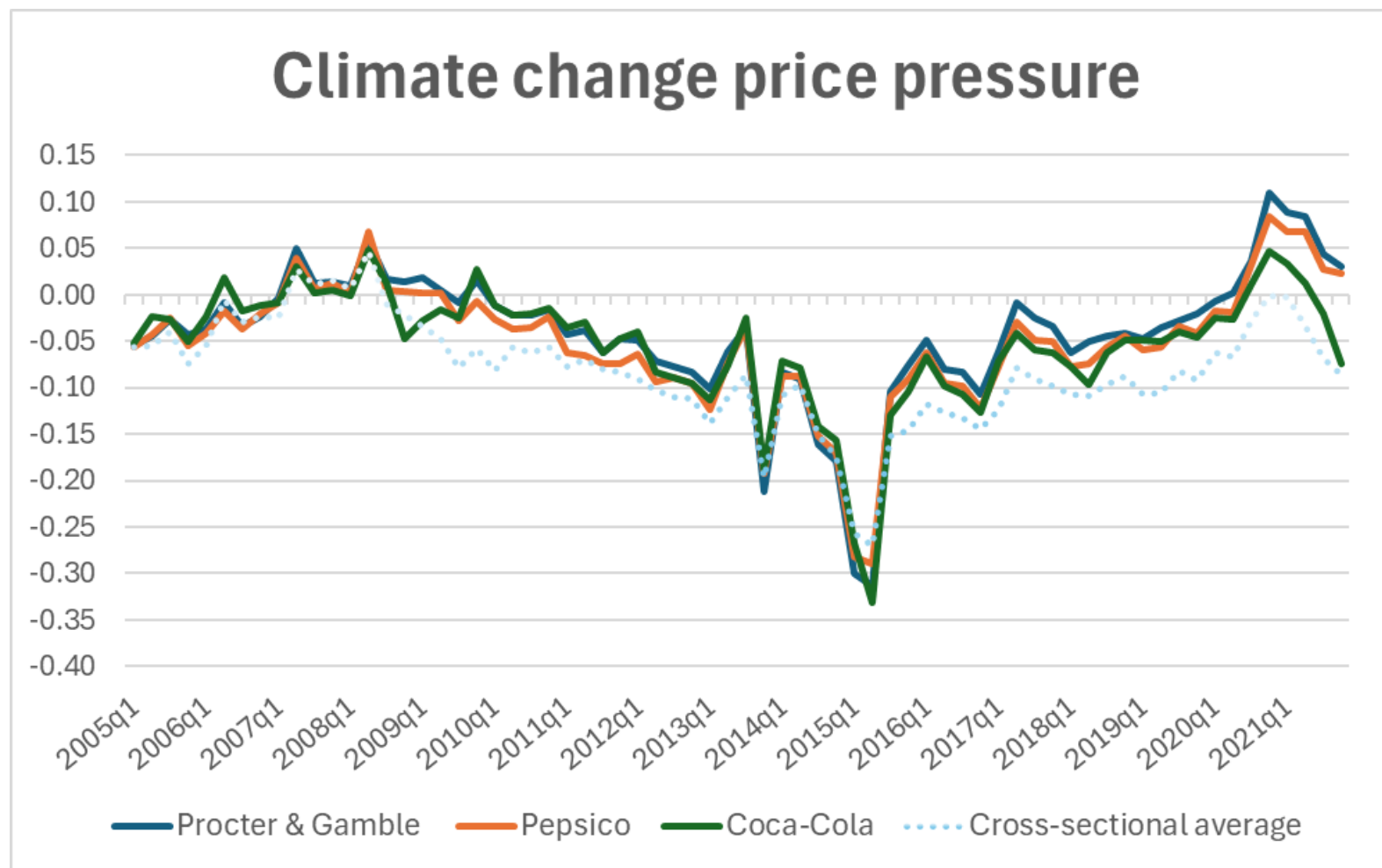
Source: Faccini et al. (2023). *Dissecting Climate Risks: Are they Reflected in Stock Prices?* *Journal of Banking and Finance*

1. **Corporate reporting and disclosures**
  2. **Green/sustainability claims and labelling: To combat greenwashing**
    - *EC Greenwashing Directive (March 2022) & Green Claims Directive (March 2023)*
  3. **Supply chain obligations**
    - Deforestation risk commodities, Forced labor product ban, Land use, Water pollution
  4. **Product packaging and presentation**
    - Single use plastic, Chemicals used in food
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- **Risks for FMGCs: Threats to profitability**
    - Penalties following litigation
    - Reputation

- **Came into force:** 5 January 2023
- **Phased in application** from Jan. 1, 2024, to Jan. 1, 2028
  
- **Requires companies to disclose information on**
  - What they see as the risks and opportunities arising from social and environmental issues, &
  - The impact of their activities on people and the environment
  
- **Entities are required to provide new sustainability disclosures, if:**
  1. “Large” EU entities or groups (250 employees,  $\geq$  €40 million in net turnover,  $\geq$  €20 million in assets), or
  2. Have securities listed on an EU regulated market (except micro-enterprises), or
  3. Are non-EU entities with significant EU revenues and an EU branch or subsidiary.



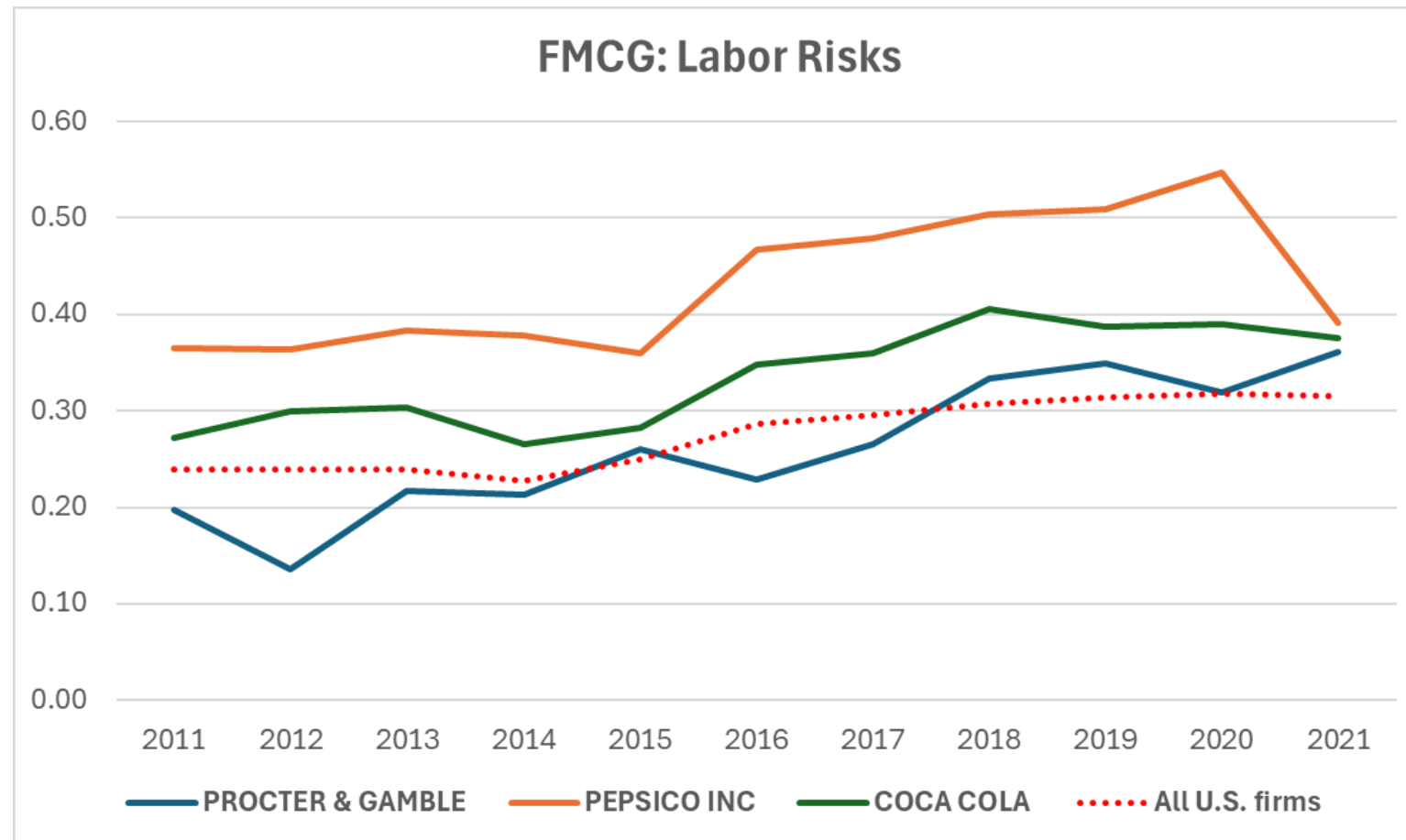
Source: Trucost



Source: Skiadopoulos & Xue (2024)

# FMCG: Social dimension is also important

- Labor risks are greater for some FMCG than for the average U.S. firm



Source: Politis & Skiadopoulos (2024). *Labor Risks*



- 1. Set Clear Sustainability Goals** (e.g. reduce carbon emissions, minimizing waste, recycle)
- 2. Identify the environmental & social impact of your products & operations**
- 3. Take measures:**
  - Sustainable Packaging - Water Conservation in production processes
  - Responsible supply chain
  - Energy Efficiency: Improve energy efficiency in manufacturing processes and distribution
  - Sustainable Transport and Distribution: Consider using electric or hybrid vehicles
  - Employee Engagement
  - Track & Report Progress - Certifications & Standards
- 4. Consumer Education & Engagement - Collaborate & Innovate - Continuous Improvement**

- **ESG is important, yet there is still a long way to go**
  
- **Engaged parties need to**
  1. Identify the open questions
  2. Admit that *'doing well by doing good'* may not always be possible
  3. Trace distortions & misconceptions caused by the incentive structure of the key ESG players
  4. → **Answer honestly two related questions:** *"Do I believe in ESG?"* and if so, *"Am I willing to suffer any financial/political costs to achieve the ESG transformation?"*
  5. **Mind the confirmation bias:** People accept "evidence", if it confirms what people would like to be true and reject contrary evidence
  
- **Addressing challenges is not trivial: It requires expertise & Genuine willingness to reform**

# Don't forget: ESG is not something new

*“ESG is both extremely important and nothing special.*

*It's extremely important because it's critical to long-term value .... Thus, ESG doesn't need a specialized term, as that implies it's niche. Considering long-term factors when valuing a company isn't ESG investing; it's investing.*

*We want great companies, not just companies that are great at ESG”,*

**Alex Edmans (2022)**

- **Changes in ESG scores reflect changes in firms' fundamentals (Ahn, Patatoukas, Skiadopoulos, 2024).**

*Thank you for your attention!*

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Ahn, B. H., Patatoukas, P.N., and Skiadopoulos, G. (2024). [Material ESG Alpha: A Fundamentals-Based Perspective](#), **The Accounting Review**, forthcoming

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Skiadopoulos, G. and Xue, C. (2024). and Climate-triggered institutional price pressure: Does it affect firms' cost of equity?

Politis, K. and Skiadopoulos, G. (2024). Labor risks