IE Cleantech Corner

Green Investing: A Beginners Guide

Green investing holds integral importance to the future of clean technology and a greener future. Without investment from governments, corporations, and individuals, projects to propel us into the future are less capable of being developed and reaching their potential. It is important for all parties to understand what green investing can be defined as, what the potential and meanings of those definitions are, and what investing can do for the future of industry and technology. Especially in a time when the economy is at a turning point due to COVID-19, being informed to make financial decisions that benefit the future is of the utmost significance. There are certainly many different opportunities to invest greenly, but this paper aims to help with understanding the definition and potential of green investing.

What is Green Investing?

Green investing is a concept that holds different meanings and significance to people across the world. To those first getting involved, it can be very confusing to know where to start and what it truly means to be investing greenly. The primary concept behind green investing stems from the idea of socially responsible investing (SRI). By individuals or groups taking fiscal risk with their own money and placing it into causes they see as providing benefit to society, they are serving to encourage those organizations to continue their actions (Green America, n.d). Where things get complicated is deciding what defines "green." While it may seem obvious to say that green investing is solely picking stocks that are good for the environment, it is also fair to say that a definition such as this is still broad. If a company is producing lower CO_2 emissions but also poorly manages the data of their consumers, is it still equitable to fund those companies? These are questions often asked as a means of measuring "green" but are not often easily answered (Chen, 2019). In order to more formally define how a company can be determined to be benefiting society, the standard for ESG investing was created. ESG Funds judge an institution based upon Environment, Social, and individual Governance factors. Although these parameters are largely popular within Europe and are far from a perfect measuring tool, ESG standards are on the way to setting a global definition. Historically, these funds have proven more profitable for investors as well since 75% of ESG Funds outperformed the average return of a broader fund. This number was accomplished mostly through technology stocks (Toplensky, 2021).

What makes ESG Funds a useful way of quantifying impact is their use of different categories for decision-making. There are three ways to build a portfolio under this method: exclusionary, single theme, and best in class. Exclusionary means the investor chooses what types of companies they do not want. Companies that may rank highly on the sustainability aspect may be lower on things such as the social aspect. A downside to exclusionary decision making is these situations can become very complicated, thus causing the restrictions for what can be allowed to be lessened. In turn, the question can be raised to whether these funds are still upholding the same standards they originally set to meet. Best in class approaches are a way of choosing the overall "best" from a specific group of companies. An oil company may still be chosen even if they intrinsically hurt the environment because they are handling it the best out of the other oil options. A lot of the companies found within this section may not align with the stated goal of the fund once more research into the company is done (Toplensky, 2021). Single theme (or thematic investing) is investing in companies that occupy a similar space. People partake in this type of investing because it increases one's likelihood of picking the best company in a field by choosing several. Although the least risk-inducing of the portfolios, the potential for financial gain is lessened for the investors themselves (Thomas, 2020).

What is the impact of Green Investing?

One question that often resides within the conversation about green investing is whether it actually creates positive change. Fortunately, there is evidence to suggest that not only is investing in green ventures a viable way to make larger change, but there are also things governments can do to make these impacts larger. A study by Robert Heinkel, Alan Kraus, and Josef Zechner ran complex economic models to see whether ethical investing impacts corporate behaviors. One of the most important takeaways from their data suggested that if there were to be a large number of investors focused on exclusionary funding, that they would have an effect on the costs of capital for firms and, specifically, lower costs of capital for those who met specific standards. The study concludes by stating that once the profitability gap between firms that fit into green portfolios and those that don't widens enough, those who don't meet the guidelines will be more incentivized to reform and meet the standards in order to become competitive again. In the grand scheme of things, this result indicates that SRI investing can influence corporate behavior. For these positive changes to happen, the model predicts that about 25% of investors would have to be green investors for such influence to be prevalent. The study reported that as of 2001 that about 10% of investors could be considered in the "green" category (Heinkel et al., 2001). Surely, in the 20 years passing since then, the quantity of investors has risen, leading to an even greater likelihood of influential investing behavior.

Research has also shown how to increase the number of green investors in order for the previously mentioned changes to be met. A different study, by Shu-Rong Han, Pei Li, Jian-Jun Xiang, Xiang-Hua Luo, and Chun-Yan Chen analyzed five different dimensions of institutional environments in China and found that the political, legal, and cultural dimensions had noticeable positive influences on increasing green investment willingness and education on Corporate Social Responsibility (CSR). The analysis on the financial dimension found no noticeable impact and the economic dimension had small impact on understanding of green investment, but no change in willingness to invest in green stocks. The researchers conclude that in order to best take advantage of these results, governments should: have a more biding role on polluting industries; establish financial incentives for green investments due to their long-term nature; and, lead industry in ways to help them create a "cultural system environment" in order to increase their CSR (Han, 2020). Although the results reported may not be completely applicable to the rest of the world, these points should certainly be taken note of when considering potential solutions to increasing the number of green investors. In order to best meet the required threshold for green investors needed to influence corporations mentioned in the previous study, this study provides understandings of what must be done.

In order to further implement the dimensions of influence listed in the prior study, there is one last key piece that should be acknowledged. A study by Tobias Stucki attempted to measure which types of firms benefit the most from moving toward green technologies. The results were measured from Switzerland, Germany, and Austria. They found that organizations with low or medium energy usage did not benefit from switching to green energy and utilizing green technologies. But, companies with large energy costs increase their own productivity by increasing their green energy usage. Interestingly, it was found that lower energy consumption companies were already more likely to have already adopted new technologies with clean energy production, meaning there is less need to influence them to change. In order to offset the lesser benefits for the medium and low levels, the study suggests that policy interventions are necessary with different types necessary for different levels of energy usage (Stucki, 2009). Based upon the conclusions of the study, a greater focus on pushing larger scale companies would in turn help to reach ESG goals, and ensure that green investing portfolios are living up to their intentions.

Conclusion

There are endless possibilities when it comes to green investing, whether that be for the largest of corporations or individuals hoping to make a difference. With newly developed ESG standards that can be applied worldwide, these are great markers for change. As shareholders increased influence in the market is applied, corporations will be more likely to move towards green technologies. Through using parameters created through ESG goals, the best intentions can be met. By understanding what the best versions of green investing are and what the potential is, investors of all scales can make smart and informed decisions to influence the future of cleantech.

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