GAM Investments

REFLECTIONS ON 20 YEARS OF SUSTAINABLE INVESTING

16 October 2019

GAM Investments’ Swiss equity team is celebrating its 20th anniversary of sustainable investing. We spoke to Karl Herzog about his sustainable development research, which is based on extensive manager interviews and plant visits, to help provide differentiated insight and knowledge about Swiss firms.

Karl, you have a doctorate in biology. What motivated you to move into finance?

I wanted to go where my work was particularly valuable – to me this switch was not a significant change. Biology is the science of life. It is just as relevant behind the office and factory doors as it is outside in the field. Because one thing is clear: to answer the question of how companies find the way to sustainable, viable value creation models, not only more and ever deeper knowledge is needed, but also new combinations of it. My area of expertise continues to be the assessment of viability. However, my focus today is no longer on trees, but on companies.

So can you describe the parallels between trees and companies?

I would not describe it as parallels, but rather as similarities, even if we often do not see them directly. Companies are like trees, customers, shareholders and all of us parts of the global web of life. So, to a certain extent, everyone is existentially dependent on everyone. There are clear rules, and non-compliance is sanctioned through a variety of mechanisms. Anyone who violates the rules – be they of social or ecological nature – will sooner or later face resistance. This can be very unpleasant for companies and easily results in exorbitant fines, virtual denunciations or even bans and product boycotts all of which are detrimental to the idea of value creation.

The consideration of sustainability by investors is becoming more and more a standard practice. What do you think of this development?

It is completely logical. The question of sustainability is central and is an issue that arises in every investment decision. It is all about maintaining the optimal value creation capacity for the future. In my view, this will be best achieved if a business is seamlessly integrated into the overall life system. Frictional losses must be kept to a minimum or – even better – should be converted into synergistic gains. This is the art of sustainable value creation. However, companies with such a comprehensive vision are still rare.

The team's current focus is on companies that are growing strongly. But doesn't growth contradict sustainability?

No, not generally. If we use the example of a garden - there we observe how certain plants shoot up again each Spring. Isn't that incredible? Nobody would suggest such growth is unsustainable. Growth never goes uniformly into infinity. It is part of a constant process of transformation. Sometimes it happens almost explosively, sometimes it goes through phases of change and renewal. Like plants, companies undergo regular adjustments and reorganisations. This is the only way to achieve growth. And, of course, other rules of sustainability must also be observed, for instance closing the material and communication cycles.

Does the rest of the investment team share your focus on sustainability?

As an investment team focused on Swiss equity, we work very closely together. This includes regular joint company visits and facility tours, which we dedicate exclusively to sustainability. To form a holistic view, we finally bring three complementary perspectives together – sustainability, finance and traditional economic business analysis. This is what distinguishes the quality of our investment approach.

Sustainability fits perfectly into our investment logic, as we do not pursue short-term targets. Of course, sometimes we arrive at different conclusions. Experience has shown, however, that this is less due to a lack of compatibility of views than to different levels of our information. It can then lead to heated discussions, but in the end frequently offers particularly valuable insights.

Currently, climate change and the reduction of CO2 emissions are very topical. How relevant are these issues to your sustainability assessments?

Climate change is a very complex challenge for society. Many companies are responding with voluntary initiatives, but these can vary widely in terms of plausibility and scientific rigour. In any case, such activities provide good insights about how capable and willing companies are in terms of analysing a problem seriously and tackling it in a targeted manner.

It makes a difference whether a management team commissions a 'green image' campaign or whether it effectively goes over the books, rethinks its business model and initiates the development of new, more sustainable customer solutions. In the first case, only the costs are driven upwards, whereas in the second case, the company makes investments in its future returns and viability. Clearly to us this would be a better investment proposition.

Another hot topic is management compensation. How do you assess the remuneration practices of companies?

Excessive manager remuneration is annoying, not to say foolish, and should disappear. But for me as an analyst, it also has some positives. Such information reveals a company's value system. It is particularly tragic when shareholders and the board of directors let the company's management demonstrate its lack of social competence by triggering a public outcry every year. Such behaviour is clearly detrimental, whereas effective incentive structures look very different.

Today, larger companies often publish extensive sustainability reports that highlight how they meet all important standards. How do you identify which companies achieve this better than others?

The flood of information is increasing and there are more and more standards being established. Certain companies love them. Often they are interpreted in such a way that large corporations meet them within a few quarters by management resolution and thus convert them into appealing marketing slogans. Only the companies will not - or only insignificantly - become more sustainable.

In my analysis, I directly refer to the elementary rules of living nature. Nature has around 3.8 billion years of experience in designing sustainable systems. To me, it provides the model to examine companies for sustainable system characteristics. It is about patterns, such as renewability, networks, cycles, the inclusion of locations, etc. The assessment is integral and comprehensive. Of course, the focus is not on standards, but on the individual company characteristics.

You've been doing this job for more than 20 years now. Do you ever get bored?

When I started my analysis, I was convinced I was doing something revolutionary. I thought investments without sustainability analysis would soon be a thing of the past. However, development proved to be slow. The evidence and stringency of the sustainability perspective has only gradually been recognised by investors. Today, sustainable investments are reaching new highs every day.

Being a biologist among investors has become no less fruitful and fascinating over time. And cross-disciplinary communication is still a challenge. In addition, there are indications today that the age of sustainable investments might just have begun.

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