When the 'G' in 'ESG' goes wrong

***Gary Cundill** relates his experiences as a Christian investor, including poor advice leading to substantial losses. He suggests that Christian investors have to expect evil to be present in this world, to face trials joyfully, and try to avoid making the same mistake twice by combining prudence and purity.*

It was 2017, and I was enjoying a passable steak at the exclusive enclave of Melrose Arch. My dining companion was the portfolio manager entrusted with most of my pension savings. It was then that I posed the question: 'So, what would be the trigger for selling?'

We were discussing a company called Steinhoff International Holdings NV, listed in Frankfurt and Johannesburg. In South African terms it was a significant company, about the tenth largest on the stock exchange, but its share price had taken a hit in recent months. There had been rumours about corporate misbehaviour, and the German authorities had instituted an investigation into the balance sheet treatment of certain transactions that had taken place.

'The trigger would be based on governance issues, Gary. If something came to light that led us to believe that we couldn't trust the management, we would sell.' Bert[1] then went on to give his view that, although the situation was worrying, there was not sufficient reason at this point to dump the shares. Members of the board of directors were titans of the business world, with decades of public success in running large listed companies. Some had hefty proportions of their personal wealth invested in the company. Notably, the chairman had recently dramatically increased his shareholding in the business. It seemed highly unlikely that the allegations made about the company would lead to a material impact on its ability to continue to deliver good financial returns. Surely these directors wouldn't so embarrass themselves, and lose themselves large amounts of money in the process?

Fast forward a few weeks, to the end of November that same year. The situation had changed dramatically. Just days before the company was due to announce its annual results, it became known that its auditors were not prepared to sign off on them. The share price fell precipitously. The company then committed to publish unaudited results, but later announced that these would not be released either. Shortly afterwards, the board revealed that the chief executive would be leaving the company with immediate effect, and indicated that very serious problems had been detected. The share price fell further.

The next day, the asset management firm my lunching companion worked for put out a trading note. This stated that, although the situation was clearly serious, the share price had fallen to a level that offered little further downside risk. Clients' investments in the company would therefore be retained.

Markus Jooste, former Steinhoff CEO, on trial next year for fraud

Photo: Financial Times

During the day, however, further concerns about the company came to light, and the share price halved again. The asset managers issued another note the next day, stating that the level of uncertainty had now reached the stage where the share could no longer be held. All such shareholdings held on behalf of clients would now be sold. 95% of the value of that investment in my pension portfolio had now evaporated.

For most of us in the West who are privileged enough to have such savings, our pensions are usually invested in vehicles over which we have limited influence. Pension fund trustees select asset managers, who then invest in a combination of equities and bonds, and sometimes more exotic financial instruments. We usually don't know exactly what businesses are being financed by our savings and, even if we did, it's not easy to assert our preferences by, for example, insisting that none of our money is invested in an arms manufacturing enterprise.

Our family had lived quite frugally during my years in corporate life and had been able to accumulate a comforting[2] little pot of savings. When I left that life the question then was how to invest this to provide income for our future. I wanted to have a say in this, and therefore looked for ways to obtain this say. (Regulatory requirements where I live prevented me from having direct access to the money, which was housed in preservation funds).

I found a service provider that would place the largest tranche of the money in an equity portfolio focused on delivering a growing stream of dividends. Although this portfolio was not fully bespoke, I would be able to exercise an influence over which shares were and were not held. Here was where I could then put my Christian values into practice, I thought. What's one of the most reliable sources of dividends? The tobacco industry, of course, and BAT (British American Tobacco) played a prominent role in the model portfolio that the asset manager recommended to me. I however, could and did insist that BAT was excluded from my portfolio. I felt quite virtuous about it, perhaps even more so given that this decision did reduce slightly the financial returns from the portfolio[3]. The rest of the selection of about 20 stocks didn't ring any ethical alarm bells for me, and so I was content for the portfolio manager to implement his mandate accordingly.

And then there was Steinhoff. Even now many of the details about what led to the implosion of the company remain obscure. What is certain is that fraud on a massive scale took place. Yet what Bert said to me over that steak remains largely true: the company board tasked with governing the company was constituted of experienced and respected men and women who had now lost both wealth and reputation. How could they have allowed themselves to end up in such a situation? How did they fail to detect and deal with what must have been widespread financial mismanagement?

In hindsight, it would have been rather nice if, over that steak, I'd said to Bert something along the lines of, 'No, I don't want to be invested in Steinhoff, as they're now under investigation by the German authorities'. But an investigation in itself doesn't constitute proof of wrongdoing— surely the company management should be given the benefit of the doubt? An acquaintance subsequently remarked to me that he wouldn't have invested in Steinhoff because of the way that they apparently offer credit to already indebted consumers. Not being a very active shopper, this wasn't something that had occurred to me when I applied my mind to the ethical implications of my pension investments. A failure on my part, perhaps, for not understanding the company's business model?

British American Tobacco ethical statement

When I worked in risk management I would sometimes repeat a statement made by a wise man I met with occasionally: 'Only make new mistakes'; the point of course being that one should learn from one's mistakes, and not repeat them, or at the very least not too often.

Watching 3% of my pension funds evaporate in a matter of days was not a pleasant experience (and this wasn't merely a paper loss to the portfolio, such as when markets move temporarily lower; the asset manager sold the shares after they fell). What lessons could and did I draw from this for the future?

Corporate managers are presented with many temptations: money, sex and power are a dangerous mix.

First, although none of us should need this reminder, it's yet more evidence of the damaging role that sin plays in this world that lies under the control of the evil one[4]. Corporate managers are presented with many temptations: money, sex and power are a dangerous mix, as Richard Foster reminds us[5], with the love of the first being the worst, as St Paul warned a younger man[6]. As outsiders we will never know exactly what's happening in the companies we invest in—even Steinhoff's chairman lost his money—and it's certainly appropriate for most of us to rely on the advice of investment professionals. Yet when we learn of issues pertaining to a company we're invested in perhaps we, as Christians, should be setting a higher bar than the broader investment community for what we will tolerate.

Second, governance matters. There's much talk today about the idea of 'ESG'[7]. The acronym is linked to and often used synonymously for terms such as sustainable, responsible, and green. But the third letter in the acronym stands for governance, an idea far from being novel. Governance in this context is all about how companies are run. On the assumption that a company's performance is at least partially dependent on how it is run, it's something that should matter to the most cold-hearted and financially driven investor. Yet listen to a senior investment analyst, speaking after the Steinhoff debacle: 'governance has always been something that you looked at but not necessarily take heavily into consideration'[8]. Quite. Perhaps it is time for a little more serious consideration.

Third, bad things happen in this fallen world. An investment made in the Japanese stock market during 1989 has seen the JP225 index remain below those purchase levels for nearly a quarter of a century. Ukrainians following a 'safe as houses' approach that put their savings to use by purchasing apartments in Kherson may have lost all of their investment. The attitude of Job is a tough one to emulate: 'The Lord gave, and the Lord has taken away; blessed be the name of the Lord'[9]. Nonetheless, we Christian investors are called to face trials joyfully, knowing that by our enduring them we are being made more mature and complete[10].

I'm deeply cognisant of the fact that it's quite possible that a similar situation may again arise in my portfolio, despite anything that I have learned and any decision that I may take in the future. (This isn't the place to start unpacking the importance of and techniques for investment diversification). But even if I feel a little sheep-like while the wolves of Paternoster Square prowl nearby, I remember the call to be as guileless as a cooing dove, while maintaining the craftiness of the proverbial snake[11]. A 'balance of prudence and purity'[12]; a fitting approach for the Christian investor.

1. Name changed.
2. Recognising, of course, the spiritual and physical hazards associated with the use of this adjective (see Luke 12:15-21; Matthew 6:19-21).
3. 'Virtuous' investing does not necessarily lead to reduced financial returns (see my earlier article in FiBQ 15.1, pp. 13-17 ,'Must green behaviour always penalise profitability?'). However, some research has indicated that investing in vice stocks may lead to superior financial returns (e.g. Hoje Jo, Tamanna Saha, Roopali Sharma and Silvie Wright, 'Socially responsible investing vs. vice investing', 2010, Academic and Business Research Institute Conference–Las Vegas).
4. cf. Ephesians 2:2.
5. Richard Foster, *Money, Sex and Power*, Harper & Row, 1985.
6. 1 Timothy 6:10.
7. See, for example, my earlier article in FiBQ 21.3, 'ESG: an acronym for Christians to embrace?', pp. 16-`19.
8. Personal communication, 27 February 2018.
9. Job 1:20.
10. James 1:2-4.
11. Matthew 10:16.
12. R.T. France, *Matthew: an introduction and commentary*, InterVarsity Press, 1985, p 186.

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