Putting our hearts into responsible investment

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Responsible investment as change management

Anyone working in responsible investment (RI) knows that it is an exercise in change management: changing investment organisations so that they give attention to environmental and social issues in a way they did not previously do.

Everyone I have put this point to has said, 'Yes of course, Rob. We all know that'. So if it's so obvious, why do we so seldom talk in these terms about what we do? A Google search for 'organisational change management' returns 27.7 million hits. A search for 'responsible investment and change management' returns none. Why is that? And why might seeing responsible investment more formally through the lens of change management help us do a better job?

There's a particular recurrent theme in the change management world that resonates strongly with my own experience both in full-time roles in investment organisations and as a consultant. That theme is the importance of people and the 'soft stuff' of why individuals and organisations behave in the way they do, and why they often resist change. As the leading Harvard Business School change management professor John Kotter puts it:

> '… the central issue is never strategy, structure, culture or systems. All those elements, and others, are important. But the core of the matter is always about changing the behavior of people, and behavior change happens in highly successful situations mostly by speaking to people's feelings. This is true even in organisations that are very focused on analysis and quantitative measurement, even among people who think of themselves as smart in the MBA sense. *In highly successful change efforts, people find ways to help others see the problems or solutions in ways that influence emotions, not just thought*. [Emphasis added.]'[1]

In the RI world we spend a lot of time looking for conclusive evidence and arguments that ESG issues are financially significant. Is X a material risk? Will Y add alpha? Does Z affect my asset allocation? We also devote a lot of attention to policies, systems, procedures and reporting – the 'engineering' of RI.

These dimensions are important. However, all too often we forget – or do not allow ourselves to remember – that the roots of many ESG issues lie in the domains of values and ethics. Some sustainability issues have implications for companies because of physical factors – storms, floods, sea level rise, water scarcity. In many cases, however, business

[1] The Heart of Change: Real-life stories of how people change their organizations. John P. Kotter and Dan S. Cohen. Harvard Business School Press, 2002.

implications arise because people care – as consumers who make purchasing decisions; voters whose opinions prompt action by governments; members of society who collectively create norms of corporate behaviour. Investment institutions are affected by these external forces in the shape of members', customers' and society's expectations. And people working for investment institutions have personal values and ethical standards that differ little from those of the societies of which they are part. Like most of us, they feel uncomfortable if they know they are doing things that are inconsistent with their values.

Perhaps we should spend more time thinking about how to win over hearts, not just spreadsheets and business processes.

Real-world examples

Here are three areas where approaching RI with an awareness of the intangible, 'non-numerical' factors that influence organisational and individual behaviour can help remove obstacles to change.

1. Developing a vision

The first step that organisations take when they embark on RI is often to develop a policy. But a good policy needs strong, deep roots. It needs to draw its legitimacy from an organisation's fundamental understanding of what it is; from its sense of purpose and identity; from its heart. An RI policy that does not flow coherently from an organisation's overall vision and purpose risks being ineffective because it will not be seen by staff as part of 'who we really are'.

Why does the organization exist? Who does it exist to serve? How does it serve them? What do members, clients, customers or other key stakeholders expect of it? How does RI relate to investment beliefs – the 'investment heart' of the organisation? I have worked with several organisations that have re-energised their approach to RI by asking themselves these questions.

Vision precedes policy. And vision is about emotion as well as rationality.

2. Focusing on the bright spots

The goal of RI is to 'integrate' ESG into investment activity. From the outset this creates an impression, and a mindset, that we are 'injecting', even *forcing* something new into the investment process from the outside. We may unintentionally convey the message that portfolio managers and analysts have 'failed' to identify 'material' issues, and that this is a 'problem' we are trying to 'solve'. It's not surprising that this may encounter resistance.

'ESG' may be viewed as alien, 'a foreign language' – even as an attack. At face value the discussion may be rational, focusing on numbers and analysis. But beneath the surface the real energy driving 'mainstream' portfolio managers' or analysts' response to ESG may flow from strong emotions. These may be stirred up by threatened professional pride, a desire to defend territory and even fear of losing the respect of investment colleagues if the PM or analyst demonstrates an interest in sustainability.

An alternative paradigm is what the change management writers Chip and Dan Heath call 'focusing on the bright spots'.[2] As the Heaths put it, 'don't solve problems, copy success'. In other words, find examples of where things are going well, highlight these, and encourage more behaviour of this kind. In the RI context, this means looking for and making visible 'ESG' that is already happening. Many investment processes already address at least some key ESG issues – though they may be couched in the language of structural changes in markets, resilient business models and efficient cost management.

Demonstrating that people are already acting on a new organisational priority – even if they did not realise it – sends a positive, supportive message. Encouraging people to do more of what they are already doing is far more motivating than arguing that they should do something they are not currently doing – and which they do not understand or value.

Moreover, this approach can enable people to find a path to behaviours and decisions that are more aligned with their personal values – without prejudicing investment returns or breaching fiduciary obligations.

I have seen at first hand how resistance to ESG and RI can recede, and interest in the underlying issues can be sparked, when the ESG content and value of existing investment processes are recognised and acknowledged.

3. Creating a culture

RI programmes can grind to a halt if they are not sustained by a supportive organisational culture. As Kotter puts it, culture is 'the norms of behavior and the shared values in a group of people. It's a set of common feelings about what is of value and how we should act'. *Rational* processes and structures – e.g. requirements to consider ESG before investment decisions are made, or RI committees – can create the impression of commitment and 'integration'. Ultimately, however, they cannot compensate for a culture that does not generate *feelings* that ESG is 'of value' and is part of 'how we should act'.

Mature, confident organisations recognise that a 'responsible investment culture' needs regular communication from the top – CEO and CIO – that reinforces the importance the organisation attaches to RI. Cursory references at the bottom of long lists of news items in general emails to staff are not enough. (I have seen situations where even this did not happen.) Ideally senior staff will be visible as RI champions not just internally but externally - and be models for the new culture by consistently applying the new approach in practice, not just in speeches and memos.

In organisations where RI is more deeply embedded, the new RI norms and knowledge are communicated horizontally across the organisation, not just from the top down. Creating opportunities for staff to share ESG insights across teams – e.g. across different asset classes – allows people to learn from peers, reducing the sense that ESG is being imposed by outsiders (ESG specialists) or is 'just the latest management fad'. Human resources practices – recruitment, performance appraisal and reward systems – nurture a supportive culture by encouraging RI behaviours and skills.

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[2] Switch: how to change things when change is hard. Chip and Dan Heath. Random House Business Books, 2011.

I have seen how a lack of sustained leadership from the top can leave policies, processes and committee structures ineffective, and leave staff with no understanding of the purpose or objectives of responsible investment for the organisation.

Balancing head and heart

A key insight of change management is that 'people change what they do less because they are given a*nalysis* that shifts their *thinking* than because they are *shown* a truth that influences their *feelings*'.[3] This may be difficult to believe in investment organisations, where numbers supposedly reign supreme. And of course it's true that numbers are important – along with systems, processes and policies.

But investors are people too. As responsible investment change agents we need to get the balance right between the head and the heart in the way we work. I have heard many stories from RI people who suffer deeply and bitterly the emotional stress of being repeatedly dismissed by colleagues who reject 'rational' arguments based on the conventional repertoire of 'materiality', 'risk' and the 'business case'. Equally, I know many RI people who are able skilfully to blend a range of styles and techniques – from numbers-based and technocratic to human and relationship-orientated – to achieve their goals.

My very strong sense is that (most) RI people know all this instinctively, and my direct experience is that they acknowledge it in private conversations. Yet discussing it explicitly is still considered inappropriate – even dangerous. My contention here is that by acknowledging it more openly, sharing experience and learning lessons framed in this way, we can become more effective at what we do.

And if we are truly serious about bringing sustainability to financial markets, that can only be a good thing.

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If the themes discussed here resonate with you and you would like to share your experience and discuss how we can develop this area further, please get in touch at rob.lake@roblakeadvisors.co.uk.

[3] Kotter, The Heart of Change.