



*ESG in context:*

*Capital allocation  
and the role of  
communication*

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# Programme

## Welcome

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## Speakers

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# Six Capitals - Our Service Offering

## ESG & Impact Advisory



## Research & Reporting Advisory



## Development Finance Advisory



## Financial Education (specifically trustees and employees)



## Reporting Advisory

(e.g. Materiality assessments, Gap analysis, Sustainability frameworks/strategies)



## ESG & Impact Research

(E.g. best of breed analysis, ESG factsheets and bespoke/thematic research projects)



Examples  
of clients/  
partners





***Managing the trade offs  
between short-termism  
and long term value  
creation***

**17 February 2021**

**Where do I sit in the investment value-chain?**



# The short-termism proposition – What is it?

- **Concentration on projects or objectives that will yield immediate advantages or profit at expense of long-term security (Oxford Dictionary)**
  - System-wide issue
    - ✓ “Quarterly capitalism”
    - ✓ “Corporate Achilles heel”
    - ✓ “Managerial Myopia”
- **Reinforced by diverse drivers**
  - Mostly linked to “frantic” trading patterns and demands for immediate profits by among others, “transient institutional investors”
  - Causing companies to “short-change” longer term strategies in favour of short-term profits rather than reinvesting corporate capital

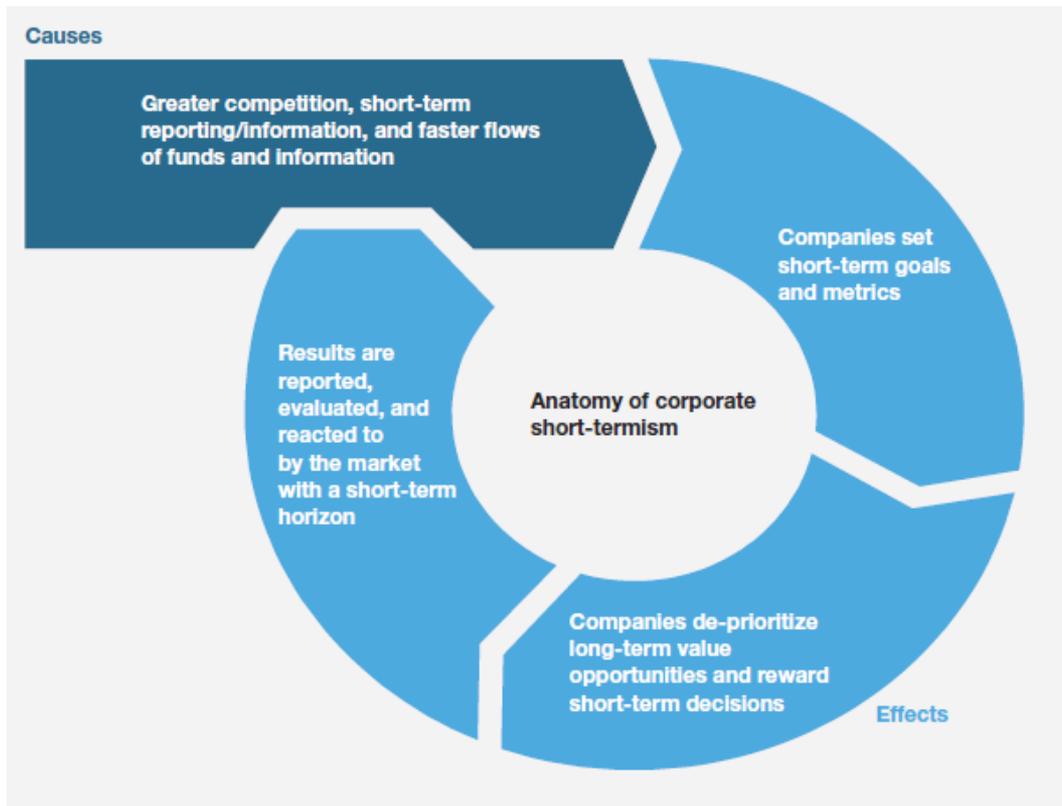


# The ESG context

- **Given long investment horizons associated with sustainability, it is understandable that short-termism is seen as significant barrier**
- **However - disagreement about whether or not taking a longer-horizon view necessarily presumes the incorporation of ESG considerations**
- **What is the problem?**
  - Lack of regulatory pressure
  - Complexity of investment value chain
  - Misaligned incentives
  - Lack of understanding / knowledge
  - Insufficient disclosure



# The short-termism proposition – reality or perception?



- Topic of much study, debates and campaigns
- Empirical evidence assessing causes and consequences remains limited
- However, perceptions do exist as evidenced by survey results
- Is it always problematic?



**Do you think short-termism is always a problem?**



# Link between corporate and investor short-termism

- **Research shows that –**
  - firms with a large number of transient investors are more likely to manage earnings in order to meet analyst and investor expectations
  - firms that focus on the short term tend to have a more short-term oriented investor base
  - short term investors tend to reinforce a short-term focus within the firm
  - companies that take a longer-term view may be able to attract a different type of (longer-term) investor
  
- **Implications for capital allocation?**



**What are the primary drivers of capital allocation  
in your organisation?**



**Do ESG considerations feature in your organisation's capital allocation decisions?**



# Is there an ideal ESG Investment Case?

- **Causation between ESG integration and holistic financial performance**
  - Not direct but evidence is growing, and other benefits are pervasive
- **Recent local study found:**
  - Local firms that had improved ESG disclosure seemed to benefit from a lower overall WACC and cost of debt
  - Equity capital providers, however, seem to perceive increased ESG disclosure as additional risk and require a higher return from such firms in South Africa
  - A growing number of capital providers consider a firm's ESG practices and disclosures which could offer a firm the opportunity to raise additional sources of capital

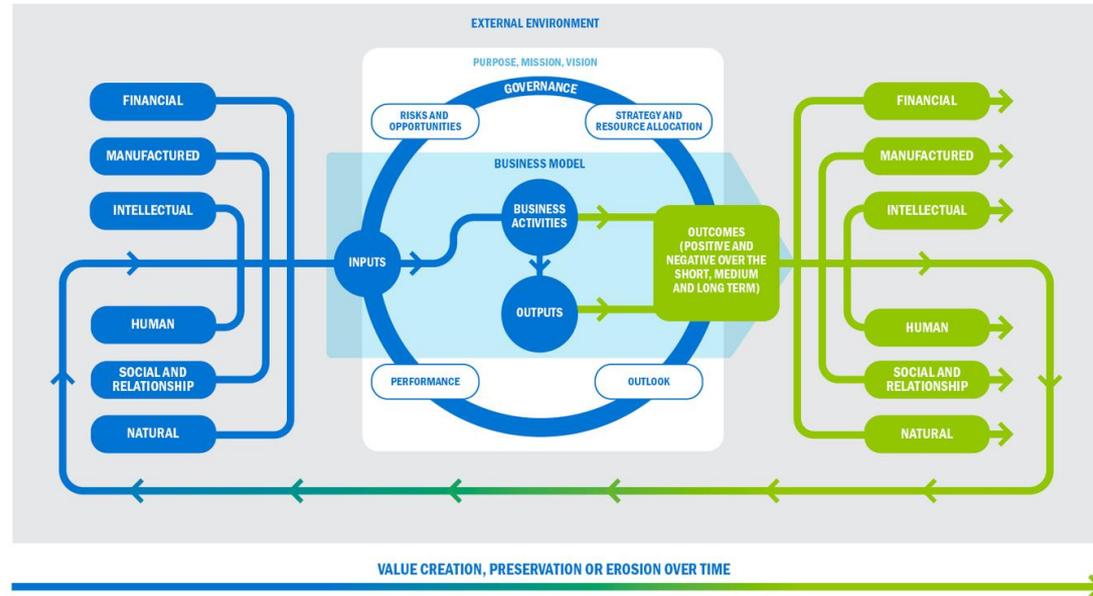


# Integrated Thinking and trade-offs to find balance



- **Multiple capitals operate concurrently**

- Integrated thinking requires trade-offs not only between short and long term but between various forms of capital
- Holistic capital allocation decisions informed by trade-off
- Understand short-term decisions and long-term impact or outcomes



Source: International Integrated Reporting Council, 2021,  
*International Integrated Reporting Framework*  
Process through which value is created, preserved or eroded



# The role of communication – improving the corporate narrative

- **Transparency about trade-offs should permeate through stakeholder management strategies**
- **Strive for improved quality of engagement**
  - Investor relations and stakeholder management
  - Encourage two-way dialogue rather than one-way communication
- **Reporting**
  - Needs to be holistic, transparent and effective
  - Focus on material information and value-generating strategies
  - Improve disclosure of ESG impacts and performance
  - Integrate long-term factors



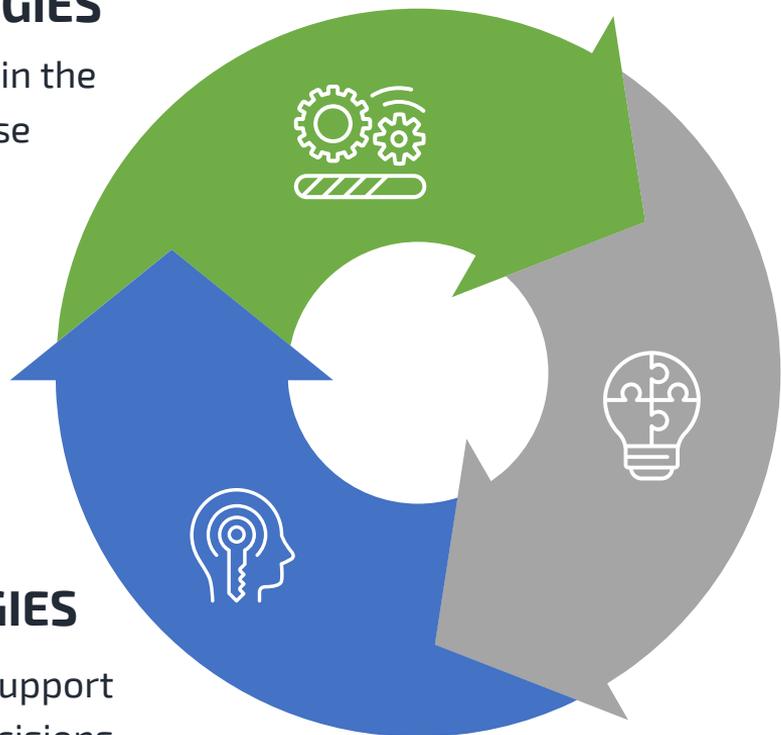
**Would you say the responsibility of managing short-termism sits with investors or companies?**



# Key recommendations for corporates

## COPING STRATEGIES

Address short-termism in the existing investor base



## SHIFTING STRATEGIES

Attract investors that support long-term decisions

## CHANGING STRATEGIES

Support wider systemic change in capital markets



Source: UNPRI & UNGC, 2017,

*Coping, Shifting, Changing 2.0: Corporate and investor strategies for managing market short-termism.*

# Key recommendations for investors

## COPING STRATEGIES

Help companies cope with market short-termism



## SHIFTING STRATEGIES

Support long-term decision-making



## CHANGING STRATEGIES

Support wider systemic market change



# And if COVID-19 upsets the apple cart...

- **Pandemic has altered business landscape more radically than the 2008 GFC**
  - Shifting patterns of consumption, production and behaviour
  - Pace and scale of change have forced business away from long-term mindset towards short-term survival<sup>1</sup>
- **How to respond**
  - Focus on being agile to build resilience
  - Don't lose the long term
  - Be purposeful about capital allocation



## ICGN Viewpoint, July 2019:

*“Capital allocation is where corporate finance meets **corporate governance**... development and communication of the long-term strategy and capital allocation framework is critical for ensuring full understanding of management decisions by investors ... as well as other relevant stakeholders.*

*The capital allocation framework should focus on what the company believes to be the optimal balance between the interests of key stakeholders, address all main uses of capital that are relevant for the business, and set out governance and decision-making process around major capital decisions.”*



# Thank you!

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