

The Rise in Responsible and ESG Investment

6 June 2022 6 min read

ESG Framework

by Natalie Scott, Director, and Janice Geel, Candidate Attorney

The King IV Report on Corporate Governance for South Africa was published on 1 November 2016 (**King Code**) and ever since, corporates in South Africa have been encouraged to comply with the environmental, social, and (corporate) governance (**ESG**) principles set out in the King Code. Despite the King Code making provisions for an ESG framework, legislation such as the National Environmental Management Act No. 107 of 1998 (**NEM Act**), the Mineral and Petroleum Resources Development Act No. 28 of 2002 (**MPRD Act**), and the Broad-Based Black Economic Empowerment Act No. 53 of 2003, have codified the ESG principles in the statute.

Even though the King Code provides extensively for compliance with ESG principles, compliance with the King Code is voluntary. However, the ESG principles contained in the statute create a statutory obligation on companies to comply with the legal objectives in relation to the ESG principles.

In recent years, there has been a rise in, and a shift towards, responsible investment and ESG investment. At first glance, responsible investment and ESG investment appear to be the same form of investment as both are underpinned by ESG principles. In respect of responsible investment, investors align their investments with the ESG principles that the investor has specifically identified. Therefore, a responsible investor may for instance choose to only invest in companies that value environmental conservation.

ESG investors

Whereas, ESG investors assess the company's overall ESG compliance before deciding to invest in the specific company. In this way, responsible investors and ESG investors play an active role in the manner in which companies comply with ESG principles and manage business operations.

However, the link between ESG principles and investments has highlighted the fact that the ESG principles that are applicable to one commercial sector, may not be appropriate in another sector. In this regard, we assess the healthcare, mining, and technological sectors within the framework of responsible investment and ESG investment and the consequences of non-compliance with ESG principles.

The healthcare sector

The healthcare sector has received a lot of attention since the beginning of the COVID-19 pandemic in 2020, with some of the ESG principles being clearly identifiable specifically within this context. The COVID-19 pandemic highlights, *inter alia*, the need –

- to dispose of medical waste in a manner that is not detrimental to the health and safety of communities and to mitigate the environmental impact of medical waste disposal;
- for the responsible testing of medication and vaccinations in a way that is not contrary to the protection of human or animal welfare; and
- for access to healthcare facilities for all members of society.

Additionally, the ESG principles that may be applicable to the healthcare sector, include social principles such as [data privacy](#) in relation to the personal information of healthcare users. The governance principles include ensuring effective management of patients, transparency, and disclosure, and ensuring that there is diversity in the board representation of healthcare companies.

Mining sector

The mining sector has a significant impact on the environment during the life of the mine, specifically in relation to carbon emissions, air and water pollution, and waste management. Therefore, mining operators have to ensure that they comply with environmental principles in relation to ESG and the applicable statutes (such as the NEM Act).

Mining operators may also be required to put in place measures to mitigate the environmental impacts of the mining activities after such mining activities have ceased. Additionally, the MPRD Act also emphasises the importance of consulting with interested and affected parties when mining companies procure mining rights, which is an integral social principle in the ESG framework.

In addition, mining companies should ensure that the necessary corporate governance structures are in place to prevent corruption, and bribery and to ensure legal compliance.

Technology sector

The technology sector may, at face value, not appear to have a significant environmental and social impact. However, companies in the technology sector, *inter alia*, contribute to increased electricity consumption, pollution, and natural resource depletion.

In order to comply with ESG principles, companies in this sector should consider implementing recycling practices and natural resource conservation practices, which will reduce their environmental impact. Similar to the healthcare and mining sectors, the technology sector should comply with the social and corporate governance principles

ESG investment and responsible investment

It is evident that investors are at the forefront of motivating companies to comply with the ESG principles in order to access investment opportunities, in terms of which investors not only seek financial returns on their investments but also social returns (such as addressing climate change issues). The shareholders of a company may also be responsible for a shift towards compliance with the ESG principles to encourage the board of the company to comply with the ESG principles in order to access investment opportunities.

Notwithstanding the nexus between ESG principles and investment opportunities, we note that the ESG principles that underpin these types of investment opportunities are not static. As a result, ESG principles that influence investors to invest in particular companies may differ depending on the geographic area in which the company is located and may change over time.

Consequently, there is no one-size-fits-all approach in respect of ESG compliance for all companies, especially within the framework of securing responsible investment and ESG investment and companies need to consistently re-assess their ESG compliance.

Consequences of non-compliance with the ESG principles

Companies that do not comply with ESG principles, especially the ESG principles contained in legislation, may not only face statutorily prescribed penalties but may also be excluded from, *inter alia*, tender processes as a result of their non-compliance. Additionally, investors may choose to invest only in companies that are ESG compliant and align with positive environmental and social impacts, and companies that do not comply with the ESG principles may lose investor trust.

Companies may also face scrutiny by the company shareholders, as was seen in the BP oil spill in 2010, in which shareholders questioned BP, specifically in relation to the lack of transparency in respect of environmental safety practices.

Conclusion

The rise in responsible investment and ESG investment has highlighted that there is no one size fits all approach in relation to ESG compliance. Different sectors may have to focus on different ESG principles in order to attract investment and even financing opportunities. Companies need to be cognisant that the ESG framework is constantly changing, therefore, it is not enough for companies to comply with ESG principles and then become complacent.

Companies need to adopt a forward-looking ESG policy to build investor trust and remain competitive within their respective sectors. Even though legislation and the King Code have resulted in companies adopting ESG principles, responsible investors, ESG investors, and shareholders have contributed to companies becoming more aware of the need to comply with ESG principles within their respective sectors.



Natalie Scott
Head of Sustainability

[View Profile](#)