Learned Lessons on ESG Investing from the Current Boohoo Slavery Scandal

By Hemanshi Kumar

There has been a strong chorus for sustainable investing in the financial sector, with more than 120 billion Euros poured into across 360 ESG-focused funds in Europe last year, according to data provider Morningstar.

The Covid-19 landscape plagued by staggering public health outcomes and global economic crises has highlighted the increasing interrelationship between institutions, domestic economies, and society.

The slowing down of international trade during the advent of Covid-19 is a notable example of the impact public health issues can have on International relations and the market economy. More importantly, it has communicated the tangibility of this relationship in our globalised lives. The urgency to address this relationship has been identified as 'ESG' (Environmental, Social, and Governance), one of which has entered the financial investment space for quite some time.

The rise of ESG-focused portfolios by asset and fund managers will arguably only grow. Though while investors have poured money into strengthening their ESG footprint, or namely, investing in spaces that have a long-term social impact, the outcomes have not always been as such.

The current slavery scandal by Boohoo, a multi-million dollar online fast-fashion outlet, has indicated ironically common trends in ESG Investing by fund managers. Over 20 Sustainability-focused funds invested in Boohoo before the wake of Boohoo's slavery scandal, since criticised following the Sunday Times investigation of its UK supply chain. Evidence of suppliers paying workers 3.50 pounds per hour, Boohoo was engulfed into media scrutiny and spotlighted conversations about the risks posed by investors failing to undertake effective due diligence.

Workers at the Faiza Fashion factory in Leicester during Covid-19 Lockdown, Photographed by Vivek Chaudhary for the Daily Mail

How did a major data provider, MSCI, measure Boohoo's ESG?

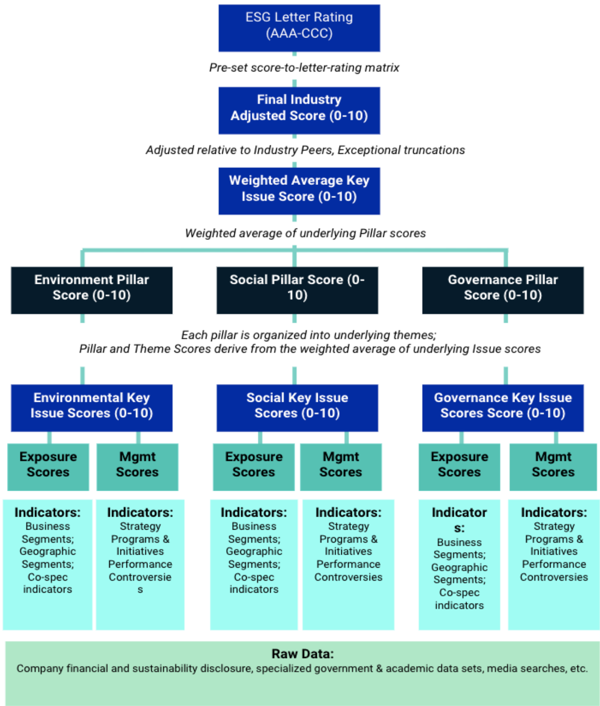
Investors who used MSCI's Double-A ESG-rating to inform their investment in Boohoo because it was placed among decision the top 15% of its peers have now been called into question about their commitment to ESG. MSCI's methodology ranges from data collection, evaluation of key issues from exposure, management perspectives and then follows into the development of pillar scoring. This generates a final rating (AAA-CCC) based on the weighted average of segment scores.

The ESG metrics assessment of companies poses as an attractive point of reference for ESG investors, though their elaborate scoring system has been described as overly simplistic in the way it quantifies social risks.

This is evident in the complexity of translating qualitative ESG Data into objective quantitative measures, extensive professional judgements required, and the dilemma in handling non-disclosure information. These factors thus end up posing inconsistencies that can hinder accurate ESG outcomes.

Given that MSCI's Rating's model is industry relative and uses a weighted average approach, their company score may not be wholly encompassing of E-S-G processes. Attracta Mooney and Patricia Nilson, journalists from the Financial Times reported that elaborate scoring systems often mean "that you can do really well in some areas and be really poor in another but get a pretty good score." Additionally, the use of raw data voluntarily provided by companies to assess ESG pillars disallows adequate transparency and impartiality in the ESG assessment process.

Figure 7 **Hierarchy of ESG Scores**



MSCI ESG Ratings Methodology Executive Summary, Sept 2019

Poor wages of workers were not reflected in MSCI's rating before Boohoo's allegations, reflecting that the system is not consummate. The advent of Covid-19 as well as the absence of granular financial information would've limited MSCI's ability to conduct on-site visits and thoroughly investigate Boohoo's social pillar. This would thus entail Boohoo's ESG rating not being entirely encompassing of its internal policies, let alone commitment to ESG.

Another concern regarding ESG rating assessments has been highlighted by Mooney and Nilson who detail that rating providers like MSCI assess the location of manufacturing facilities to make a judgement about their labour standards.

Diane Menville, head of ESG at Scope in Washington gave Boohoo an ESG rating of 7. 6/10, larger than the industry average (at 5.8) due to the company's manufacturing base being in the UK. This has been criticised, attributed mostly to the inconsistencies between the assumed high standards of UK manufacturing bases and Leicester's long-withstanding poor labour conditions.

Why did Fund-managers invest in Boohoo?

The answer to why ESG fund managers were attracted to Boohoo is hard to decipher, though one can assume that their staggeringly high stock price is a possible reason. This is particularly controversial in the context of fund managers who consider ESG aside of financial return in investment decision making.

Kefan Patel, a fund manager at Edentree Investment Management, highlights the paradox presented by fund managers in his questioning of why sustainable fund managers were solely using rating scores to inform investment decisions let alone investing in fast fashion at all.

The 20 funds invested in Boohoo, such as Standard Life Aberdeen, Legal and General Investment Management, and Mans group have now opened a can of worms about the legitimacy of the ESG Investing process.

What are the key lessons we learn?

These issues teach us that ESG Investing is a tricky pond to enter and must be done thoroughly, or not at all. For fund and asset managers, responsible investing requires a critical lens to detect possibilities of greenwashing and data inaccuracies, ensuring that their decisions not only benefit them but truly live up to ESG pillars.

One of the most pressing lessons that can be learned is redefining the way scoring systems are utilised. While rating scores try to encompass a company's alignment with ESG themes, their quantification and averaging system limit a 360 perspective of their strategy, policy, and people processes and most of all, their intent to create social impact.

Due diligence on part of investors would therefore involve quality-based assessments beyond what rating scores do, enabling a fuller picture and a genuine sustainability portfolio. The use of different data vendors to cross-check ESG assessments would also be necessary.

The fundamental lesson that we may learn from this scandal resides in the question for fund managers about their commitment to ESG. These questions would ultimately result in an infrastructural shift in our investment system about intent, transparency, and legitimacy in ways that extend financial parameters.

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