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Greenwashing Among Risks of ESG Investing

Willie Sutton, born in 1901, was one of the most notorious bank robbers of the 20th century in New York. But today he is best remembered for his answer to why he robbed banks. Sutton replied, “Because that’s where the money is.”

Within every investing fad and hot stock category, fraud proliferates for a very simple reason, “That’s where the money is.” When people become willing to pay more for a name, a sentiment, an investment theory or a get-rick quick scheme, there’s someone more than willing to exploit that desire with everything from misleading statements to inventive fakes.

Ironically, environmental, social, and governance (ESG) investments have become a prime example. ESG investing criteria are designed to select stocks based on how a company acts as a steward of nature, manages relationships with employees, suppliers, customers, and its communities, and the ethical conduct of company leadership and policies. Demand for ESG and “sustainable” funds are fueling the 21st century’s biggest investing trend, according to the Forum for Sustainable and Responsible Investment.

The concept of ESG investing is admirable. Demand for ESG mutual funds and companies is on the rise, and therein lies the problem. Welcome to greenwashing and an expanding host of green fakes.

Successfully portraying a public company as “green” and sustainable has become a means of increasing stock value. Mutual fund companies who have rebranded themselves as “sustainable” report increased inflows. Greenwashing is also a means of marketing private companies to investors who want their funds invested in socially responsible companies.

There is no standardized system for assessing “green” or sustainable investments, much less ESG investments. Virtuous statements may be no more than feel-good promotions to help boost demand for a company’s stock. There’s also the dilemma of the ends justifying the means. Does producing batteries for electric vehicles offset the environmental impact of obtaining the raw materials?

ESG investing is anything but simple. It requires knowing exactly what you consider an acceptable investment and then researching to make certain that you are buying companies that truly represent your views and are not just greenwashing their operations with platitudes that sound good but have little application to the business.

It is also important to remember that you are INVESTING for your future. The socially responsible investment needs to have:

1. a viable product or service
2. demand for that product or service,
3. good management that can run a financially sound company,
4. a plan for growing the value of the company,
5. the financial and intellectual capacity to make that plan reality.

If the company cannot meet just one of those criteria, you might not be investing, but instead making a financial contribution to an idea that may never offer you a return.

While ESG investing may be a morally appropriate approach to your investment portfolio, there are very real risks if you don't take the time to thoroughly vet your investments or work with a financial adviser experienced in analyzing and selecting good companies and mutual funds. Con artists go where the money is. And right now, that includes "green," "sustainable," "ESG" investments.

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