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DO BALTIC INVESTORS CARE ABOUT ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)?

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Abstract. As the environmental, social and governance (ESG) adoption practices in large and developed economies are becoming more sophisticated, in the still developing economies the non-financial information disclosure practices are gradually evolving. This article aims to capture the ESG implementation practices and challenges of the financial investors and banks operating in the Baltic countries - Lithuania, Latvia and Estonia. By analyzing survey data of 37 financial market players, the results reveal that around 81% of the respondents already use ESG data when evaluating their investments, which can partly be explained by the regulatory drivers coming from the large share of private equity and venture funds managing local and international public funding. Moreover, a substantial average weight of 0.39 is found to be attributed to the sustainability factors in the investment evaluation process, which is rather high given the general perception of the ESG being a recent addition to the investment evaluation tools. While 51% of the respondents admitted that Covid-19 pandemic has made no changes in their ESG practices, there are other common challenges named by the investors e.g. lack of general and quantifiable ESG data from the side of the companies and struggles to find matching benchmarks for the large share of the small and mid-sized companies dominating the Baltic investment market. By addressing the obstacles highlighted by this research, the policy makers can explore the ways how to foster a wider adoption of ESG policies in the Baltic investment universe.

Keywords: Environmental; social and governance (ESG); Financial investors; Sustainability

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JEL Classifications: G30, G32, Q56

1. Introduction

With the increasing importance of the non-financial factors in the investment process, more and more investors are actively looking for companies demonstrating high environmental, social and governance (ESG) standards. While historically ESG aspects assuredly played a side role in the investment evaluation, the trend has recently been changing. The effect of the changes is twofold – while more financial investors and banks are favouring investments in high ESG standard companies, the companies themselves must start paying more attention to their non-financial performance to be able to attract financing (UN PRI, 2019). This has become even more important during the uncertainty caused by the Covid-19 crisis. The ESG investments are on the rise – despite the financial downturn driven by the pandemic, the 2020 marked a new all-time high of 1 trillion USD in assets under management in sustainable investment funds (Morningstar, 2020). As the general uncertainty in the financial markets has increased, there is a certain pressure on the investors and companies themselves to maintain resilience in their operations, which arguably is easier achievable for the higher performing ESG companies (Reynolds, 2020).

The shift is noticed globally – by both academics and businesses. Eccles & Klimenko (2019) reported that the results of their interviews with 70 executives from 43 global institutions suggested ESG being the next priority for the global investors. Similarly, EY Fifth global institutional investor survey dated July 2020, revealed that 98% of the global institutional investors are assessing company performance using ESG factors (EY, 2020).

The Baltic countries in terms of ESG is still a growing market. Even though there are certain investors, which are actively pursuing responsible investment strategies and even leaning towards impact investing concepts (Süsi & Jaakson, 2020), the overall ESG compliance and requirements relative to the Western Europe or Scandinavia is assumingly lower. A Central Europe based survey performed by Deloitte in 2020 including also the responses of the Baltic investors, revealed that 62% of the private equity (PE) and venture capital (VC) funds believed that ESG factor consideration can increase their expected returns (Deloitte, 2020b).

In order to provide an aggregate view on ESG application, challenges and practices by the financial investors investing in the Baltic countries, this study aims to analyse the ESG preferences and policies of the financial investors and banks operating in Lithuania, Latvia and Estonia. In addition, this study expands the sample to include also smaller ticket investors – venture capital and acceleration funds - as well as banks, to see if there are differing viewpoints coming from variously sized financial investors. In addition, it might be assumed that ESG adaptation in the Baltic countries is hindered by certain challenges, which are shared by most of the investors in the market, therefore the identification of the specific obstacles is set as another goal of this study. Finally, given the certain timing of the research, the study also aims to evaluate if any changes in the investor behavior have occurred due to the Covid-19 pandemic.

In order to explore the investor view, a survey consisting of 15 closed and open-ended questions was distributed to a list of financial investors, asset managers as well as the major banks actively participating in the corporate financing. The questionnaire addressed the view on the ESG relevance, the policies and standards currently implemented and the identification of struggles the investors might have. 37 responses were gained for the survey revealing a response rate of around 66%, which taking into account the total size and number of players in the financial market can be considered as a representative sample for the region. To allow for more correct interpretation of the results and additional explanatory power, in-depth interviews were held with four respondents representing various corporation types.

This paper provides several contributions to the academic literature. Firstly, it contributes to the existing volume of the academic research, which aims at describing the ESG factor application in the investment process, in this case, in respect to the specific Baltic country geography. Secondly, by identifying the main obstacles currently faced by the financial sponsors, the hindering factors can be better understood by the policy makers and allow to make suggestions to correct for them.

The remainder of the paper is organized as follows – Section 2 summarizes the relevant literature about investors view on ESG applications and the main challenges they face, Section 3 sets forth the methodology employed in this study, Section 4 describes and discusses the results and finally, Section 5 concludes.

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2. Literature review

Financial investors and ESG

With the rise of the sustainable investing, growing body of financial investors declare the inclusion of non-financial risks and opportunities in the investment evaluation process (van Duuren et al., 2016). The degree of ESG factor inclusion in the investment evaluation process varies greatly in a scale from negative screening or exclusion criteria to a moderate level of non-financial risk evaluation and finally to ESG opportunity recognition and value derivation (Schramade, 2016).

The specific long-term and active relationship between the financial investors and the companies, ensures that the private equity and venture capital companies are particularly well suited to integrate and improve the ESG standards in their portfolio companies (Invest Europe, 2021). The effect of these activities can be substantial – it has been estimated that as of 2019, the VC and PE funds in the Baltic countries had 309 active portfolio companies generating over EUR 1.6 bn in revenues (Deloitte, 2020a).

Banks and asset managers, on the other hand, can stimulate the companies to improve their sustainability standards by ensuring that a certain ESG performance has to be achieved to allow for financing or investing. In this way, an indirect pressure is exerted on the companies to improve their sustainability endeavours and consequently also financial resilience (OECD, 2020). The banks and asset managers therefore not only achieve higher compliance with the regulatory standards imposed by the European Green course initiative, but also arguably lower their exposure risk to certain risks coming from the non-financial factors.

There are several drivers fostering the wider adoption of sustainability frameworks for the financial market players. A significant influence is exerted by the asset owners, who can request certain level of ESG standards and disclosures to be ensured in their portfolio (Eurosif, 2016). A study performed by S&P, which surveyed 194 credit risk professionals employed in banks and other financial institutions, reported that 86% of the respondents indicated that increased demand of the investors is pushing the ESG factor integration in the credit risk analysis. 83% of the respondents noted that they believe that the role of ESG factors in the credit risk assessment is integral (S&P Global Market Intelligence, 2020). All in all, a higher creditworthiness is a rather strong factor pushing the companies towards sustainability improvements.

Another common driver is the regulation, which in the recent years has been developing rather dynamically. Developed within the frame of the European Commission's Action Plan on financing sustainable growth adopted in early 2018, a Regulation 2019/2088 on Sustainability-Related Disclosures in the Financial Services Sector (SFDR) is set to enter into force in 2021. The core of the SFDR lies within promoting transparency in sustainability-marked financial products and services, as well as disclosure of ESG policies, processes and principle adverse impacts on sustainability areas, which may results in negative impact on the ESG matters (Official Journal of the European Union, 2019). In line with the green taxonomy trying to unify the standards of the financial products across the industry, institutional investors, banks, pension funds and asset management funds will have to devote much higher attention to the proper implementation of the law-requested sustainability standards (OECD, 2020).

Several global and regional studies allow to estimate the current level of ESG compliance by the financial investors. So, for example, EY global institutional investor survey reveals that 98% of the institutional investors surveyed are assessing company performance using ESG factors, thereof 72% perform a methodological approach in this assessment, which indicates a significant increase from 32% mark in the prior year. Furthermore, 43% of the respondents admitted that company's nonfinancial performance has frequently played a pivotal role in the investment decision-making during the 2019 (EY, 2020). It has to be noted, however, that the global studies often

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lack comparability to the developing markets. A regionally closer experience to the Baltics, therefore, is captured by the Deloitte Central Europe PE survey (Deloitte, 2020b). With respect to the ESG dimensions, 62% of respondents agreed that consideration of an ESG strategy can amplify the investment returns. When applied practically, 57% of respondents revealed that their companies always perform ESG evaluation as part of due diligence, while 28% of the respondents agreed to the statement with respect to certain companies or industries most likely to be at risk. Only 6% of the respondents suggested that they see no reason in performing ESG evaluation before doing an investment. Data availability and quality are considered the main obstacles hindering wider ESG adoption. Finally, even though the vast majority of the surveyed sample admitted that they are using ESG factors in their investment evaluation, only 30% thought that ESG can be a value driving factor. With respect to the SFDR, Deloitte has recently published a report indicating that 44% of the Central European financial investors are unaware of the details of the EU Regulation to be implemented already in the first quarter of 2021 (Deloitte, 2021). This signals that the adoption of the regulation will be difficult and potentially lagged. In addition, it is likely that as the financiers will put a higher pressure on the data gathering from their portfolio companies, the companies themselves will struggle with providing sufficient data (Morrison & Foerster LLP, 2020).

Challenges in ESG application

A commonly cited problem when addressing the obstacles in ESG implementation in the investment evaluation process is the data availability and quality. According to European Central Bank, the endeavours in creating a common green taxonomy, can only be successful if the corporate information is presented in coherent and granular manner, otherwise the metrics and comparisons cannot be properly used (Schnabel, 2020). This view is supported by the investors surveyed in 2020 by the EY, indicating that the investor dissatisfaction with the ESG data has risen since 2018. The percentage of the dissatisfied investors has increased since 2018 by 14% for the Environmental data, 20% for the Social dimension and even by 28% for the Governance factor (EY, 2020). Also academics have recognised that data inconsistency creates challenges in proper data evaluation. Kotsantonis and Serafeim (2019) in their analysis reviewed a sample of 50 large publicly listed companies and manually collected their disclosures on employee health and safety data. The authors found more than 20 different ways how the sample companies chose to report this metric, implying that such inconsistencies may likely lead to significantly different ESG scores.

The data quality is also an issue mentioned when discussing the large discrepancy in the external ratings. According to Eccles et al. (2019) there were around 500 ESG rankings, more than 100 ESG awards and 120 voluntary ESG disclosure standards estimated to be in the market. The ESG data market is growing constantly – according to Opimas market study, at least 20% annual growth is expected for the ESG data business (Foubert, 2020). As the demand for ESG data grows with the volume of responsible investing, one of the challenges that has emerged is the variances in the ESG scores by various agencies. This does not come as surprise given the hardly measurable concept of sustainability in general and inclusion of various subjective scoring attributes. In et al., (2019) highlighted the problematic of the ESG data quality, suggesting there exists a trade-off between validity and reliability of ESG data. Authors suggest that as there is no agreed theoretical framework, the data should be used with caution and the overall data quality shall be improved in order not to compromise the reliability of the data for the investors. The data quality has a direct implication also on the scores issued by the scoring agencies. Chatterji et al. (2016) examined 6 ESG raters (KLD, Asset4, Calvert, FTSE4good, DJSI and Innovest) and generally found a surprisingly low correlation among the issued ratings. Furthermore, the differences remained even after adjusting for the likely differences in the definition of the score awarding principle, implying that the agencies not only present varying definitions of the same rating, but also use different measurement techniques for the same variables. Similarly, an utmost recent paper by Berg et al. (2019) compared the ESG ratings by five market dominating ESG rating agencies (KLD, Sustainanalytics, Vigeo-Eiris, Asset4 and RobecoSAM) and on average found a correlation among the ESG scores of 0.61, which is strikingly low in

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comparison to the average of 0.99 correlation coefficient among the usually compared credit ratings like S&P and Moody's. The differences were mostly explained by three main factors – (1) scope divergence – referring to various sets of attributes used by each agency, (2) weight divergence – referring to attribute weighting in the calculation of scores and (3) measurement divergence – cases, when agencies use different proxies for measuring the same attributes. Lack of ESG rating convergence is also documented by Dorfleitner et al. (2015).

In addition, as very few of the single data points can be analyzed on absolute terms, a selection of a proper peer group to perform the benchmarking exercise is a crucial step in the evaluation. As the vast majority of the ESG ratings are awarded in a relative relation to a peer group, the proper definition and allocation is crucial, however often not explicitly disclosed and therefore might lead to deviations in the actual ESG assessment (Kotsantonis & Serafeim, 2019).

According to the EY global institutional investor survey (2020), another problem lies within the disconnect between the financial and non-financial reporting of the companies. 41% of the survey respondents are dissatisfied that ESG disclosures do not communicate sufficiently how the company creates the long-term value. In this sense, the materiality assessment is to be considered. As the materiality strongly changes by the industry and geographic region, it is a key facet that investors should consider in respect of their portfolio. According to Khan et al. (2016) particularly the concentration on the specific material domains for each company ensures high ESG performance company outperformance.

Finally, as pointed out by a recent OECD Report 2020, there are also challenges in the capacity and knowledge of the financial institutions themselves. As the ESG and sustainability domain in the finance field is still growing, it is challenging for the investors and lenders to ensure that the in-house capacity is sufficiently high (OECD, 2020).

ESG in times of Covid-19 pandemic

The global health crisis starting in 2020 has caused not only severe economic implication, but also created a shift in the way investors are viewing the likelihood of such unexpected and tremendously impactful risks on their investments. According to the head of Principles for Responsible Investment (PRI), there was a concern early in the crisis that investors' focus will shift from the long-term sustainability track to the more immediate threat avoidance, however the opposite has turned out to be true as the record peaks have been documented not only in the absolute numbers of the sustainable investments, but also in the number of PRI signatories committing to high ESG standard implementation (Reynolds, 2020).

Arguably, the largest shift has been experienced by the social factor – especially in the domains of occupational health and safety, employee protection, social security measures as well as the domains of supply chain resilience and longevity, which had been put on a test with the commencement of the global health crisis. A survey conducted on PRI signatories in 2020, reported that 64% of the respondents admitted a greater focus on S dimension following the crisis (Reynolds, 2020). Similar results have been found also by the EY global institutional investor survey (2020), which summarizes that the current crisis has finally put the spotlight on the human capital disclosures shifting the focus from general rhetoric to measurable data (EY, 2020).

On the other hand, many parties agree that the current disruptions can be perceived as an opportunity in re-evaluating the importance of non-financial factors in ensuring resilience of the company's operations in times of crisis. With the significant drop in air travels and mobility, the total carbon dioxide emissions in 2020 are expected to be around 4 to 7% lower than estimated before the crisis, which has never happened before in the past (Schnabel, 2020). In respect to corporates, 71% of the respondents of the J.P. Morgan Research admitted that they likely see the current crisis as a point to re-evaluate their previous approaches to the climate change awareness by e.g. shift to more intensive online meeting tool use also in the future (JP Morgan, 2020).

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2021 Volume 8 Number 4 (June)
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Even though there is limited research on this topic so far, some early studies suggest that companies having better ESG performance are also more resilient and absorb the shocks during the pandemic better (OECD, 2020), (Broadstock et al., 2021).

3. Research objective and methodology

In order to obtain a view on ESG factor application in the Baltic market, a survey was created and digitally distributed via e-mail or Linkedin to 56 financial investors, asset managers and banks with their primary operational markets in Lithuania, Latvia and Estonia. The survey was addressed directly to the investment managers or executive level decision makers to ensure that the responses reflect the opinions of the persons generally meeting the investment decisions as a part of their daily work routines.

The survey, which was open for responses from January 4, 2021 to January 24, 2021, consisted of 15 open and closed questions focusing on the Baltic investor's opinion on (1) ESG factor importance in their investment evaluation process, (2) the methods and practices applied in the evaluation process, as well as (3) current obstacles in ESG implementation. In addition, the study was seeking to capture the investment managers experiences on how the Covid-19 crisis has impacted their view on the ESG factors and the use of them in the portfolio management.

The survey was offered on no-name basis to ensure that honest and non-biased results are obtained. In addition, to be able to better explain the results as well as capture any remaining thoughts and sentiments, four in-depth interviews with different companies (a bank, two private equities and one venture capital company) were organized.

In the survey 37 responses were gained revealing a response rate of around 66%, which taking into account the total size and number of financial institutions and investors can be considered as a representative sample for the region. As most of the financial sponsors operate across all three countries, there is limited sense in drawing country-based conclusions.

The sample split according to the operation types is presented in Table 1.

Table 1. Sample split according to the respondents operation type. Created by authors

Operation type	Count	Percentage of sample
Asset management company	10	27%
Venture capital fund	9	24%
Bank	5	14%
Private equity fund	11	30%
Early-stage investment fund	2	5%
Total	37	100%

Source: Created by authors.

Due to the diverse type of operations, the sample companies showed a wide discrepancy in terms of operation size – the average investment ticket of 4.29 mEUR was indicated ranging from a minimum of 0.05mEUR to 20mEUR. While all the banks and 75% of the asset managers surveyed had loans issues or investments made into more than 40 companies, the majority (52%) of the PE and VC funds reported having more than 15 companies in their portfolio.

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2021 Volume 8 Number 4 (June)
http://doi.org/10.9770/jesi.2021.8.4(20)

4. Results and discussion

The first section of the survey aimed to estimate the sentiment of the investors towards the sustainability inclusion in the financial decision making. When the respondents were asked to reveal a personal opinion on which financial market players should consider ESG information in the investment evaluation process, two clusters emerged.

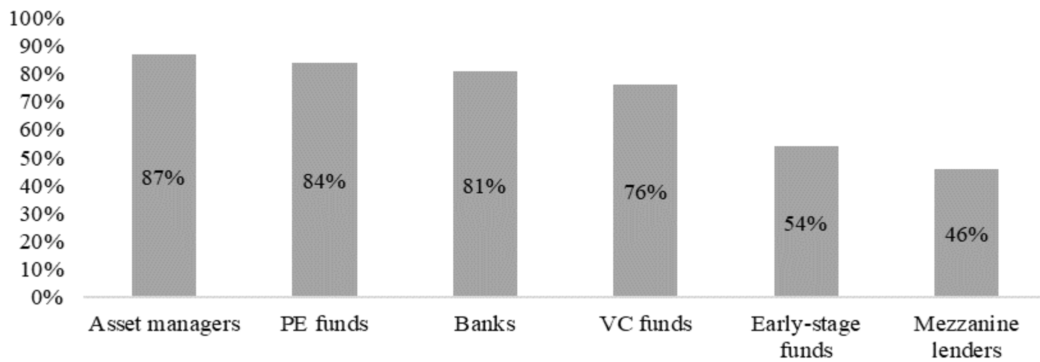

Figure 1. Share of respondents who believe that ESG factors should be considered by the mentioned type of investors

Source: Created by authors based on survey results.

As depicted in Figure 1, the vast majority named asset managers (87%), PE funds (84%), banks (81%) and venture capital funds (76%). The share of proponents was relatively smaller for the second cluster - early-stage funds (54%) and mezzanine lenders (46%). In addition, it was commented by some of the respondents that ESG factors should be considered by all those financiers, who have obtained such a mandate from their capital owners. When asked about their own experience in ESG due diligence, 81% of the respondents answered positively, whereof 46% perform ESG evaluation for all their investments and 35% do that in limited scope or for companies representing specific industries. The remaining 19% told that due to varying reasons it has not been done so far, but it is in their plans for the future. None of the respondents believed that there is no value in ESG factor implementation in the investment evaluation process.

The large share of ESG-integrating financiers and generally the positive sentiment towards the ESG inclusion goes in line with the previous conclusion that capital owners can be one of the primary drivers ensuring that certain level of ESG compliance is achieved by the investment portfolio (Eurosif, 2016). As highlighted by a recent study about investment funds in Latvia, even after more than a decade after the first risk capital funds were launched in Latvia, the funding is still largely dependent on local or international public resources (government, EU funds, EBRD etc). As found out at the time of the study, there were no VC funds in Latvia without public capital (Matisone & Lace, 2017). This finding partly explains the results – as a significant share of the sample companies manage capital, which is based on public resources, they have an implied requirement of at least a high-level sustainability risk evaluation in their investment process. In addition, the results of the survey imply that also the private capital managers are similarly minded.

As depicted in Figure 2, when asked about the drivers directly, however, most of the respondents (70%) cited global tendencies as the main reason to perform ESG evaluation. Regulatory requirements and attempt to lower the risk (each selected by 35%) came next.

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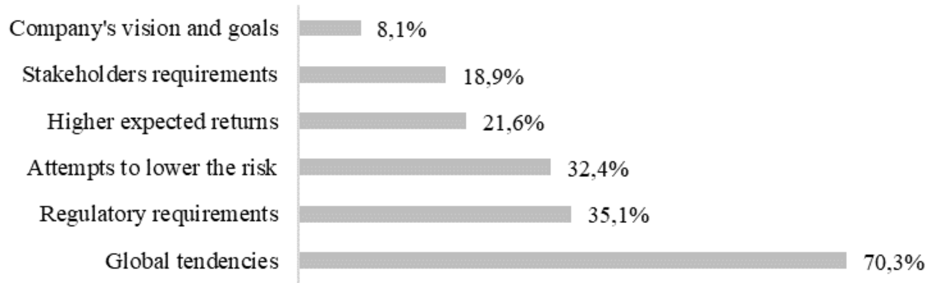

Figure 2. Share of respondents, who selected the corresponding option as a driver for their ESG inclusion

Source: Created by authors based on survey results.

In line with the previous answers, 73% of the respondents believed that ESG performance can be a value driver for the investment. Interestingly, that among the 27%, who considered that ESG factor implementation does not add any value, 80% of the respondents still admitted performing the evaluation. This implies that there are investors, who even though consider the sustainability metrics before investment, still are not sure about the value added of this process and potentially just follow the set-out guidelines or general market trends. This result comparatively is more positive than reported by Deloitte for Central and Eastern Europe investment funds, where only 62% of the respondents considered ESG factors as a value driver (Deloitte, 2020b). As further explained in one of the in-depth interviews, if previously the ESG factors were mainly viewed as a source of potential risks or mismanagement, a slow shift is happening in the market to view the sustainability factors as a source of opportunity and potentially higher return. The finding generally goes in line with the global evidence as summarized by e.g. Eccles & Klimenko (2019).

When asked about specific factor importance (see Figure 3), 49% respondents indicated that all three (E, S, and G) factors are equally important to them when evaluating an investment opportunity. Additional 35% voted for the environmental factor and 14% for the governance factor. Only one respondent mentioned the specific social domain potentially suggesting that the social dimension is yet still the least evaluated as of now.

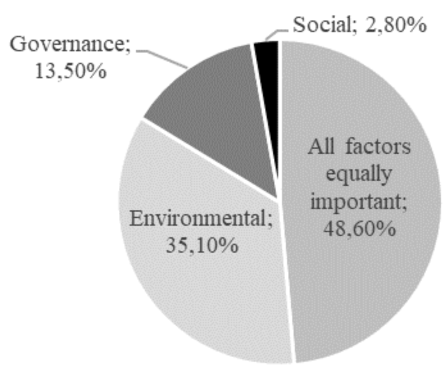

Figure 3. The choice of the most important ESG factors by the survey respondents (only one answer possible)

Source: Created by authors based on survey results.

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An important section of the study concentrated on the obstacle determination allowing to potentially explore the ways how to solve them in a meaningful manner by the policy makers. With respect to the current ESG challenges, only 16% (see Figure 4) of the respondents believed that there are no current obstacles in ESG data application in the investment process.

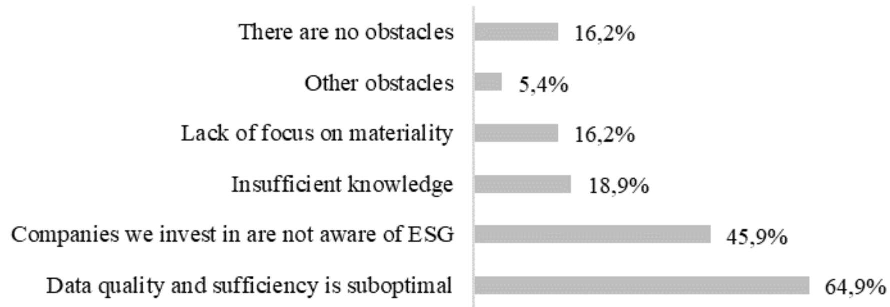

Figure 4. Share of respondents, who selected the corresponding option as an importance obstacle for ESG implementation

Source: Created by authors based on survey results.

As discussed before, globally, data availability, which goes in line with the general ESG application by the invested companies, is one of the most commonly cited obstacles in ESG application. With respect to the Baltic companies, the situation is even dimmer given the fact that only a handful of companies have an external ranking ESG score available, most of which are rather large, publicly listed or state-owned companies, which mostly are outside of the investment scope for the local financial investors (except certain largest banks and a slight share of the asset managers). The lack-of-data barrier is supported by the survey results as depicted in Figure 5, which suggest that around 86% of the respondents are not satisfied with the volume and quality of non-financial data that the companies can offer.

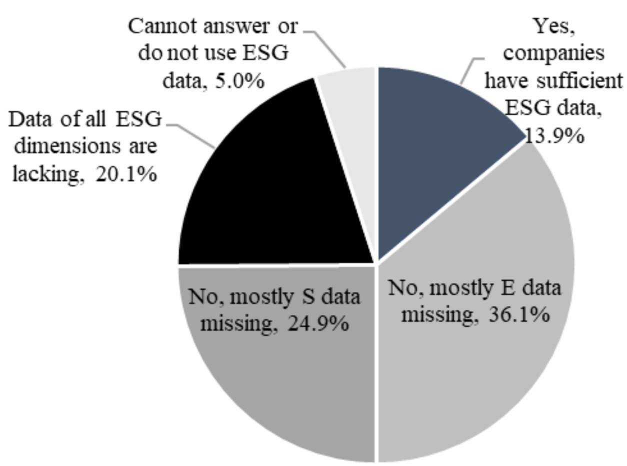

Figure 5. Do companies usually have sufficient ESG data to provide?

Source: Created by authors based on survey results.

As shown in Figure 5, the largest gap seems to occur specifically in the environmental data. Several respondents additionally indicated that the information is not sufficiently quantifiable or numeric as well as that a general ESG data infrastructure should be developed to improve this aspect. Interestingly, that from the 14%, who indicated that there is sufficient data availability, the vast majority (85%) are asset managers, which makes sense given that

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these funds usually face a different kind of investment universe than locally operating banks and financial investors mainly due to the geographical exposures - while local asset managers usually have the opportunity to invest in stock markets globally, the banks and investors work with the local, most often privately-held and frequently also small and medium sized (SME) companies, thus also the ESG data universe available to them is more limited. In line with the previous research by Kotsantonis & Serafeim (2019), the lack of proper benchmark data was stated as another meaningful obstacle – as the privately held, mostly SME can hardly be comparable to the global listed peers, the financial investors are frequently struggling to understand the reasonable level of the metrics measured. Also, as noted by several respondents – due to the different reporting approaches, industries and materiality, the ESG data among the portfolio companies are rarely comparable, leading to an overall benchmarking problem in the market.

A potential solution could be the creation of a unified reporting database, which would provide access to potentially anonymous peer data to the companies choosing to disclose their own results. As pointed out by The European Fund and Asset Management Association (EFAMA) the creation of such a public EU-wide ESG database would ease the obstacles that investors face in the light of required disclosures as requested by the upcoming regulations. In addition, such data would also benefit other stakeholders as the investors, academics and general society (European Fund and Asset Management Association, 2020). While a common EU-wide database is still no present, a local Baltic country wide could be a first step if such a suggestion could be explored further by the local regulators. Correspondingly to the poor level of the general data availability, when asked about the ESG data sources used, 87% of the respondents admitted using in-house research data. While 8 respondents (22%) had used Bloomberg as sustainability data source, other data providers as RepRisk, Sustainalytics, Refinitiv and MSCI were applied on very rare occasions (on average 1 to 3 respondents had used them). Furthermore, these external databases had dominantly been used by banks and asset managers, while PE/VC majorly rely on their own in-house research and external consulting companies.

Another key topic frequently mentioned in the global investor reports is the confusion about the materiality of the specific indicators attributable to companies from different industries. Also 51% of the survey respondents indicated that materiality is an important topic that the financiers have at least on a high level discussed with their investment companies. Nevertheless, the lack of focus on material issues by the companies was cited as a serious obstacle by 16% of the respondents. Finally, in line with the (OECD, 2020) results, the lack of knowledge and experience by the financiers was admitted by 19% to be an additional obstacle implying that greater explanatory work would be beneficial to at least a part of the industry players.

With respect to the disclosure, the majority or 53% of the respondents indicated that they do not publish designated Sustainability reports, nor report such information on their webpages. Nevertheless, only 11% thought that there is no value in such disclosures for the portfolio companies, meaning that even though the disclosure practices are mostly not elaborated yet, the value of such information is recognized. As discussed before, one of the strongest driving forces for the non-financial reporting is undoubtedly the regulation. While currently the Non-financial Reporting Directive directly applies only to the large entities, the general trend in the legislation for companies moves towards greater disclosure (European Commission, n.d.). For the financiers themselves - SFDR is likely to increase the sustainability disclosures if not in the form of dedicated reports, then at least in wider information availability online.

As displayed in Figure 6, with respect to the current economic downturn, on average 51% of the respondents declined any changes in ESG agenda during the pandemic.

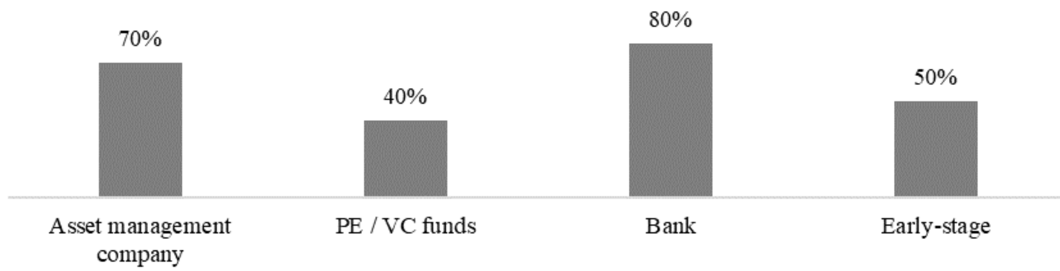

Figure 6. Share of respondents in the respective subgroup declining any changes in ESG agenda due to Covid-19

Source: Created by authors based on survey results.

Contrary to the global evidence by Morningstar (2020), only 19% reported paying more attention to the ESG risks and 16% - in specific a higher concentration on the social domain. Merely 14%, whereof all of them PE/VC funds, told that as other, more crucial factors are at risk now, the focus on the sustainability has currently dropped. It is also visible in the Figure 6, that most of the asset managers and banks, who usually have more developed Sustainability policies in place, have made no changes in the ESG perception due to the global epidemiology crisis.

Finally, while it is difficult to precisely measure the extent of ESG factor importance, the authors tried to estimate this figure by asking the respondents to appraise the approximate weight that sustainability factors cover in the overall investment evaluation process. The average result of the sample in a scale from 1 to 10 turned out to be 3.9 (median score of 3) corresponding to a weight of 0.39 in the decision-making model suggesting that even though there are various obstacles in the ESG implementation and differing views on the value added, a significant portion of the investment decisions already lies outside the scope of pure financial matters.

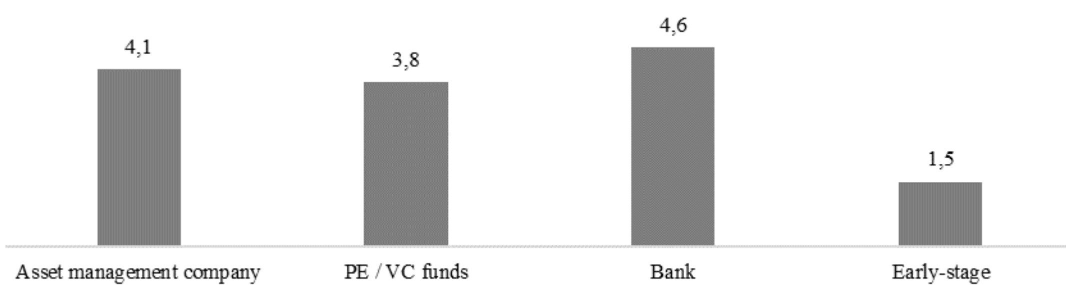

Figure 7. Average weight ESG factors play in investment evaluation measured in scale from 1 to 10

Source: Created by authors based on survey results

When dividing the scores into the operation type subgroups (Figure 7), in line with the assumption, the results show that banks and asset management companies currently put the most effort on the ESG factor inclusion, while PE / VC funds and early-stage funds are slightly below. Particularly high the result is for banks, which means that already now there are companies in the Baltic countries, which most likely cannot obtain bank financing due to the non-financial factors. Along with the finding that 46% of the respondents believed that an important obstacle for ESG inclusion is the lack of sustainability knowledge of the companies they invest in, a general undertaking from the policy makers point of view should be to raise the awareness and educate companies about the meaning of ESG factors and their implications.

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5. Conclusions

The aim of this study was to understand the ESG factor application patterns and challenges of the financial investors and banks operating in Lithuania, Latvia and Estonia. It contributes to the existing research, which aims at examining ESG factor implementation practices in the investment process, in this case, in respect to the specific Baltic country geography.

Several conclusions can be drawn based on the results obtained. Firstly, the adoption of the ESG factors in the investment evaluation practice is already widely spread across the examined region - the results show that 81% of the respondents already perform ESG evaluation in at least limited extent before investing in or lending to the companies. In addition, the share of the surveyed companies, which believe that ESG can be a value driver for their investments is even larger than previously found for the entire CEE region. While the existing academic and professional literature name the requirements of the capital owners and regulation as the main factors positively driving the ESG implementation, the Baltic investors, on the other hand, mostly cite global tendencies over the regulatory requirements and risk reduction. From this result it can be concluded that the regional investors are largely up to the date with the latest global tendencies and try to implement them in their practices.

A significant contribution to the scientific literature is the identification of the specific obstacles in ESG application. In addition, based on the results of the study, corrective measures can be discussed by the policy makers. The study revealed that the current degree of data availability (including benchmarking data) and lack of respective sustainability related knowledge of the companies and the investors themselves are the key factors that harm further ESG practice implementation. The lack of data challenge is also not improved by non-financial disclosures as more than a half of the respondents admit that they do not publish designated sustainability reports, nor report such information on their webpages. Remedies to the most frequently mentioned obstacles such as data insufficiency and lack of benchmarks, could include a creation of a ESG database open to the disclosing parties in order to ease the data access for benchmarking purposes. In addition, increased educational effort, which could be performed by, for example, national venture capital associations would raise the investors knowledge on the sustainability matters, which the financiers could then pass on to their portfolio companies.

The importance of this study and proceeding implications is highlighted by the fact that already now sustainability factors are highly integrated in the financiers' decision making processes. The average weight of the sustainability factor impact on the overall investing decision is found to be 0.39 being somewhat higher for banks and asset management companies. This result is surprisingly high given the previously mentioned challenges and lack of knowledge in the field, however signal that further developments in the ESG applications are to be expected.

Finally, contrary to the global tendencies, the majority of the Baltic respondents declined any changes in ESG agenda during the Covid-19 pandemic. While it could be assumed that more pressing, financial issues came ahead of the sustainability during these times, only 14% indicated it to be the case demonstrating that sustainability remains an important factor of the financial investors also in times of the global health crisis.

With respect to the limitations of this study, it should be pointed out that the main aim of the study was to obtain a high level overall picture of the ESG landscape as currently seen by the Baltic financial market players. The results to some of the questions, however, were notably different in the sample sub-groups given the differing investment exposures and geographies by the respondents - asset managers, banks and VC/PE funds. In order to further explore propositions for policy changes mentioned in the study, a suggestion for further studies could therefore be to perform more in-depth evaluations by concentrating on more narrowed samples of the financial industry players, which potentially could provide more focused results.

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