ESG Isn’t Just an Initiative for the Future, It’s a Must-do for Today

Establishing Environmental, Social and Governance (ESG) goals in equipment finance is becoming an important component of an equipment finance firm’s overall strategy.

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It’s easy to say, as the leader of a company, “We want to do good in the world and we promise to.”

But turning that promise into a real strategy that benefits your stakeholders is a different conversation and one that needs to be had within equipment finance firms now to keep the industry on the forefront of unfolding social and economic movements. Turning sustainability promises into real positive impact requires measurable “ESG” goals, standing for Environmental, Social and Governance. A firm’s articulated ESG goals are an increasingly important element in a borrower’s selection of lenders, in a prospective employee’s choice to join an organization and in an investor’s decision to provide capital.

But the rollout of ESG strategies across financial services has been uneven, since there is a lack of standards for reference. Banks and equipment finance companies in Europe are well ahead of their North American counterparts in adopting clear ESG frameworks and implementing them into their everyday business decisions. The U.S. Securities and Exchange Commission (SEC) is taking notice of what the European financial regulators are doing to promote ESG practices and disclosures, and in the next 12 months will likely issue some guidance on this topic. But equipment finance firms can get a jump-start on ESG strategies before the SEC issues its formal guidance. The key is selecting a measurable set of ESG goals and consistently reporting on them with great care every year.

Keep in mind, our industry has always been environmentally friendly given its focus on minimizing total cost of ownership and optimizing asset utilization. End of term activities and asset remarketing are a core competency in equipment finance. Moreover, as an industry we’ve been thinking about ESG way before the terminology ESG was popular. For example, project-based finance has been using an ESG mindset for a long time. When financing these long-term projects, lenders consider the potential effects of climate change on equipment and the social impact of a project. If a flood takes out supply, or the community protests against the project, then the project becomes economically unattractive.

The roots of ESG go back decades in various forms such the Community Reinvestment Act, socially responsible investing and Corporate Social Responsibility (CSR) practices. During the pandemic, though, thinking on how to help the world socially and environmentally accelerated. It’s as if the “industrial revolution 4.0” happened in the last year. The global COVID-19 pandemic, severe weather events and social justice issues all accelerated the way people think about corporate responsibility. We paused and looked around and realized: There are structural issues to fix.

Before the pandemic, Millennials and more recently Gen Z began flooding the workforce, and these generations both want to work for a company that mirrors their own values. ESG has become a talent issue in a hard to navigate hiring

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climate. It's a move from shareholder to stakeholder capitalism – and this change is accelerating, not slowing down. Not only do these young stakeholders want to work for companies they believe in, but they also want to buy from or invest in them, as well.

Now is the time. Here are some things to think about as you forge your own ESG path:

When considering your own ESG strategy, make sure the move is top-down. The board and senior management collectively should make ESG a priority and communicate that strategy to all stakeholders. Consider creating an ESG team or office to proactively manage and report on your firm's ESG progress and tying goals to incentive compensation.

Be thoughtful and methodical. Don't jump ahead! There is no one-size-fits-all solution to ESG. Equipment finance firms must consider both the ESG opportunities and challenges in financing their customers. For example, lending to the commercial aviation industry carries some negative climate considerations, but financing solar panels is a net positive to the environment. Perhaps adopting a hybrid workforce would advance your firm's commitment to reducing carbon emissions by minimizing business travel. You may already be implementing some ESG policies without realizing it; most equipment finance firms have long-standing credit policies against lending to restricted industries such as polluters, firearm manufacturers and vendors, and illegal substances, and have their own policies promoting safety and workforce diversity, equity and inclusion (DEI). And when considering governance, transparency is essential, as is considering internal policies on whistleblowing and bribery.

Pulling it all together, let's look at the trucking industry. From an "E" or environment perspective, an equipment finance firm can choose to finance Class 8 electronic or hybrid commercial vehicles such as tractors, bucket trucks and refuse trucks as well as specialty heavy electric vehicles like cranes and refrigerated trucks. From an "S" or social perspective, the same equipment finance firm can focus on ensuring driver safety by financing vehicles using state-of-the-art AI to avoid collisions in real-time.

Make sure your people know what ESG is, and your organization's strategy. Principles for Responsible Investment (PRI), an investor initiative in partnership with UNEP Finance Initiative and UN Global Compact, has studied how to consider ESG factors in credit risk analysis since the start of the ESG in Credit Ratings Initiative in 2016. Their research shows that a lack of awareness and misconceptions about objectives serve as disconnects in any industry. And PRI has found organizations can improve internally by categorizing efforts by type and improving awareness and transparency. ESG factors that reflect ESG beliefs should be more explicit in the credit assessment process.

At The Alta Group, we have been helping clients in two ways: researching current industry ESG practices, and helping companies create their ESG roadmap. Equipment finance parent companies like CAT, John Deere, Cisco and Huntington are leading the way in ESG disclosure, but they're all doing ESG very differently. We encourage you to review these ESG disclosures as well as disclosures by firms in other industries as you begin your ESG journey.

Consider what you're already doing now and what data you can collect. As you identify your ESG goals, take the time to understand what data is necessary to track progress and then begin collecting that data so you can report future changes. Take a deep, thorough look at data that you are already collecting – capture any low-hanging fruit. Reliable ESG goals hinge on transparency and being able to prove your impact. It's as easy as considering your inside view and outside view: What are we doing to make a difference and how do we talk about it?

So what are the benefits for equipment finance firms that adopt a clear set of ESG metrics?

Foremost, managing a business with clear ESG goals does good for your people, your customers, your investors and the planet. Yet there's another benefit that's around the corner that many equipment finance providers haven't realized: ESG as a source of capital. The real opportunity here isn't in green or sustainability bond issuance but rather ESG securitizations. Investor demand for ESG paper far outstrips supply. There is no reason why equipment-backed securitizations won't be a major source of quality ESG assets once Wall Street cracks the code on ideal ESG securitization structures. Once this happens, and it will very soon, a new source of capital is available to our industry and in some cases, that may narrow the cost-of-funds advantage enjoyed by some of the industry's largest players.

Remember, ESG is not just a nebulous idea of do-gooding. As we move into the era of stakeholder capitalism, ESG strategies will become essential to remaining competitive in the marketplace. Those who can't prove their positive impact on the planet and her people will simply fall behind.

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