ESG Impact Investing:
The Tao of Impact, Confucian Capital, and Investing in China's Future

By Jed Emerson

The history of ESG Impact Investing stretches back many centuries, just as its evolution may be projected many centuries into the future. While some think of ESG as a relatively new approach to investing and impact investing as an even more recent development both have their roots in humanity's world philosophies and understanding of economics, meaning and value. Our understanding of investing and the purpose of capital is, at its core, a social construct—a conceptual and practice framework that has evolved from diverse human experience, vision and ideology. Each investor, family, generation, and nation must step back from the historic investment practices and thinking we have inherited from previous generations to reassess our understanding of the purpose of capital and role investing may play in advancing the society our generation seeks to create in this time.

The History and Future of ESG Impact Investing

At the very birth of modern corporate finance, investors were integrating their values with their investing and seeking to hold companies to a higher degree of performance than the pursuit of financial return alone. In 1604, the first jointly held stock company, The Dutch East India Company, was created. This financial innovation allowed for the sale of ownership shares to a diverse group of investors, making possible risk sharing and the ability to raise the funds required to finance a commercial trade expedition.

After discovering the Captain of the expedition had not engaged in trade, but rather piracy in that he attacked trading outposts and vessels of other nations, at least two investors did not view the expedition as a success in that as Mennonites their beliefs forbade them from engaging in warfare. One opted to sell his share holdings to publicly protest the practices of the expedition; the other engaged in a decade long legal campaign against the Company's Board of Governors, claiming they had violated their fiduciary duty by allowing the expedition to engage in such practices under the name of "commerce."

If we fast-forward to the 20^{th} Century, in the 1960s other stewards of investment capital sought to screen out companies engaging in business practices which violated investor religious commitments to social and environmental values. These investors initially moved to screen out investment portfolio holdings in firms within particular sectors (tobacco, firearms, and alcohol), firms that were a part of the military industrial complex or companies thought to be engaging in business practices resulting in environmental damage. These initial efforts to practice values-based investing through screening out "bad" companies culminated in the 1980s Anti-Apartheid campaigns where investors were exhorted to divest investments in companies with significant holdings in South Africa as a way of protesting the practices of apartheid. And these practices continue in today's "Divest/Invest" movement targeting global oil and gas companies.

From this experience of screening out "bad" companies, investors began exploring the opposite—namely, if it were possible to screen out bad firms, was it then also possible to screen in "good" companies? Accordingly, investors began executing what were referred to as "Best in Class" investment strategies which many liked because they allowed investors to deploy capital across a wider universe of firms and to invest in "good" companies in "bad" sectors. For example, in order to maintain a diverse set of investments, one might still invest in the Energy Sector's oil and gas development firms, but one would invest in firms viewed as leading the way in what might be promoted as more sustainable oil production and distribution practices, if one believed there is such a thing as "sustainable" oil or "clean" coal—which, of course, there is not!

By the late 1980s and 1990s, environmental and social data disclosure and analysis practices had evolved to the point where investors could engage in what came to be called Integrated ESG investment. Under this approach, investors sought to compliment traditional financial analysis with consideration of what came to be called "off balance sheet" factors (named so because they included extra-financial indicators such as broad assessment of a firm's overall sustainability, corporate carbon footprint analysis, employee compensation and benefits assessment, and other aspects of firm management). These factors, while having potential financial implications, were not included in traditional financial analysis of publicly traded companies. Investor focus came to rest upon a wide array of factors thought to be material to the firm's ability to execute its business model and generate a profit. In this way, discussions of "materiality" and "off balance sheet risk" became the focus of analysts' efforts and continue to be areas for debate and action to this day.

Finally, in the late 1990s, yet another form of mission-driven capital investing evolved, executed by investors who sought not simply to avoid "bad" companies or weave consideration of environmental and social factors into their analysis of publicly traded corporations, but rather to use their investments to directly advance positive social and environmental outcomes. These investors sought to draw as straight a line as possible from their direct investment of capital to the creation of positive environmental and social impacts—to use capital to change the world. These investors came to be known as Impact Investors. Initially, these investors targeted direct and fund investing in private equity and debt strategies, as distinguished from many of the traditional screened, Best in Class and ESG Integration strategies which had focused upon investments in publicly traded companies.[1]

From Public Securities to Direct Impact to ESG Impact

Over recent decades, actors in each of these areas of investment practice (social responsible screened strategies, Best In Class, ESG Integration and Impact Investing) have come to recognize that while these are each discrete approaches to investing mission driven capital, the reality is that *all* capital and *all* companies have impact. While some (especially newcomers to the field or those committed to the promotion of a single approach to investing) continue to engage in debates regarding definitions, terms and the relative, effective impact of various seemingly competing practices, many experienced asset owners and advisors now see there is a capital continuum ranging from philanthropic to near-market to market-rate capital and that across this continuum of various investment asset classes (philanthropic, recoverable grants, high risk/long-term loans, fixed income, venture and private equity and, finally, public securities and cash) each asset class has its own risk, return and impact profile.[2]

While there may be individual fiduciaries of certain types of capital that may have specific investment terms and requirements, many asset owners have the potential to invest their assets on an impact basis across the entire capital continuum. This awareness and approach to wealth management is known as Total Portfolio Management[3] or Total Portfolio Activation[4] and allows investors to manage *all* of their assets to generate various levels of financial return (depending upon the particular asset classes within a portfolio) together with the creation of various types of measureable social and environmental impact, thereby executing a holistic approach to capital deployment and the creation of net positive impacts benefiting diverse groups of shareholders, stakeholders and, potentially, the Planet as a whole.

Taken together, the previously outlined practices and approaches to mission-driven portfolio management may be called, simply, *ESG Impact* since they consolidate the best practices of screening, integration and impact investing, bringing a holistic perspective and vision to the construction of an investment portfolio. Rather than debate the various definitions and practices of these individual, historic approaches to investing, our field is best served by simply acknowledging all capital has impact and refocusing our efforts upon promoting that reality within the mainstream investing community. Rather than focusing upon the parts, we should promote and emphasize the "whole" and in this way benefit from a unified understanding of investing and value creation, which may then be viewed as the Tao of Impact, as described further below.

ESG Impact, Taoist Philosophies and Principles of Confucian Capital

With that history and analysis in mind, there is one additional observation to be made: This entire financial framework, history and discussion is premised on a bifurcated understanding of the nature of the value being created through the investment of financial capital. Namely, traditional approaches to Western financial capitalism around the world are founded upon the belief that economic interests may be considered in the absence of reflecting upon environmental and social components of value creation. This promotes an understanding of economics and, indeed, the reality of our world, as consisting of two separate parts, financial and non-financial.

The implication of this bifurcation, rooted in Western philosophic traditions and intellectual dualism introduced during The Enlightenment, is that one must choose. For those operating within this Western perspective, much work needs to be done to bridge the divide and adopt a more holistic, integrated understanding of value and investing. In contrast, as one seeks to identify answers to the challenge of doing well and doing good, one is struck by the perspective offered by an Eastern worldview and philosophy, one grounded in an understanding of value as not bifurcated but whole, within the fundamental concepts of Taoism and Confucian thought.

What is interesting to note is that the Western notion of doing well or doing good, of investing or engaging in charitable giving, fits well within Eastern, Taoist understandings of Yin and Yang, of two aspects of energy which when taken together represent the power of The Path, The Way, or The Tao. It could be argued that this mindset and philosophical understanding of life and reality lays a stronger foundation for investing than Western efforts to bring together the parts, to bridge the financial and non-financial divide in new ways. When viewed in this light, the new way of investing, ESG Impact, may actually be viewed as having its roots in Eastern understandings of value and may perhaps most easily be understood in terms of the Tao of Impact and first principles of Confucian Capital.

To begin, we may understand the yin and yang of Taoist philosophy nicely mirrors the standard financial concepts of alpha and beta, with Alpha strategies being reflective of active investing and Beta reflective of passive investment strategies.[5] Many portfolios are managed with some mix of both approaches in efforts to diversify risk as well as balance, in what is often referred to as a portfolio's blended core, with various alternative investment approaches being used outside of that core to generate consistent, overall financial returns over time.

As we then introduce ESG Impact approaches into strategies of wealth management within a Chinese cultural context, yin and yang come to be viewed as generating blended value, total returns across a portfolio consisting of various levels of projected financial return (depending upon the specific mix of diverse asset classes) as well as the generation of various types of social and environmental impact as previously discussed. In this way, there is a natural resonance between the ideas of ESG Impact, Blended Value and our understanding of the philosophy of Taoism.

Going more deeply into these ideas, a central concept of Taoism is that of *wei wu-wei,* which may be translated as "do without doing." In many areas of life, active engagement does not necessarily translate to positive outcomes. Rather, as one of my favorite Buddhist sayings implores us, *Don't Just Do Something—Sit There!* As it relates to wealth management and ESG Impact, we have a tendency to focus upon our tortured analysis and the answers generated instead of understanding that those answers are all predicated upon a set of underlying assumptions regarding the world, markets and investing which are themselves fully dynamic and in flux. And so we must seek a blend of both active and passive ESG Impact strategies if we are to capture the full potential value of our investments as we seek to walk the Path.

We must therefore attempt to sit more deeply with those foundational questions of *Why* before embracing the temporary answers of *How* we should invest. The values and perspective of Confucian thought are clearly resonant with those of ESG Impact in that core concepts include such considerations as harmony, well-being, and the connection between individual interest and social/environmental good.

Each of the Five Principles of Confucian values is consistent with ESG Impact first principles of

1 Viewing capital as more than money and the pursuit of individual profit alone (Ren),
2 Respecting the role and place of shareholder and stakeholder interests (Yi),
3 Creating new investment practices relevant to these times as opposed to the historic, bifurcated practices of traditional financial capitalism, and exploring and expressing this evolved worldview that all capital and companies have impact upon our world and communities (Li),
4 Developing a deeper wisdom of exploring and developing a new level of knowledge and awareness of our connectivity, of an awareness of the illusion of separation between Self and Other (Zhi), and, finally,
5 Sitting, faithfully, with the questions before us so that we may co-create the emerging answers required of our times and future (Xin).

There is, of course, a good deal more in this discussion worthy of our exploration, but for now we may simply say the ESG Impact principles of considering more than financial wealth and economic factors is fully consistent with the Confucian and Taoist principles regarding our understanding of Self and Other, parts to whole, and the balance sought as a framework for individuals and societies moving forward in time as they seek to discover their way on the Path.

Be Here Tao:
The Promise of Today's ESG Impact As A Means of Investing in China's Future

Today China stands at an open gateway, looking out upon a new, unknown territory. As a country and diverse community of people with varying traditions and visions, China has the opportunity to explore how best to integrate its various parts into a new whole, finding a new balance, which will carry the nation into the future it seeks to create. Economic development must continue to be advanced while wisely conserving the many environmental resources the nation's people steward. The draw of modern technologies and tools must be promoted with consideration of traditional values and a vision of how individual and social interests may be integrated. China has the opportunity to manage the dynamic of yin and yang in a holistic manner that allows its citizens and collaborators to move further along its historic Path over the decades and centuries to come.

The opportunity now before the Chinese ESG Impact investing community is to explore how concepts of ESG Impact may be practiced within a cultural frame founded upon the core principles and concepts of Confucian and Taoist thought—while creating new ways for capital investors to take such principles and concepts as the building blocks of a new, emergent form of investing—a form of investing that takes the best of ESG Impact and infuses it with a Chinese perspective on how to make the world anew.

Our world is clearly moving through a period of broad challenge and reflection. On the one hand, the answers we seek are simple—wholeness, a connection between our wealth and our world, and so on—but that does not mean securing our future Path is easy. Recent, global events reflect our need to move from parts to whole. The current Covid-19 pandemic arose from humanity's supposed dominance over nature, out of our destruction of natural habitat and disrespect of other species—out of our being "out of balance" between the yin and the yang. As the virus was then exposed to not only our physical selves but our world of technology and global transport, it rapidly moved across our planet. As our various societies have sought to respond to the pandemic, each of our nation's systems of economic, social and racial inequity was revealed for what they are. In the end, while we may act as if we are (at individual and national levels) separated one from the Other, in truth what the virus has revealed is the reality of our interconnectedness and the illusion of our separation. In the end, we are one Planet and one Humanity; we are parts, but we are simultaneously Whole.

A Chinese perspective, informed by traditions of Confucius thought and Taoist philosophies, may only help more deeply inform our thinking regarding our interconnectedness, the deeper purpose of our capital and the emergent practices of investing to generate not simply financial returns alone, but to realize various levels of financial return together with the creation of sustained, social and environmental impacts. By walking this Path, we may be able to advance a more holistic, integrated and blended approach to our understanding of the purpose of capital. In so doing, we may then realize capital's highest potential to be managed to support the creation of the enhanced individual, familial, community and global relations needed to address the many challenges now before us as investors, individuals and communities on The Path.

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[1] It should also be acknowledged that parallel to these developments were investment entities such as development finance institutions, (often bi- and multi-lateral organizations) such as the International Finance Corporation, investing in emerging market economic development as well as community development finance institutions, that managed housing and business development in under-resourced communities, mainly located in the U.S. and Europe. See organizations such as The Opportunity Finance Network for additional information on their history and important role in development finance.

[2] For more on this topic, please see Risk, Return and Impact: Understanding Diversification and Performance within an Impact Investing Portfolio.

[3] For more on this topic, please see Total Portfolio Management: Construction of an Impact Portfolio.

[4] Please see Total Portfolio Activation and other papers on the topic.

[5] See The Tao of Investing by Kevin Wilson for more on this idea.