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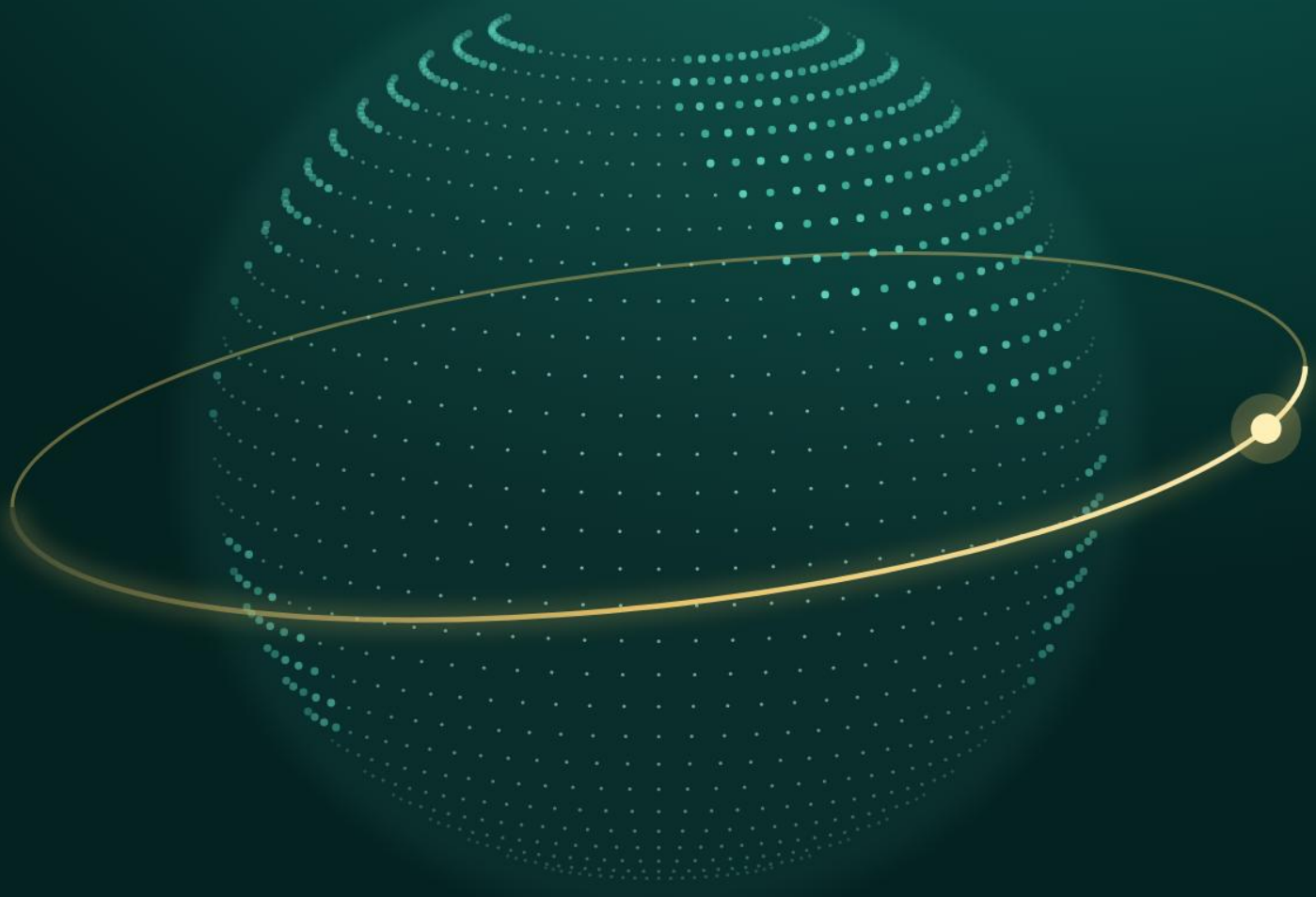
ESG
& Sustainable Investing

From Theory to Practice

VIETNAM READINESS



DR MAI HUU MINH

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ESG and Sustainable Investing

From Theory to Practice — Vietnam Readiness

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ABOUT THE AUTHOR

Dr MAI Huu Minh

FOUNDER OF NXW — NEXT WEALTH · INDEX DESIGNER · AUTHOR

Researcher, index designer and educator in finance. Dr Minh combines research at Université Paris Dauphine – PSL on market microstructure, liquidity, IPOs and derivatives with professional work on indexes, data and investor training. With IFRC — Intelligent Financial Research & Consulting — and its partners he created the VNX index family for Vietnam (2012) and the WOMEN CEO indexes (2013), later extended to Singapore and the USA — rule-based gender-equality indexes, and the Global Women CEO and Global Women on Boards research projects. He co-authored *Options, Futures and Exotic Derivatives* (Wiley, 1998) and founded NXW to bring professional-grade data, indexes and analytics to investors in Vietnam and Asia.

CHAPTER 1

What Is ESG Investing?

Environmental, social and governance factors in investment decisions

Opening question

"Everyone talks about ESG. Is it about saving the planet, avoiding risk or earning more — and what does it change for my portfolio?"

Three letters now appear in fund names, company reports, bank loan conditions and government regulations. For some people they stand for a moral commitment, for others a risk-management tool, for others a marketing slogan. This chapter cuts through the noise: it explains what environmental, social and governance factors are, why different investors care about them for different reasons, how to decide which issues matter for a given company, and which strategies investors use to put ESG into practice.

In this chapter

- What E, S and G cover, from climate change to board independence
- The vocabulary: ESG, responsible, sustainable, ethical and impact investing
- Three reasons to invest sustainably: values, risk and impact
- Financial materiality and double materiality, with a worked example
- Why the same ESG issue matters more in one industry than in another
- The main ESG strategies at a glance and how they combine
- What ESG investing is not
- Why ESG matters for Vietnamese exporters, banks and investors, and a map of the book

1.1 Three letters, one question

ESG stands for **environmental, social and governance**. It describes a family of non-financial factors — things that do not appear directly as lines in a company's income statement — that may nonetheless affect the company's long-term value, its impact on the world, or both. **ESG investing** is the use of these factors in investment decisions: which securities to buy, how much to hold, and how to behave as an owner.

The idea is old — religious investors avoided certain businesses centuries ago (Chapter 2) — but the scale is new. Since the mid-2000s, large pension funds, insurers and asset managers have adopted ESG language, data providers score thousands of companies, and regulators in many countries set rules on what companies and funds must disclose.

Several terms are used, often loosely, for overlapping ideas:

- **Ethical or values-based investing** — investing in line with moral or religious beliefs, usually by avoiding certain activities.
- **Socially responsible investing (SRI)** — an older term for portfolios built with social and ethical screens.
- **Responsible investing** — the broad practice of considering ESG factors and acting as an engaged owner; the term used by the UN Principles for Responsible Investment.
- **Sustainable investing** — today often used as an umbrella for all of the above.

- **Impact investing** — investing with the intention of generating a measurable positive social or environmental effect alongside a financial return (Chapter 10).

In this book, **ESG investing** means using ESG information in investment decisions, and **sustainable investing** the wider set of practices that also aim at real-world outcomes.

1.2 Three letters, many issues

Each letter covers a long list of issues (Figure 1.1). None of the lists is official: data providers, standard setters and investors group the issues in slightly different ways, which is one reason ESG ratings disagree (Chapter 5).

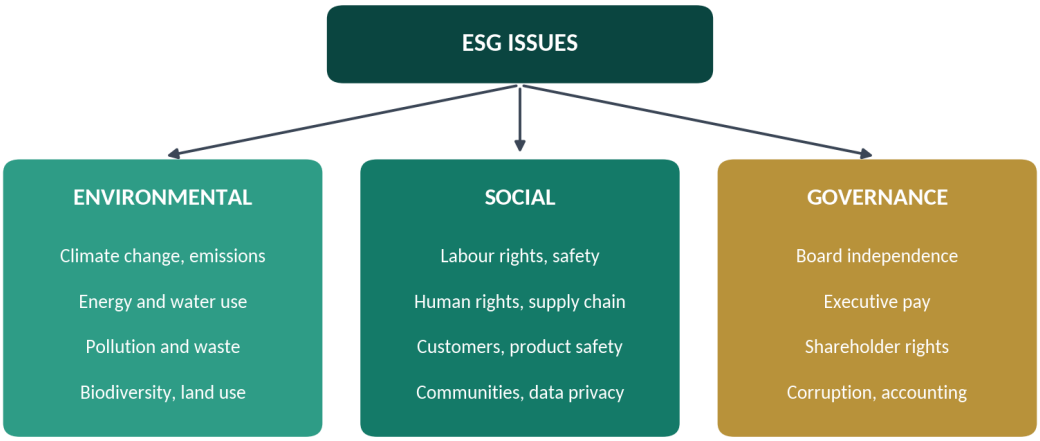

Figure 1.1 — The three pillars of ESG and examples of the issues each covers

Environmental

The environmental pillar covers how a company affects, and depends on, the natural world. **Climate change** dominates the debate: greenhouse gas emissions (Chapter 6) and exposure to carbon policy and extreme weather. Other issues include energy and water use, pollution, waste, and land use and biodiversity (Chapter 21).

Social

The social pillar covers relationships with people: employees, workers in the supply chain, customers and local communities. Typical issues are health and safety, wages, forced and child labour, discrimination, product safety, data privacy and relations with communities near mines, plants or plantations. Social issues are harder to measure than environmental ones and are often revealed through incidents rather than reported figures.

Governance

The governance pillar covers how the company is directed and controlled: board independence, executive pay, minority shareholder rights, related-party transactions, accounting quality, tax practices and corruption. Governance is the foundation of the other two: a company with weak controls is unlikely to manage its environmental and social risks well, and it is the pillar most clearly linked to large losses for investors (Chapter 3).

Pillar	Examples of issues	Examples of indicators
Environmental	Climate change, energy, water, pollution, waste, biodiversity	Tonnes of CO2-equivalent emitted, energy intensity, water withdrawn, spills, share of

Pillar	Examples of issues	Examples of indicators
		renewable power
Social	Labour standards, health and safety, supply chains, product safety, data privacy, communities	Injury rates, staff turnover, supplier audits, product recalls, data breaches, community disputes
Governance	Board structure, executive pay, shareholder rights, ethics, accounting, tax	Share of independent directors, pay ratio, related-party transactions, fines, audit opinions

Table 1.1 — What E, S and G cover: issues and typical indicators

1.3 Why investors care: values, risk and impact

Two investors may buy the same "ESG fund" for completely different reasons. Being clear about one's own reason is the most useful first step, because it decides which strategy and product fit.

- **Values.** Some investors do not want to profit from activities they consider harmful — tobacco, weapons, gambling, coal — whatever the financial consequences. Their question is: *does this portfolio reflect what I believe?*
- **Risk and return.** Other investors use ESG information to identify risks, and perhaps opportunities, that financial analysis misses: a carbon price that raises a cement maker's costs, a supply-chain scandal that costs a clothing brand its customers. Their question is: *does this information improve my risk-adjusted return?*
- **Impact.** A third group wants its money to contribute to real-world change. Their question is: *would the world be different without my investment?*

Motivation	Main goal	Typical strategies	How success is judged
Values	Align the portfolio with beliefs	Exclusions, norms-based screens, faith-based rules	The portfolio holds nothing the investor objects to
Risk and return	Better risk-adjusted performance	ESG integration, best-in-class, ESG tilts	Lower risk or higher return than a comparable portfolio
Impact	Contribute to measurable change	Impact funds, thematic investing, engagement, green bonds	Measured outcomes: emissions avoided, jobs, access to services

Table 1.2 — Three reasons to invest sustainably

The motives can conflict. Excluding an oil company may satisfy an investor's values while having little effect on the company, which simply finds other shareholders. Engaging with it may achieve more change but means owning a business the investor dislikes. None of these choices is wrong; each answers a different question.

1.4 Financial materiality

In accounting, an item is **material** if leaving it out could change the decisions of a reasonable user of the accounts. ESG investing borrows the word. An ESG issue is **financially material** if it can reasonably be expected to affect a company's cash flows, its risks or its cost of capital — and therefore its value.

Materiality depends on the industry. Water scarcity is a major risk for a beverage company or a rice exporter and nearly irrelevant for an insurance broker; data privacy is critical for a bank but minor for a cement maker. This is why most rating systems use **industry-specific weights** (Figure 1.2): the same score on the environmental pillar counts for half of the total for an oil company but only a small fraction for a

software firm. The standards originally developed by the US-based Sustainability Accounting Standards Board (SASB), now maintained by the ISSB, are built on this idea, identifying the disclosure topics most likely to be material for each of dozens of industries (Chapter 4).

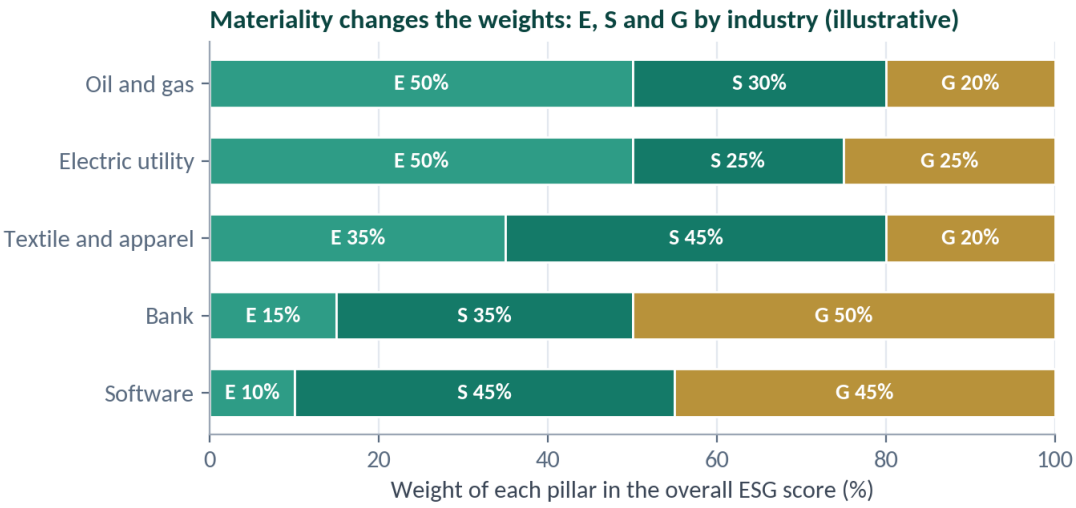

Figure 1.2 — Weights of the E, S and G pillars in an overall score for five industries (illustrative)

A materiality-weighted ESG score

$$\text{ESG score} = w(E) \times E\text{ score} + w(S) \times S\text{ score} + w(G) \times G\text{ score}$$

Each pillar score is measured on a common scale, for example 0 to 100, and the weights w(E), w(S) and w(G) add up to 100%. The weights depend on the industry: they reflect how material each pillar is for that kind of business. Real ratings use many more issues and sub-scores, but the logic is the same (Chapter 5).

Example — the same pillar scores in three industries (illustrative)

Three hypothetical companies have identical pillar scores: environmental 40, social 70 and governance 80. They operate in different industries, so their materiality weights differ, as in Figure 1.2.

- **Textile exporter** (E 35%, S 45%, G 20%): 0.35 × 40 + 0.45 × 70 + 0.20 × 80 = **61.5**.
- **Bank** (E 15%, S 35%, G 50%): 0.15 × 40 + 0.35 × 70 + 0.50 × 80 = **70.5**.
- **Oil and gas producer** (E 50%, S 30%, G 20%): 0.50 × 40 + 0.30 × 70 + 0.20 × 80 = **57.0**.

The weak environmental score barely hurts the bank but weighs heavily on the oil producer. An overall ESG score is never just "how green" a company is: it is a judgement about which issues matter for its business.

Materiality also changes over time. Twenty years ago, few investors called carbon emissions material for a carmaker; carbon prices, fuel-efficiency rules and electric vehicles have since made them central. Issues that look like ethics today can become finance tomorrow — **dynamic materiality**.

1.5 Double materiality

Financial materiality looks from the outside in: how does the world affect the company? **Double materiality** adds a second direction, from the inside out: how does the company affect the world — people, communities and the environment — whether or not this affects its profits today?

A factory that pollutes a river may face no fines or lawsuits, so its pollution is not, for now, financially material; under double materiality it still is. The European Union adopted this approach in its corporate

sustainability reporting rules, while the global baseline standards of the International Sustainability Standards Board (ISSB) focus on information that is material to investors (Chapter 7). Impacts ignored today often return as regulation, litigation or lost customers tomorrow (Chapter 3).

Two directions of materiality

- **Outside in (financial materiality).** How do climate, social trends and regulation affect the company's cash flows, risks and cost of capital?
- **Inside out (impact materiality).** How do the company's operations, products and supply chain affect people and the planet?
- **Double materiality** considers both. A risk-focused investor starts from the first; an impact investor needs the second.

1.6 A map of ESG strategies

Investors put ESG into practice through a small number of strategies; the classification below is close to that of the Global Sustainable Investment Alliance. Module 3 gives each strategy its own chapter.

Strategy	What it does	Typical tool	Chapter
Exclusions (negative screening)	Removes companies or sectors judged harmful, often above a revenue threshold	Lists of activities, revenue limits	8
Norms-based screening	Removes companies that breach international norms on human rights, labour, environment or corruption	UN Global Compact, OECD guidelines	8
ESG integration	Adds ESG information to financial analysis of risks and value	Analyst research, adjusted forecasts	9
Best-in-class (positive screening)	Selects the leaders within each sector on ESG criteria	ESG scores, sector rankings	9
Thematic investing	Invests in companies whose products address sustainability challenges	Revenue from clean energy, water, health	10
Impact investing	Targets measurable positive outcomes with a financial return	Impact metrics, private markets	10
Stewardship and engagement	Uses shareholder rights to push companies to change	Dialogue, voting, resolutions	11
Labelled bonds	Finances eligible green or social projects, or links coupons to targets	Green, social and sustainability-linked bonds	12

Table 1.3 — The main ESG strategies at a glance

Exclusions are simple and easy to explain, but say nothing about the companies that remain. Integration is invisible from the outside. Best-in-class keeps sector weights close to the market, but can include "the best of the oil companies". Thematic and impact strategies are concentrated and volatile. Stewardship changes no holdings at all; its results show up, if at all, in the behaviour of companies.

1.7 How strategies combine

Almost every ESG portfolio combines strategies. A common recipe: exclude controversial weapons, tobacco, thermal coal and norm breakers; overweight the best ESG scores in each sector; then vote and

engage. The **NXW Global ESG Leaders** index (NXWGLESG, simulated), used as a running example in this book, follows a similar logic: 50 components, rebalanced once a year, with cap weights tilted towards companies with higher ESG scores. Chapter 15 describes its methodology, and Chapter 19 shows how to build and back-test such an index.

The usual way to summarise the ESG profile of a portfolio is a weighted average of the scores of its holdings.

Example — an exclusion lifts a portfolio's ESG score (illustrative)

A portfolio holds five hypothetical companies, with weights of 30%, 25%, 20%, 15% and 10% and ESG scores of 72, 65, 58, 30 and 80. Company D, with the 15% weight and the score of 30, is a coal-heavy power producer.

- Weighted score before: 0.30 × 72 + 0.25 × 65 + 0.20 × 58 + 0.15 × 30 + 0.10 × 80 = **62.0**.
- Exclude Company D and rescale the other weights by 1 ÷ 0.85: they become 35.3%, 29.4%, 23.5% and 11.8%.
- Weighted score after: **67.6**.

The score rises by more than five points without any company changing its behaviour. That is a legitimate result for a values-based investor, but it is not evidence of real-world impact — a distinction this book returns to in Chapters 10 and 17.

1.8 What ESG investing is not

Because the term is used so widely, it helps to clear up a few common misunderstandings.

- **Not a single strategy.** "ESG" on a label tells you little until you know the strategies, thresholds and data behind it.
- **Not a measure of goodness.** An ESG rating usually measures how well a company manages the ESG risks material to its industry, not how beneficial its products are. A tobacco company can receive a better rating than an electric-car maker if it manages its own risks well (Chapter 5).
- **Not automatically a sacrifice of return, nor a guarantee of outperformance.** The evidence is mixed and depends on the period and the method (Chapter 13).
- **Not the same as impact.** Buying listed shares rarely gives a company new capital; impact needs other channels such as engagement or primary financing (Chapters 10 and 11).
- **Not static.** Standards and rules change quickly; a fund "sustainable" under one rulebook may need a new name under the next (Chapter 17).

Critics argue that ESG mixes incompatible goals, relies on poor data and invites greenwashing; supporters reply that ignoring material risks is itself a failure of fiduciary duty. This book takes a practical position: ESG information is useful when it is material, measured carefully and used for a clearly stated purpose — and much less useful as a slogan.

1.9 ESG for a Vietnamese investor

ESG may seem like a concern of large Western pension funds, but it already shapes Vietnamese companies, banks and capital markets.

Vietnam spotlight — why ESG matters at home

- **Exporters.** Exporters of garments, footwear, electronics, seafood, coffee, furniture and steel sell to

buyers in Europe, the United States and Japan who audit suppliers on labour, chemicals, deforestation and, increasingly, carbon. The EU's carbon border adjustment mechanism, phased in from the mid-2020s, puts a price on the embedded carbon of imports such as steel, aluminium and cement (Chapter 20).

- **Banks.** The State Bank of Vietnam promotes green credit, and international lenders usually require environmental and social risk management from the banks and projects they finance.
- **Listed companies.** Listed companies must report some environmental and social information under Ministry of Finance disclosure rules, and the Ho Chi Minh City Stock Exchange publishes a sustainability index, the VNSI (Chapter 15).
- **Foreign investors.** Many foreign funds apply ESG scores; companies with weak disclosure may be underweighted simply for lack of data.
- **Climate exposure.** Vietnam committed at COP26 in 2021 to reach net zero emissions by 2050, and the Mekong Delta is among the regions most exposed to sea-level rise and salinity — risks that matter for agricultural, banking and real estate investments.

For a Vietnamese investor the questions are the same as everywhere — which issues are material, what should my money achieve, which products deliver it cheaply? — but data are thinner and products fewer. Chapter 20 returns to these questions, and Chapter 18 builds an illustrative ESG portfolio in VND.

1.10 A map of the book

This book follows the same path as its companions, *Index Investing: From Theory to Practice* and *Commodity Investing: From Theory to Practice*. It is organised in six modules, followed by a seventh part, the NXW ESG toolkit, on the Vietnam ESG Portal (Chapter 23).

- **Module 1 — Foundations (Chapters 1–3).** What ESG investing is, how it developed from ethical exclusions to the Paris Agreement, and why ESG issues can affect risk and return.
- **Module 2 — Data and ratings (Chapters 4–7).** ESG data and their reliability, ratings and why they disagree, the climate risk and carbon footprint of a portfolio, and the taxonomies and rules that define what is green.
- **Module 3 — Strategies (Chapters 8–12).** Exclusions, ESG integration and best-in-class, thematic and impact investing, stewardship and voting, and green, social and sustainability bonds.
- **Module 4 — Theory and evidence (Chapters 13–15).** What research says about ESG and performance, how portfolios are aligned with climate goals, and how ESG indexes are built, with the NXW Global ESG Leaders index as a case study.
- **Module 5 — Products and practice (Chapters 16–19).** Choosing ESG funds and ETFs, spotting greenwashing, building an ESG portfolio, and building and back-testing your own ESG index in Excel and R.
- **Module 6 — Invest (Chapters 20–22).** ESG in Vietnam and Asia, carbon markets and nature, and the future of sustainable investing.

Each chapter ends with key takeaways, a practice lab with an Excel workbook and further reading. Simulated and illustrative data are always labelled.

Key takeaways

- ESG stands for environmental, social and governance factors: non-financial issues that can affect a company's value, its impact on the world, or both.

- Investors care about ESG for three different reasons — values, risk and return, and impact — and each leads to different strategies and different measures of success.
- An ESG issue is financially material if it can affect cash flows, risk or the cost of capital; materiality depends on the industry and changes over time.
- Double materiality adds the company's impact on people and the planet, whether or not it affects profits today.
- The main strategies are exclusions, norms-based screening, integration, best-in-class, thematic and impact investing, stewardship and labelled bonds; most portfolios combine several.
- ESG is not a single product, a measure of goodness or a guarantee of returns; for Vietnamese companies and investors it is already a practical matter of exports, finance and climate exposure.

Practice lab 1

Download the workbook **Lab01_What_Is_ESG.xlsx** from the companion site.

- **Sheet 1 — Classify the issues.** Sort the list of 30 issues provided into E, S and G, then mark which ones you think are financially material for a bank, a cement maker and a garment exporter.
- **Sheet 2 — Materiality weights.** Reproduce the example of Section 1.4; change the pillar weights for each industry and see how the overall score and the ranking of the three companies change.
- **Sheet 3 — Portfolio ESG score.** Reproduce the five-company example of Section 1.7, then test other exclusions and a best-in-class rule and compare the resulting scores and sector weights.
- **Sheet 4 — Your motivation.** Answer the short questionnaire on values, risk and impact, and record which strategies of Table 1.3 fit your answers best.

Further reading

- UN Principles for Responsible Investment (PRI) — "What is responsible investment?" and other introductory guides.
- Global Sustainable Investment Alliance — *Global Sustainable Investment Review* (periodic reports and definitions of strategies).
- IFRS Foundation — SASB Standards and the SASB materiality map; ISSB — IFRS S1 and S2 standards.
- Alex Edmans, *Grow the Pie: How Great Companies Deliver Both Purpose and Profit*, 2020.
- Florian Berg, Julian F. Kölbel and Roberto Rigobon, "Aggregate Confusion: The Divergence of ESG Ratings", *Review of Finance*, 2022.

“Better data, better decisions, better markets.”

ESG has moved from a niche to the mainstream of investing — yet ratings disagree, data are patchy and green claims are easy to make. This book shows what ESG really changes for a portfolio, and how to tell substance from slogans.

In 23 chapters, from data and ratings to strategies, evidence, products and the Vietnam ESG Portal, it takes you from theory to practice — with a special focus on how ready Vietnam and Asia are.

INSIDE YOU WILL LEARN TO

- Read ESG ratings and data critically
- Measure climate risk and align a portfolio
- Spot greenwashing in funds and products
- Build and back-test an ESG index in Excel and R
- Use Vietnamese ESG data for research and products

ABOUT THE AUTHOR

Dr MAI Huu Minh

Founder of NXW; designer of the VNX, WOMEN CEO and NXW index families; researcher, Université Paris Dauphine – PSL; author of the NXW Investment Library

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