

SOCIAL RESPONSIBILITY AS A KEY OBJECTIVE AMONG IPOS

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The financial community, investors and other stakeholders no longer rely purely on financial performance and market potential to determine the viability of a potential IPO. Integrating environmental, social and governance (ESG) considerations into financial performance is a key topic that is becoming increasingly important in financial markets. Socially conscious investors are expected to use ESG criteria to screen potential investments. Increasing evidence that a company's ESG profile is linked to financial performance is partly motivating this interest. The article analyses the main reasons for the popularity of the ESG in IPOs, the extensiveness of the use of such a referencing, the regulator's behaviour in relation to social responsibility and the effectiveness of ESG in IPOs.

Key words: initial public offering; stock exchange; ESG; IPO; social responsibility.

Decision-making in the investment process is a complex as well as technical task that can affect not only financial markets but also the social well-being of citizens around the world. The global financial crisis demonstrated the request for sustainability in the professional selection of projects for investment.

The most severe market crash since the global financial crisis of 2008 took place in 2020 due to the pandemic. The COVID-19 outbreak showed that many businesses are both resilient and nimble. Companies quickly adapted to new working conditions which were created by the pandemic (i.e. remote working via the greater use of technology, electing to protect jobs through government support, looking after staff and observing health directives). The most crucial lesson of all the many lessons that COVID-19 taught people is the non-negotiable need to be sustainable and resilient.

Even though COVID-19 was an economic shock for businesses, investors with a focus on integrating ESG into their investment decisions remained relatively safeguarded due to the resilience of high-rated ESG funds. The MSCI World index dropped 14.5% in March 2020. However, 62% of large-cap ESG funds outperformed the index. Furthermore, in its recent report, Morningstar evaluated 745 sustainable funds as against 4,900 traditional funds invested across large companies globally. The assessment found that sustainable funds performed better than other funds over various time horizons. Over five years, the average annual return for a sustainable fund was 7.3%, while a usual fund returned 6.1%. From 2016 to 2019, the number of investors leveraging non-financial metrics in their decisions rose from 27% to 43%, making disclosing information connected with ESG an important requirement [1].

Taking into consideration current trends and regulations, private companies that plan an initial public offering start promoting ESG strategies as a competitive. Investors have always looked for a good equity story and now investors also want an equity story with ESG at its heart - a sustainable equity story - a venture's ESG bonafides which go beyond mandatory prospectus requirements.

There are increasingly solid reasons for divulging corporate ESG matters. In order to realize what incredible amount of investment capital is gushing into sustainability funds that focus on ESG Bloomberg's news report was analyzed. According to it, it is estimated that by 2025, more than \$53 trillion could be invested globally in sustainability funds and portfolios, up from \$37.8 trillion by the end of 2021 [2]. Reuters supports that findings and reports that \$649 billion went into ESG funds in 2021, accounting for "10% of worldwide fund assets" [3].

During last five years there has been a number of companies whose mission is connected with environment has gone public. Rent the Runway had a successful IPO in October, followed by an IPO of Allbirds. Both businesses mentioned their environmentally friendly business model in S-1 several times. Chobani, the first U.S. dairy company to earn Fair Trade certification IPOed in summer. The sustainable consumer goods company Grove Collaborative went public via a SPAC backed by Richard Branson's Virgin Group.

It is worth to mention the largest IPO of the year which is the IPO of an electric vehicle startup Rivian. After its IPO, startup Rivian became the sixth largest car manufacturer in the world. Just two months after its first sales, the company surpassed Ford and General Motors in market capitalisation and became the second most valuable US car manufacturer after Tesla. As a result, the company was valued at \$76.4 billion in its IPO, and on the first day of trading, its capitalisation exceeded \$90 billion. However, the company has no revenue, but according to CNBC, Rivian expanded production over the summer and planned to build a second electric car assembly plant [4].

Not revealing ESG strategies and activities during an IPO may well deprive a sustainability-oriented investor of the opportunity to even consider financing the company. ESG considerations must be systematised early, often and continually during the IPO process.

This view is reflected in PwC's 2021 Global Investor Survey, in which 325 investment professionals were surveyed about their perceptions of the growing influence of ESG in their decision-making process. Nearly 80% of those surveyed see ESG risk as a major factor in evaluating investments, and nearly half are willing to walk away from equity stakes in companies that they believe are not meeting their ESG obligations [5].

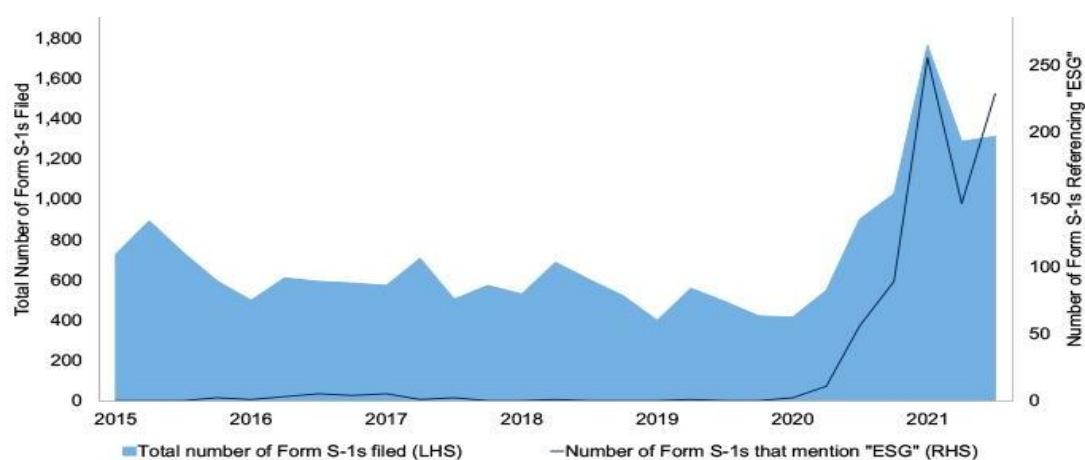
Disclosure of ESG goals and results can help new public companies create responsible value for all stakeholders, not just shareholders. In addition, the value created by such brands paves the way for other intangible assets, such as improved

reputation in the marketplace, even after companies go public. Companies with high ESG scores have a solid competitive advantage over their peers, enabling them to generate returns that go beyond the norm. ESG factors reflect a company's long-term prospects, which take into account its financial performance, resilience and ability to survive adversity.

As sustainability comes to the fore, investors of all categories are increasingly using ESG metrics when making investment decisions to improve their returns. A company's approach to ESG therefore plays an integral role in the valuation process.

Meanwhile, the environmental content seems to be disclosed more 'voluntarily' than the social and governance content.

In December 2021, the US government alerted for the very first time that



climate change posed an "emerging threat" to the US financial system, referring to the costs related to an increase in hurricanes, wildfires and flooding caused by global warming. The SEC is expected to put forward rules in 2022 that could require companies to report on climate risks and human capital management in annual 10-Ks or other public reports. A 10-K is a comprehensive report filed annually by a publicly-traded company about its financial performance and is required by the U.S. Securities and Exchange Commission.

There is a trend not only towards S-1 forms becoming more voluminous and detailed on average, but also towards ESG disclosure in general. SEC Form S-1 is the initial registration form for new securities required by the SEC for public companies that are based in the U.S. and that anticipate an IPO. This trend is likely to be the result of companies realising that disclosure on such topics is becoming increasingly important and possibly more detailed.

This trend is reflected in the data: mentions of the term "ESG" on the SEC's Form S-1, which is the registration document required of companies seeking a listing on a US public exchange, have accelerated rapidly over the past year. In

the third quarter of 2021, 17% of all Form S-1 filings during the quarter mentioned ESG, a nine-fold increase in 18 months [6].

ESG should be seen as a cornerstone of business. There is a need for businesses to take a strategic approach to ESG. Those responsible for management (e.g. the board of directors) should incorporate ESG basics into company strategy and recognize that they have a responsibility to move towards a greener and more socially responsible business. Focusing on ESG is no longer an option. It is important that all companies start to embrace these factors and make the necessary turnaround if they want to remain relevant.

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