Investment in tobacco is one of the most debated, divisive and sensitive issues within the sustainable-investing spectrum. Tobacco companies are among the most commonly excluded from sustainable-investment funds. Many institutional fund managers and asset owners are formally excluding tobacco entirely from their investment portfolios, which would have been unthinkable only a decade ago.

The issue
Tobacco companies have historically given portfolios strong income and investment returns. However, this ability has recently been challenged by the social and structural challenges facing the tobacco industry. Increasing global regulation and greater consumer education on the dangers of smoking have contributed significantly to the recent decline in global tobacco sales.

What are the ESG risks associated with tobacco?

Public health
Given the scientific evidence regarding the significant individual and public health issues caused by tobacco consumption, tobacco investments have long been under scrutiny.

It can be argued that taxes on tobacco products go some way to offsetting these issues. However, these costs are largely borne by the consumer rather than by the company. This is because nicotine’s addictive qualities mean that tobacco generally has an ‘inelastic’ demand curve – so when prices rise, the quantities sold fall only slightly.

For tobacco companies, these public health concerns represent investment risks. This is largely due to the costs associated with litigation and the ever-present threat of increased regulation, despite the sector having been heavily regulated for many years.

With extensive regulatory initiatives being applied more broadly worldwide, authorities have been seeking progressive public–health outcomes. Tobacco companies are now investing significantly in next-generation products (NGPs) in the hope that these will capture lost volume growth. Nonetheless, the NGP market share remains small, and its growth has stalled.

Supply-chain human and labour rights
In a report issued in March 2017, the International Labour Organisation noted that tobacco is produced in 124 countries, including in many of the world’s poorest and least developed nations. For investors, this raises reputational risk around tobacco companies’ exposure to child labour or even modern slavery. It is a complex area, as there is little doubt that children are required to work on family tobacco farms to ensure ongoing production. Many international tobacco companies are now required by legislation to produce a modern-slavery report to measure the effectiveness of their human-rights supply-chain monitoring.

Water
As an agricultural crop, tobacco requires significant amounts of water to grow. This can represent risks to tobacco companies in the form of increasing water costs or overexposure to regions that are susceptible to droughts and irregular rainfall patterns. Climate change is exacerbating this risk as weather scenarios are becoming less reliable.

Business ethics
The sector has long been tarnished by incidents of poor business practices and accusations of smuggling, bribery, dubious marketing practices and tax avoidance. While many large tobacco companies have worked hard to clean up their business practices and adopt a responsible approach, the harm caused by the underlying product makes acceptance of this extremely difficult.

Our approach to tobacco investments

Exclusion
In 2019, we conducted an extensive study into whether the tobacco industry should be formally excluded from our potential investment universe. We ultimately opted not to exclude tobacco from all of our funds. The sector generates strong dividend income, giving us a mixed investment view. In addition, there was a full spectrum of views on tobacco exclusions from our clients across the globe. Both of these factors led us to conclude that client and investment rationales are not yet strong enough to justify a house-wide tobacco exclusion. Nonetheless, we have tried to increase the number of tobacco-free investment funds that we offer to our clients. This includes our Ethical and Socially Responsible Investment Fund ranges, which are tobacco-free, alongside other investment restrictions. We will continue to review our exclusion policies regularly, and we have set up an internal governance framework to support this process.

Engagement
We are a large global investor and have a strong commitment to our role as stewards of our clients’ capital. We use our position as a shareholder to engage with companies to address the ESG risks and opportunities in our portfolio. For each of our tobacco-company investments, our analysts and portfolio managers assess the following:

- Historical and forecast revenue-volume growth;
- The significance and likelihood of increased litigation and regulatory pressure on the company;
- The company’s pricing power;
- How advanced the company is in developing next generation products/non-combustibles, and how successful the uptake has been.

These questions aim to incorporate the global regulatory response to tobacco’s public health impacts and how this is affecting the industry’s investment case. We need to understand how well companies within the industry are able to respond to these challenges.

Proxy voting
For our equity investments, we exercise our voting rights on behalf of our clients at all of our investee tobacco-company general meetings on issues such as director elections, executive remuneration and capital raisings. The tobacco companies in which we invest generally have sound governance structures and practices, and in recent years we have tended to vote in favour of these related resolutions. We will continue to monitor the issue of tobacco investment closely and update our position accordingly.

Sustainable investing at abrdn
As a leading global asset manager, we believe that investing sustainably can help generate long-term value for our clients. How and where the world chooses to invest has critical implications for the wellbeing of society and our planet. Equally, investments that could have negative social and environmental impacts can pose risks for the investment performance we can deliver for our clients.

Environmental, social and governance (ESG) considerations are an integral part of our decision-making when investing your capital. By understanding how ESG factors affect our investments, we believe that we can generate better outcomes for our clients, society and the wider world.

To help us achieve this, our dedicated, 20-strong ESG investment team works closely with colleagues across all asset classes. Dedicated ESG asset-class analysts provide an additional layer of expertise.

Please visit our website for more detail.

“We have tried to increase the number of tobacco-free investment funds that we offer to our clients.”
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