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# ESG integration by small- and mid-cap companies: a difficult yet essential transition

The major movement to promote the imperatives of an ESG approach in the contemporary economy now seems to be irrevocably under way. The European Union aims to play an important role in this transition, by pursuing a proactive soft power strategy for green growth, as recently adopted by the Commission. Sustainable finance is the key lever for action in this area.

For several years, the EU has been engaged in work to gradually establish a framework, including a taxonomy and guidelines, aimed at encouraging investors to systematically embed the analysis of multiple ESG factors in their asset allocation decision processes. National authorities throughout Europe have reaffirmed this approach, which has already been taken on board in the large-cap sector, where many companies have put in place substantial measures to ensure better dialogue with the financial ecosystem (stock exchanges, investors, issuers, NGOs, rating agencies, regulators, etc.).

The situation is entirely different for small- and mid-cap (SMID) companies, which tend to be more varied in terms of capitalisation (from several hundred thousand to about five billion euros) and available resources. Investors are becoming more aware every day of just how much this sector, with a few brilliant exceptions, is failing to embrace such an approach. The reasons for this astonishing unpreparedness range from a lack of knowledge to an existential fear brought about by developments confusedly perceived more as threats than as opportunities. Companies in the sector are discouraged by the methodological complexity (with a multitude of factors to be analysed and reported) and the cost of the transition to a business model that includes ESG considerations. But the stakes could not be higher, since it is SMID companies, and more generally SMEs, that are the backbone of the European economy. There is thus a risk that, in the absence of proportionate action, these companies could be eliminated in coming years from asset allocation strategies, raising crucial financing issues for them and endangering their very survival. The same is true for intermediaries specialised in the SMID sector, already deeply affected by the transformation of the investment research industry due to the arrival of MiFID II.

As a leading investor in French SMID companies, the equity fund management firm CDC Croissance, a subsidiary of the state-owned Caisse des Dépôts group, has decided to opt for a persuasive approach. The firm is studying the feasibility of an ESG fund based on a “best efforts” investment philosophy, rather than the more commonly applied best-in-class approach. The aim will

be to select listed companies not among the top ESG performers, but instead having prepared for ESG integration only to a minimal or moderate extent and that will agree to engage in a gradual and measurable adaptation process. The fund, with a target size of €100 million, is expected to begin operations in mid-2020 using a specific methodology. It is anticipated that its launch will coincide with that of an ESG SMID index, designed by Euronext NV and the Ethifinance rating agency.

This new fund should thus become part of an intense mobilisation effort driven by European and national authorities to implement a distinct and gradual adaptation process for SMEs, in order to support their transition towards more sustainable business models. ●