Living up to the promise of SRI

With social, environmental and political issues now increasingly recognised as indicators of business value, both companies and those that analyse them need to raise their game or risk being caught out.

The past few years have been heady times for Socially Responsible Investment (SRI). Around the world both retail and institutional investors are being attracted to SRI, encouraged by an increasing level of consumer awareness of social and environmental issues. Following this increase in consumer interest, the inevitable proliferation of products and services designed to tempt their business has followed.

In the UK, the popularity of SRI for the individual investor continues more or less unabated despite the current travails of the stock market. It is not hard to link this with public awareness of the ever-hardening scientific evidence over global sustainability challenges such as climate change or the grim reality of scandalous working conditions for millions of those who sweat to service the changing whims of western fashion.

There is also much discussion of SRI ‘going mainstream’ in the wider investment world. Legislation around the world now requires the trustees responsible for occupational pension funds—accounting for hundreds of billions of dollars—to disclose their approach to social, environmental and ethical issues.

Rules for share trading on the London Stock Exchange oblige companies to sharpen up their risk management, prompting many to address environmental and other corporate social responsibility (CSR) issues with unprecedented seriousness.

The company law review in the UK has proposed that companies be required by law to report on ‘material’ aspects of their environmental and social performance. It looks as though sustainability and CSR are being woven into the very fabric of capital markets.

So with the overall picture for the development of SRI looking so positive, AMP/Henderson and CSR Europe (a Brussels-based Corporate Social Responsibility organisation sponsored by the EU) commissioned research recently into the trends taking place.

Firstly, recent research into consumer attitudes supports the suggestion that the wider understanding of social and environmental issues shown by consumers is now finding its way into attitudes towards financial products:

- 86% of people think it is important that a company shows a high degree of social responsibility;
- 81% think that social responsibility is important when deciding about financial services;
- 76% think that “using investments to influence large companies to be more socially and environmentally responsible is an effective way to improve the world we live in”, with 34% agreeing strongly. Ages 16-34 and 45-54 have the highest level of agreement with this statement.

Source: Mori poll, October 2001, 1003 people surveyed (487 male, 516 female) in the UK.

With the opinions of investors and the consumer clearly evolving, attention is therefore being paid to which issues are most important to people, and therefore should be at the centre of a company’s thinking when addressing CSR.
WHAT DO INVESTORS LOOK FOR?
Among the following examples of social and environmental policy in companies, which are the ones that you would take into account?

- Respect for human rights 86%
- Communication and transparency on social practices 85%
- Environmental policy 85%
- Working conditions and atmosphere 73%
- Training policy 68%

Source: CSR Europe, October 2001

THE VIEW OF THE PROFESSIONAL INVESTOR
Interesting research of professional investors in Europe also reveals that attitudes are evolving quickly to meet the needs of the consumer. CSR Europe surveyed 197 mainstream equity analysts and fund managers in the EU zone on their attitudes to SRI issues and CSR in general:

For a company, do you think that social and environmental risk management can have a more positive or a more negative impact on its market value?

- In the short term: 56% more negative, 30% more positive, 14% don’t know;
- In the long term: 86% more positive, 6% more negative, 8% don’t know.

50% of those interviewed believe a company’s socially and environmentally responsible attitude leads to a better management of social and environmental risk.

When asked if the same fund managers and analysts would grant a premium to socially responsible companies, 46% indicated that they would.

Source: CSR Europe, October 2001

The CSR Europe research suggests that the financial community’s attitudes may not yet reflect the consumer’s apparent willingness to embrace SRI. Fear, and perhaps the perception of added costs or profits given up to embrace CSR, clearly bother some analysts over the short term. Given the luxury of a longer time frame, the overwhelming view is that CSR can only be a good thing. Yet for all the talk about the compelling business case for good corporate practice, the raw reality is somewhat different. A survey is one thing, but reflecting the growing awareness and expectations of the consumer through strategy and recruitment policy is another.

While a growing body of companies have become expert at communicating with environmental and social stakeholders, few if any chief executives incorporate CSR issues in their routine presentations to investors.

Part of the problem is the lack of crunchy metrics that investors will believe. Even for an environmental manager of a leading company that is well down the track to sustainability, making the links between environmental and business performance remains an “act of faith”.

SRI SKILLS NEEDED
Many companies are identifying important synergies between a responsible reputation and staff recruitment and motivation, but are unable to quantify this in a financially meaningful way. But an equally important barrier is that many in the investment industry still lack the basic literacy to understand the business significance of key social and environmental issues.

As one deeply frustrated company secretary told us, we’re having great difficulty communicating sustainable development to fund managers”. This raises interesting and important issues. Does the average fund manager possess the skills needed to understand the sustainability indicators that can affect share prices, and where can he/she acquire these skills?

The investment industry has a long history of attracting people well versed in financial and business analysis, but to these skills must also be added resources in social, environmental and political understanding. In sectors as diverse as energy and water and from healthcare to mining, corporate success is driven not only by financial factors but also social, environmental and political ones.

Where do the skills come from to ensure that these areas have the same rigorous research and understanding that we demand from financial analysis?

Perhaps this conservative industry of ours needs to examine itself. Every fund management or investment business has its complement of financial analysts and portfolio managers together with...
knowledge of the sustainability agenda together with financial analysts is the key, and allows the investment manager to see a company from all sides.

Beyond the charmed circle of large corporations that operate in high-profile sectors with reputations to protect and budgets to spend, a whole different set of issues arises. Size, sector and structure all have a powerful bearing on getting companies to take the sustainability agenda seriously.

LACK OF SRI RESOURCES
A one size fits all approach, that expects every company to respond in a similar way, creates bafflement and in some cases resentment. For some companies with a history of good practice on the ground, the reason for not producing an environmental report or completing a SRI questionnaire can be as basic as not having resources at head office to do the job.

One finance director expostulated that the reason his company would not produce an environmental report was that his company did not have much “fat” at the centre. Similarly, many software and media companies have yet to see a convincing case for adopting formal CSR programmes often derived from the industrial model.

Today’s business structures create another challenge. The rising tide of questionnaires, researchers, journalists and other seekers of information on companies’ environmental and social performance usually focus on ‘group-level’ policies.

Yet many companies are highly decentralised, with the minimum of necessary functions at headquarters and most of the action at the operating company or business unit level. There may be very few ‘group-level policies’ even on core business areas, let alone exotica such as the environment or social responsibility.

These are significant bottlenecks, even for some of the largest companies. For smaller firms, the current model of environmental reporting, and the emerging practice of social and sustainability reporting, with elaborate free-standing reports, glossy charts and expensive verifiers, is daunting and quite possibly irrelevant.

BETTER COMMUNICATION NEEDED
Understanding and communicating clearly the real links between sustainability and corporate performance, in terms of opportunities and risks, is the key, not following generic prescriptions. We need a new generation of corporate disclosure, more efficient and more focused on the business case.

So here is the challenge. Investment analysts and fund managers need to raise their game in understanding sustainability issues, and how they apply to mainstream investment management.

We have passed the stage where debate should occur over the merits of SRI; the point is proven. Few business sectors are immune to either consumer sentiment or social, environmental, or political drivers. These issues can create or destroy business value, and the investment industry needs to understand these indicators in more detail and be better at speaking to companies about them.

Research from the likes of CSR Europe indicates that analysts and investment managers broadly agree that long-term financial benefit is a result of good CSR. The consumer, the ultimate owner of the assets we manage, has indicated that these things matter to them. It is time for these issues to manifest themselves through investment policy, and the skills we seek to develop in order to effectively manage investment portfolios.

Companies must help investors understand the real business benefits they derive from addressing sustainability and CSR. Give chapter and verse on the cost savings, the increased ability to attract and motivate good staff, the intellectual capital development that generates new products, the enhanced reputation and avoided risk.

The chief executive should include this story in the standard presentations to analysts and shareholders. The business and sustainability community needs to develop the tools to understand and report the complex interactions of sustainable development, costs, intangible assets, business leadership and corporate governance, tailored to widely differing business sizes, sectors and structures.

And do all of this in a way that widens the circle of business involvement and commitment.

The industry cannot ignore the inexorable movement of economic development toward sustainability. SRI issues have a direct impact on financial markets.

Environmental risk and opportunity, labour standards, the retention of skilled labour and the protection of brand value through a defined policy of CSR are all sources of business value. They merit research and understanding with as much rigour as that applied to analysing a balance sheet.

---

Does the average fund manager possess the skills needed to understand the sustainability indicators that can affect share prices... ?