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Sustainability reporting and business value

by Jay Falk, SRI World Group President

In today's global business environment it has become abundantly clear that companies must implement policies and programmes to address a wide range of social, environmental, economic, and corporate governance issues. The business case for doing so is compelling.

An effective corporate social responsibility or sustainability strategy can have a positive impact on reputation, alliances, license to operate, customer relations, employee satisfaction, intellectual capital, etc. Likewise, a well-founded sustainability strategy can help companies avoid legal, regulatory, business, and brand risks.

Over the past 10 to 20 years, external stakeholders have driven much of the demand for greater corporate transparency. This demand has increased pressure on companies to collect, manage, and communicate their sustainability information. As a result, sustainability reporting has emerged as a key stakeholder communication strategy.

Although sustainability reporting is still in its early stages, it is developing rapidly and is being defined by three significant trends: standardisation, materiality, and verification. These trends will help enhance the value of sustainability information because this information will be easier to compare (standardised), more relevant as an indicator of performance (material), and more credible as a result of an audit process (verified). Free markets depend, and thrive, on this type of information.

Research and rating agencies are among the largest and most sophisticated consumers of sustainability information. The research community is a critical link in the sustainability information value chain because their analyses reach thousands of investment managers, public/private pension funds, mutual funds, endowments, foundations, and religious institutions.

So why are investors increasingly adopting sustainability investment strategies?

First, 'values' based investors are



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concerned about the impact of companies on society and the environment. Second, 'business case' investors want to more fully assess risks and value creation opportunities. This investment strategy is a more recent phenomenon and is based on a growing body of research that shows a link

between superior sustainability performance and financial performance. For example, a recent meta analysis (study of studies) found a positive association between corporate social performance and financial performance across industries and study contexts.

This type of evidence is luring more mainstream institutional investors to consider sustainability investment strategies. For example, in 2004 the Global Compact convened a meeting of nearly 20 financial institutions with over \$6trn in assets under management to discuss ways of better integrating social, environmental, and governance issues in analysis and asset management. At the table were institutions such as HSBC, Morgan Stanley, Deutsche Bank, UBS, Goldman Sachs, and Credit Suisse Group. And you can expect this interest to continue.

There is also a growing recognition in the financial community that intangible value, which is, in part, driven by sustainability performance, can no longer be ignored. Current price-to-book ratios indicate that 75 percent to 80 percent of a company's market value is attributable to intangible assets. In other words, value that cannot be found on a balance sheet. Given the magnitude of these numbers it is not surprising that institutional investors are increasingly interested in intangibles.

Investors have two fundamental questions: Does the company understand the drivers of its intangible value? To what extent are these drivers being managed? Within this context, companies will need to communicate intelligently about their sustainability performance, as well as other areas of non-financial performance.

Corporate customers are also becoming important consumers of sustainability information. For some companies, supply chain reporting is a requirement of doing business. In the past, this type of business-to-business reporting was limited to product, price, quality, and delivery information. Now supply chain owners are requiring their

suppliers to report on a broad range of sustainability issues. Supply chain owners are incorporating this information into their risk management strategy, as well as using it to help protect their reputation.

While much of the demand for sustainability reporting been driven by outside stakeholders, an effective sustainability reporting strategy can also be used internally to drive business value.

Most companies view sustainability reporting as an external communication strategy. These companies are missing out on an important opportunity. Any company that has gone through a comprehensive reporting process has vast quantities of sustainability data from facility, division, and corporate levels. This data is valuable and can be leveraged by the company for its own benefit.

This process begins with the identification of key performance indicators (KPI). These are the measures that are most directly tied to the objectives of the company's strategic plan. The initial identification of KPIs is often done on an intuitive basis, but they can be validated and adjusted accordingly through the development of a causal model. These models can be used to demonstrate a cause-and-effect link between

Sustainability Information Value Chain



improvement in a KPI and a chosen financial measure. Once KPIs have been agreed upon, they can be analysed and acted on to help drive financial value, something that both managers and investors will appreciate.

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