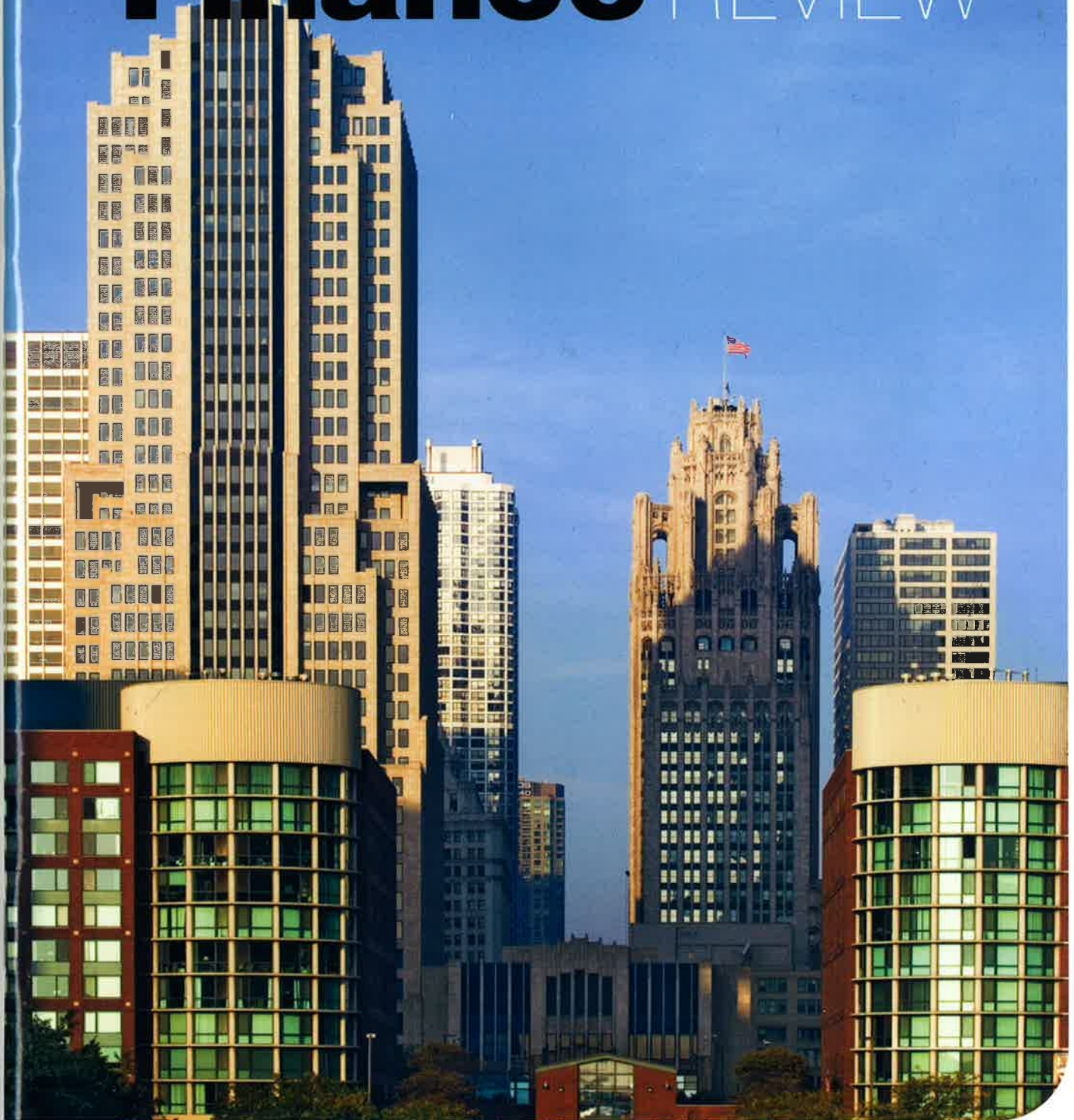


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CORPORATE Finance REVIEW



Tyranny of the Unknown

What Boards Need to Do to Remain Relevant

The Goldman Standard and Shades of Gray

Sustainability Rises to Top of Strategy-Setting for Growing Number of Corporate Leaders

SUSTAINABILITY RISES TO TOP OF STRATEGY-SETTING FOR GROWING NUMBER OF CORPORATE LEADERS

Question: How important is “corporate sustainability” to investors and stakeholders? When the question is posed to them in the context of the projected long-term viability or sustainability of the firms that they do own or might invest in, the answer is “very important.” On the topic of sustainability, there is definite convergence with the views of today’s forward-looking corporate leaders. The responses from a recent survey of leading global chief executive officers showed that when the question about sustainability is asked of them, an overwhelming majority of corporate leaders responded that sustainability was very important to them and their enterprises, and was on its way to being fully embedded into their core business.

Recently, Accenture and the United Nations Global Compact surveyed 766 CEOs around the world (including in-depth interviews with 50 CEOs of leading global companies) on the topic of corporate sustainability and an astonishing 93% stated that sustainability would be critical to the long-term success of their business. And that within the decade a tipping point would be reached that meshed sustainability with their core business (processes and systems), and throughout the global supply chain and subsidiary business units. That is already well underway at a small but growing number of firms in the US and Europe.

To illustrate how much CEO opinion has changed on this, a similar survey of CEOs

in 2007 revealed that just about half of the leaders said that sustainability issues had become part of their company’s strategy setting and operations. This confirms the definable trend among both issuers and investors that began roughly around the 2004–2006 period, with a focus on “corporate sustainability” and later as environmental, social, and governance (ESG) factors became more important to asset owners and managers.

Three-quarters of the CEO respondents to the 2010 survey agreed on the primary reasons for embracing sustainability: building and protecting brand, corporate reputation, and trust factors. On a more finely measurable basis, the potential for lowering costs and growing revenues was also important (almost half of the respondents cited these).

But interesting results on surveys tell only a part of the story. The results can indicate or verify an emerging trend that is headed for the mainstream. Making the business case for sustainability in the board room and among C-suite occupants can be a daunting task. Are we talking about those intangible and non-financial and even nonmaterial “things” that are really more within the province of the PR and corporate communications departments? The answer is clear from corporate sustainability leaders: No, this is about baking sustainability and corporate responsibility into every element of the enterprise.

The sea change that took place in executives’ and even some board members’ views on corporate sustainability and corporate responsibility began in the first decade of the twenty-first century, in the wake of the Enron, WorldCom, Global Crossing, Tyco, Adelphia, and other such corporate financial scandals.

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Socially responsible investors cheered the reforms and, not resting on their victory, demanded more change in the behavior of public company management; the asset owners pressured their external management firms to develop better means of judging risk and opportunity in portfolio choices.

How do we know which companies are going to be around for a while and moreover act responsibly in the shareowners' interests? The questions were quickly answered by a growing universe of financial analysts, researchers, rating and ranking services, index managers, consultants, authors, and others who were already focusing on a number of methodologies or approaches that were known by different names: Triple Bottom Line (considering *people, the planet, and profits*), ESG, sustainability, socially responsible investing (SRI), among other titles. Forward-looking corporate leaders were developing effective corporate social responsibility responses in the form of strategies and programs (the preferred term is becoming *corporate responsibility*).

A popular variation on the *buy/sell/hold* question today is, Would you invest in a corporation that is acting irresponsibly and that does not value sustainability? The question answers itself; the third-party research providers and consultants answer the "how-do-we-know" questions—our methodology and approach will help you determine "who" is responsible and for the longer-term, sustainable and will be a market winner, not a laggard or loser.

Goldman Sachs and GS Sustain

Among the most prominent of investment banking organizations that embrace the corporate sustainability quotient is Goldman Sachs; the firm developed its GS SUSTAIN approach in the 2004–2006 period, and the first public dissemination of the framework was in 2007. (The original effort came out of an invitation from the United Nations Environment Program Finance Initiative and the Asset Management Group to develop a framework to help investors around the world analyze the potential sustainability of companies. Several years of work later, a

team of fifty-plus professionals around the world now manage the GS SUSTAIN efforts.) Though there may still be emerging or even no clear "evidence" for investors that clearly indicate that sustainability efforts add to market value in the minds of some investors, the GS SUSTAIN framework enabled Goldman Sachs to select large-cap picks that have outperformed the MSCI Index (the standard benchmark); in the first public release, 72% had outperformed their peers in mature industries by at least a 25% premium (in energy, mining, steel, food, beverages, media). The framework was also applied to emerging industries—alternative energy, environmental technologies, and biotechnology with similar results. (The framework is regularly updated.)

Thomson Reuters—ASSET4 transaction

At year end 2009, Thomson Reuters acquired ASSET4, a global provider of ESG information and tools for investors and corporate executives. The transaction was another important step forward in the integration of corporate ESG data into mainstream financial analysis and decision-making. As Thomson Reuters explained, the global credit crisis, climate change issues, and new regulation, among other issues, have stressed the need for financial firms in every region to assess corporate risks.

Through the well-established ASSET4 organization clients now have direct access to the most comprehensive global database of objective, consistent, and transparent ESG information and a wide range of analytical tools that enable asset owners and managers to integrate these into their decision making. The information that many in the capital markets have previously considered nonfinancial, extra-financial, or intangible is becoming tangible to many investors. The asset owners' objective: to help improve investment performance, address and reduce portfolio risk, and lower investor research costs; and, through engagement, to encourage corporate executives to address and reduce risk, enhance corporate governance, and



ESG KEY PERFORMANCE INDICATORS AND OTHER INFORMATION RELATED TO ESG ARE NOT A PASSING FAD.

increase corporate accountability, transparency, and trust. Several European countries are now mandating ESG performance disclosure.

ASSET4 is a signatory of the UN's Principles for Responsible Investment and an important contributing member to such organizations and initiatives as the UNEP-FI, the Eurosif network, the United Kingdom's Social Investor Forum (SIF), the US Social Investment Forum (a trade association of ESG investors and analysts), Nachhaltiges Investment, and the Ceres Coalition. Through Thomson Reuters such clients as Bank Sarasin, Storebrand (Nordic asset managers and advisors) and Société Générale now have access to the ASSET4 resources for integrating ESG information into their investment processes.

Bloomberg takes note

Around the globe some 250,000 or so desktop "Bloombergs"—which are sophisticated, financial-market quote machines that also deliver breaking news, market trends, sector and industry analysis, the state of the markets, and much, much more—are relied on by investment professionals for decision making. The Bloomberg organization took note of the growing investor interest in sustainability about three years ago and quietly built a powerful platform within the professional services offerings for research and others uses. Bloomberg News is serviced by 100-plus bureaus worldwide and by a large number of "feeder" sources of news, data, and commentary.

Bloomberg Chairman Peter Grauer explained the company's strategy at the Responsible Investor's ESG USA conference in June 2010: Bloomberg had just acquired New Energy Finance (a provider of environmental data) and predicted that ESG analysis would soon become fundamental to equity market analysis. "We believe that ESG will be a long-term growth area for us. We've only just begun." Bloomberg has included a disclosure score system to its platform to rank companies on how they disclose material information and is building another platform for corporations to provide ESG data.

Riskmetrics/MSCI Group consolidation

In 2010, the global index creator MSCI Group bought RiskMetrics, a major provider of advice to public employee and labor union pension funds. RiskMetrics had earlier acquired Institutional Shareholder Services (ISS), and two well-known and long-established ESG/sustainability research houses—KLD and Innovest.

Conclusion

All of these acquisitions and consolidations are sending a clear message to corporate finance and general management executives: ESG key performance indicators and other information related to ESG are not a passing fad or the focus of a relatively few asset owners; rather, ESG is material, and shareholder and stakeholder expectations are rising and helping to create what is popularly known as the new normal of the capital markets. ■