



# Making the Business Case for Sustainability:

## Why Does it Need to be This Hard?

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to the UNEP FI Global Roundtable**

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“There is a growing body of evidence that companies which manage environmental, social, and governance risks most effectively tend to deliver better risk-adjusted financial performance than their industry peers.

Moreover, all three of these sets of issues are likely to have an even *greater* impact on companies’ competitiveness and financial performance in future.”

**Jean Frijns**  
**Chief Investment Officer**  
**ABP Netherlands**  
**(Largest pension fund in the world)**

# Emerging New Risk Factors are Influencing Corporate Competitiveness - AND Investment Results!



# Addressing Them Can Add Value . . .

## 1. By Identifying Downside Risks – An “Early Warning System” for Investors:

### Some Examples:

- HealthSouth – strategic governance and transparency
- GE – asbestos and other environmental liabilities
- Phillip Morris – tobacco
- Monsanto – genetically modified foods
- Anglo-American – costs of HIV/AIDS in the workforce
- Tyco – strategic governance and transparency
- American Electric Power – climate change
- Federal Mogul – (now bankrupt) asbestos liability

In each case, the “non-traditional” risks provided warnings 3-6 months before conventional analysts and rating agencies became concerned

# Addressing Them Can Add Value . . .

## 2. By Adding Value on the Upside:

Companies with top-quartile ability to manage non-traditional risks have...

- **Reduced regulatory risk exposure** – e.g. American Electric Power: lower exposure to potential carbon tax/regulated limits
- **Enhanced market access in difficult countries and regions** – e.g. Imperial Oil: “license to operate” through stakeholder engagement in Arctic
- **Reduced energy and materials costs** – e.g. British Petroleum: energy efficiency cost savings from reducing greenhouse gas emissions
- **Improved relations with regulators and other stakeholders** – e.g. Anglo American: HIV/AIDS drugs in Africa
- **Greater ability to attract, retain, and motivate a top-quartile workforce** – e.g. Intel: environmental performance
- **Lower cost of capital and insurance** – e.g. ABN-AMRO: integrates these factors systematically into credit risk pricing

i.e. Sustainable competitive advantage

# Addressing Them Can Add Value . . .

## 3. By Addressing Fiduciary Concerns:

### Historically . . .

- Environmental and social factors were believed to lie **OUTSIDE** the purview of fiduciaries' proper focus on purely financial risk and return.

### But . . .

- There is a growing body of academic and practical evidence that paying – and *not* paying – attention to these factors *does* in fact directly impact returns.
- U.K., European and Australian pension legislation now *mandates* addressing environmental and social factors; rest of world cannot lag behind for long in a globalized investment climate.

### This is now . . .

- Social/environmental risks **ARE** increasingly, financial and competitive risks.
- Therefore, today's prudent fiduciaries **MUST** concern themselves with companies' social/environmental performance and strategic positioning.

# And These “Non-Traditional” Risk Factors Will Become Even More Critical to Investors Going Forward...

## Some Global Mega-Trends:

- Accounting-based numbers are telling less and less of the story – post-Enron demand for new, more objective and forward-looking investment analytics
- Tightening global, regional, and domestic regulatory standards, e.g. Kyoto Protocol; new E.U. directives, U.S. clean air regulations
- International pension reforms placing greater emphasis on socially and environmentally responsible investment and greater disclosure to investors, e.g. U.K., France, Netherlands, Switzerland, Sweden, Germany, Australia
- Tougher company disclosure requirements for “non-traditional” risks – Sarbanes-Oxley, new U.S. SEC rules
- Rapidly changing consumer/investor demographics – baby boom bulge of younger consumers and investors with greater environmental and social consciousness
- Increasing pressure from NGO’s and other external stakeholders, armed with better and faster company information and instantaneous global communications ability
- Broadening interpretation of fiduciary requirements by public and corporate pension funds to include sustainability issues
- Unprecedented institutional shareholder activism on sustainability issues

# So Why Is Making the Business Case so Difficult?

## Dispelling 4 Powerful Myths:

- 1. “Addressing sustainability factors is either irrelevant or injurious to financial returns.”**
- 2. “As a direct result, it would be a breach of fiduciary duty to incorporate sustainability factors into investment strategy.”**
- 3. “Sustainability analysis is inevitably less rigorous and more arbitrary than traditional investment analysis.”**
- 4. “Our money managers are already addressing sustainability issues on our behalf.”**

. . . And a 5<sup>th</sup> Myth. . .

The “granddaddy” of them all:

**“Leading-edge institutions are actually doing something substantial already.”**

Remember:

RHETORIC does **NOT** equal *ACTION*

and

INSTITUTIONAL HYPOCRACY does **NOT** equal real *LEADERSHIP*

“Over the long term, investments based on sustainability criteria are expected to out-perform those based on traditional performance measures.”

**Mr. Roderick Munsters**  
**Chief Investment Officer**  
**PGGM, \$50 billion Dutch pension fund**