Extra-Financial Analysis and Investment Processes

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What is “extra-financial” analysis?

“Systematic assessment of corporate governance, environmental and social responsibility”
## Example - Automotive Industry

### Financial Criteria

- Trends in developed markets
- Emerging markets exposure
- Timing and margins of new models
- Incentives to customers
- Supply cost increases
- Operational efficiency and flexibility
- Product quality and recalls
- Currency and interest rate exposure

### Extra-Financial Criteria

- Corporate governance - role of family/state shareholders
- Fuel economy - CO2, smog and particulate emissions
- New technologies (hybrids, fuel cells)
- End-of-life vehicles
- Worktime flexibility
- Pension liabilities
- Employment practices in supply chain
Why is “extra-financial” analysis becoming more relevant to investment decisions?

> Well-governed companies tend to outperform poorly governed companies
  • a trend exacerbated by financial scandals

> Environmental and social issues are increasingly regarded as “material” and financially relevant
  • more stringent legislation
  • changing consumer preferences
  • increasing NGO pressure

A more complete view of investment risks and opportunities
A path to mainstreaming

Traditional SRI Approach

Investment Universe

SRI Screening

Restricted Universe

Financial Analysis

Fund

Parallel Analysis

Investment Universe

Financial Analysis

Extra-Financial Analysis

Model Portfolio

Fund

Full Integration

Investment Universe

Fundamental “+” Analysis
- cash-flows
- risk premium
- growth rates

Model Portfolio

Fund

Source: BNP PAM
Some Challenges

> Understanding and acceptance of ESG

> Competing for access time with companies

> Evaluation and remuneration of sell-side research

> Integration with in-house valuation models, ratings and investment recommendations

> Performance attribution

> Application to different asset classes
Evaluate and Reward Sell-Side Research

> Yearly questionnaire sent to all brokers

“Please describe your current and projected product offering in the field of corporate governance, environmental social responsibility (...)

• “N/A”
• “No specific product yet”
• “Theme-based reports at the moment. Our project is to instill ESG considerations in company reports as a way to provide a more comprehensive assessment of the risk premium attached to the company”

> Extra-financial analysts have a stake in the voting process

> Participate to Extel survey