The state of responsible business: Global corporate response to environmental, social and governance (ESG) challenges

Executive summary version

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The state of responsible business: Global corporate response to environmental, social and governance (ESG) challenges

A report by Ethical Investment Research Services (EIRIS)

Written by Bob Gordon with special thanks to Stephen Hine and Niaz Alam

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The EIRIS Foundation is a charity that supports and encourages responsible investment. It promotes research into the social and ethical aspects of companies and provides other charities with information and advice to enable them to choose investments which do not conflict with their objectives. The Foundation funds specific projects to achieve these charitable aims.

Ethical Investment Research Services (EIRIS) Ltd is a non-profit, independent research organisation which has been conducting environmental, social and governance (ESG) research on publicly listed companies for nearly 25 years. EIRIS Ltd provides research on corporate ESG and other ethical performance indicators to more than 100 institutional investors. It is a†wholly-owned subsidiary of the EIRIS Foundation.

Ethical Investment Research Services (EIRIS) Ltd

80-84 Bondway, London, SW8 1SF

Tel: 020 7840 5700

Fax: 020 7735 5323

Email: ethics@eiris.org

Website: www.eiris.org

Design: Anna Kendler at Susan Rentoul Design

Copies of the report can be obtained from EIRIS at the web-address above

Executive summary

This report provides an overview of the extent to which companies are addressing their environmental, social and governance (ESG) impacts. The companies examined are constituents of the FTSE All-World Developed Index and the data presented was extracted from databases maintained by EIRIS in March 2007[1]. The data is presented by country/region and contextual analysis is provided. The issues covered are corporate governance, equal opportunities, human rights, supply chain labour standards, environmental responsibility and community involvement. The report focuses on these issues because they illustrate a cross section of key ESG risks that companies face and key sustainability issues of interest to clients. Other topics examined include climate change, HIV/AIDS and responsible business approaches in emerging markets.

EIRIS is a leading global provider of independent research into the social, environmental and governance (ESG) performance of companies. Over the past quarter of a century EIRIS has conducted detailed research on the issue of corporate social responsibility (CSR) on behalf of investors in the UK and abroad. During this time, the proportion of companies reporting ESG information has risen significantly. When EIRIS was founded in 1983 only a handful of companies reported anything publicly on their corporate responsibility activities. The first stand-alone environmental reports emerged in the late 1980's and by the 1990's social data was included as well. As the demand from investors for more information on CSR has grown, there has been an increase in the number of company CSR reports, as well as the volume of information contained in the reports. Reporting that started as a description of philanthropic activities has risen sharply over the past 25 years into a description of responsible business practices. EIRIS expects that corporate responsibility reporting will continue to grow, meeting the needs of all stakeholders whilst ensuring that investor needs are increasingly central.

Today EIRIS provides research on corporate ESG and other ethical performance indicators for approximately 3,000 companies worldwide. EIRIS currently has over 100 clients ranging from those who use the research for stock selection or exclusion, to pension funds and other institutional investors applying an engagement or responsible investment overlay to their investment strategy. The range and depth of issues covered, transparent research methodology and focus on providing research and consulting services exclusively to investors, makes EIRIS unique among independent research organizations. EIRIS' growth over the past 25 years reflects both the growth of responsible investment generally, as well as its widely recognized expertise and quality as providers of research on 'extra-financial' issues.

Company reporting on ESG issues has risen significantly over the past 10-20 years. A wide range of factors have influenced corporate approaches to ESG issues including regulation, NGO activity and responsible investment. Responsible investment is most developed in Europe, although there is also significant investment of this type in North America and Australia/New Zealand. Responsible investment in Japan has also risen consistently since 1999, however it is at a lower level. Responsible investment is less well developed in emerging markets, although this is changing as investors are increasingly considering ESG issues in their emerging market investments and several responsible investment funds have been launched in emerging markets. The value of responsible investment funds has grown dramatically in the last ten years, with around USD 4 trillion of funds incorporating an analysis of ESG factors now being managed globally[2].

1 The EIRIS database holds ESG data on a set of approximately 3,000 companies from across the world.
2 Calculation made by EIRIS using information published by the Social Investment Forums in the US, Canada, Europe and Australia/New Zealand.

EIRIS' experience of researching ESG issues for nearly 25 years suggests that investor appetite for increased responsiveness to ESG issues by companies will continue to grow. One should expect to witness an increase in the value of assets managed according to ESG and responsible criteria. The value of assets represented by the signatories of the Principles for Responsible Investment (PRI) already exceeds USD 8 trillion[3], a figure that is likely to increase. In addition, recent evidence suggests that incorporation of ESG issues into investment analyses can help fund managers better understand the future performance of companies in the long term. Customer demand, competitive pressures, increased transparency and a growing number of initiatives encouraging responsible business practices are likely to work together to continue to raise expectations of the standards adopted by companies. In particular the continued growth of responsible investment will drive companies to improve their responsible business strategies.

Main findings

- Over the past 25 years EIRIS has seen CSR evolve from a mainly philanthropic activity to a more mainstream approach that integrates responsible business principles into core business activities.
- Responsible business practices are increasingly being adopted by companies worldwide though there are significant differences between regions.
- European companies have well developed responsible business practices across a broad range of issues. This is due to a sophisticated responsible investment market, NGO pressure and a strong regulatory environment.
- Japanese companies demonstrate strong performance on environmental issues, although need to make progress on other areas to match European levels.
- Beyond a core of companies which have adopted responsible business practices, North American companies significantly lag behind their European counterparts across all the areas researched.
- Large companies are more likely to adopt responsible business practices than smaller companies. Larger companies by market capitalisation are more likely to adopt human rights policies and demonstrate environmental performance improvements
- Continued growth in responsible investment especially amongst 'mainstream' investors, driven by a belief that environmental, social and governance issues affect financial performance, is expected to drive greater corporate take up of and reporting on these issues.

Additional findings

- European and Japanese companies are clear leaders with respect to managing environmental impacts. Over 90% of high impact companies in Europe and Japan have developed basic or advanced policies, compared with 75% in Australia/New Zealand, 67% in the US and 15% in Asia ex-Japan.
- Progress is not as good with respect to human rights approaches both in companies' owned operations and in the supply chain, particularly in countries outside Europe. Nearly 75% of European companies operating in high risk countries have developed a basic or advanced human rights policy compared with less than 40% of North American companies and around a sixth of Asian companies. Over 50% of European companies have adopted a basic or advanced supply chain policy where relevant, however less than 20% of North American companies and less than 10% of Asian companies have done the same.

3 The Principles for Responsible Investment www.unpri.org

- Corporate governance practices are converging globally. Governance codes are being revised to improve levels of transparency and independence, and the proportion of companies adopting Western board structure models is increasing. The proportion of independent directors is on the rise, as are disclosure of director remuneration and the proportion of women on the board.
- Companies in Asia ex-Japan are least likely to have adopted responsible business practices in relation to all the criteria examined, although this may be set to change as NGO presence is increasing in Asia and investors are becoming more interested in emerging markets.
- Australian, New Zealand and Canadian companies do not perform exceptionally on any issues compared to their peers in other countries.
- Large companies are more likely to adopt responsible business practices. 56% of all companies in the FTSE All World Developed Index have adopted an environmental policy meeting at least basic. These companies represent 77% of the value of the index. Similarly, 43% of all companies operating in high impact countries have developed at least basic human rights policies and these companies represent 70% of the value of those companies in the index.
- A number of factors have driven the rise of responsible business practices, including regulation, ethical consumerism, brand reputation management, process improvements and responsible investment.

Summary findings in relation to each of the ESG issues examined are provided below[4]:

Corporate governance

- 62% of the companies studied have boards containing more than a third of independent directors. However the proportion of independent directors varies greatly between countries. Over 90% of companies in North America, UK, Switzerland, the Netherlands, Norway, Finland and Australia have more than a third of independent directors, compared with less than 10% in Germany, Austria and Japan.
- Disclosure of directors' remuneration is consistently high, with 96% of all companies disclosing this information.
- In half of the countries studied over 90% of companies separate the roles of chair and chief executive. However rates of separation are lower in the US (30%), Japan (54%) and France (56%).
- These differences are driven by the fact that companies largely adhere to their relevant national Corporate Governance guidelines.
- However corporate governance practices are converging. Governance codes are being revised to improve levels of transparency and independence, and the proportion of companies adopting Western models of board structure is increasing.

Equal opportunities/Women on the board

- Increasingly, companies view equal opportunities less as a way to avoid criticism or lawsuits, but more as a means to build reputation and gain competitive advantage by accessing a broader skill set.
- Around 90% of companies in North America (94%), Europe (88%) and Australia/New Zealand (87%) have basic or advanced equal opportunities policies. Conversely, just over 50% of Japanese and less than 25% of companies in Asia ex-Japan meet these standards.

4 These have been included because they illustrate a cross section of key ESG risks that companies face and key sustainability issues of interest to clients. However EIRIS examines over 60 different social, environmental and governance areas.

- The pattern is slightly different for equal opportunities management systems. The criterion includes disclosure of staff demographics in relation to women and ethnic minorities as well as the presence of flexible working policies. Europe and Australia/New Zealand both perform well, with around 80% and 70% respectively demonstrating at least basic systems. Performance amongst Japanese companies is also strong at 60%, whereas it is weaker amongst US companies at 25%. In the US, companies are less inclined to disclose this information, possibly due to fear of litigation.
- Worldwide, only 8.1% of board members are women. Representation of women on the board continues to be lowest in Japan at less than 1% and remains generally low in Mediterranean countries. These low levels are driven by a mixture of cultural factors including a history of fewer women in formal employment combined with weak legislative encouragement.
- The highest rate of 33% is seen in Norway where the government has enforced a quota for a minimum of 40% board members to be women by the end of 2007. The number of women on the board is set to increase in Spain as the Spanish government has recently established a quota similar to that imposed in Norway.

Human rights

- NGO campaigns have placed the spotlight on companies operating in countries where human rights are seen to be at risk. In addition, responsible investors are increasingly considering human rights and labour standards in their investment decisions. These factors are forcing corporations to better manage the risk and challenges of operating in such countries and their potential impact on the human rights of their employees and the wider community.
- In particular, investors look for proof of compliance with standards of fundamental human rights as recognised in the Universal Declaration of Human Rights and related international conventions.
- Companies in Norway, the Netherlands, the UK and Finland are more likely to have developed advanced human rights policies; 50% or more of companies in these countries with large operations in high risk countries have an advanced human rights policy.
- In contrast, a low proportion of US and Japanese companies operating in high risk countries have developed advanced policies, less than 5% in each case.
- Less than 5% of relevant companies in Hong Kong, and none of the companies in Singapore or Portugal have developed even a basic human rights policy, system or report.
- The low proportion of US companies achieving an advanced grade may be explained by the frequent omission of freedom of association and collective bargaining from human rights policies.
- The low proportion of Asian companies achieving an advanced grade may be explained by differences in their perceptions of what constitutes human rights, as well as relatively lower levels of NGO and responsible investor activity in Asian countries.
- Large companies are more likely to address their human rights risks. 15% of all companies in the FTSE All World Developed Index operating in high risk countries have adopted an advanced policy. These companies represent 27% of the value of those companies in the index. Similarly, 43% of all companies have developed either basic or advanced policies and these companies represent 70% of the value of those companies in the index.

Supply chain labour standards

- Companies are increasingly sourcing products from developing countries as supply chains become more globalised. As a result they are under increasing pressure from responsible investors and NGOs to demonstrate that their products are manufactured employing acceptable labour standards.
- Across all regions, with the exception of Europe, the majority of companies with a significant degree of reliance on global supply chains show little or no evidence of having a supply chain labour standards policy. Over 80% of companies in North America and Australia/New Zealand and over 90% of Asian companies do not demonstrate any evidence of a supply chain labour standards policy.
- Conversely, over 50% of relevant European companies have developed a basic or advanced supply chain policy.
- This pattern is repeated for supply chain systems and reporting mechanisms.

Environmental responsibility

- Public concern about environmental degradation has grown in recent years, particularly due to growing public awareness of climate change.
- 57% of all companies have a publicly available environmental policy statement in place. A similar percentage of companies have implemented environmental management systems (58%), although a much smaller proportion (29%) report their environmental performance.
- A greater proportion of companies with a high impact on the environment have environmental policies, systems and reports (78%, 81% and 57% respectively).
- Large companies are more likely to address their environmental impacts. 56% of all companies in the FTSE All World Developed Index have adopted an environmental policy meeting at least basic. These companies represent 77% of the value of the index.
- Over 90% of high impact companies in Europe and Japan have developed basic or advanced policies for managing environmental impacts, compared with 75% in Australia/New Zealand, 67% in the US and 15% in Asia ex-Japan.
- Environmental performance is strongest amongst companies in Europe and Japan, however performance in Asia ex-Japan and the US is less encouraging. 7% of Asia ex-Japan and 18% of high impact US companies demonstrate an improvement in environmental performance, compared with over 50% for companies in Japan and in several European countries.
- A number of factors drive the strong performance demonstrated by European companies including strict EU regulation and a high level of pressure on companies to adopt sustainable environmental practices from investors, NGOs and civil society.
- Performance is strong in Japan as ISO 14001 has been widely adopted, championed by the government as a way of providing customer assurance and as a means to avoid losing export business to certified firms elsewhere.

Community involvement

- Community involvement can range from simple donations of money to donations of expertise, time and resources.
- Community involvement is widely used in all regions of the world as a means to build reputation. In all the countries covered, at least 50% of companies score basic or advanced (Europe 85%, Australia/New Zealand 77%, North America 70%, Japan 66%, Asia ex-Japan 60%). Even in the lowest performing country, Hong Kong, 58% of companies meet at least the basic level.
- Differential tax rates and incentives for charitable giving between different countries play a part in affecting the average amount donated from country to country.

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Disclaimer

The information contained in this report is provided by way of illustration of broad trends only. Clients should not rely on this information in making any investment decisions. While every effort is made to ensure the accuracy of the information presented, EIRIS does not and cannot guarantee that information is accurate. It is important to note the date of this document as circumstances may have changed since then.

Other publications and guides

Additional publications and guides for investors are available from EIRIS, including briefing papers addressing ESG risks facing specific sectors, for example

- 'Obesity concerns in the food and beverage industry'
- 'Beyond REACH – chemical safety and sustainability concerns'
- 'Project finance: a sustainable future?'

To obtain further copies, copies of the full report or for information on how EIRIS research can assist the investor to better integrate extra-financial environmental, social and governance issues please email clients@eiris.org or visit www.eiris.org

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