

IR and ESG Worlds Collide!

Emerging Practices for Sustainability as an Investor Relations Differentiator



Jeff Zelkowitz
October, 2010

Many companies today have at least a basic approach to sustainability – although it’s typically in a separate world from investor relations. But as corporate leaders are showing, integrating sustainability into the IR information flow is an opportunity to differentiate a company’s investment story, management quality and innovative potential driven by trends shaping today’s business landscape.

Companies and investors are now talking about sustainability in strategic, and arguably material, IR terms. Environmental, social and governance (ESG) factors are now widely accepted as critical to business. And many company managements are tackling related risks and opportunities in their strategies in ways that ought to resonate with investors and give them a fuller picture of future prospects. >>

RISING ESG TRENDS FOR COMPANIES, INVESTORS AND REGULATORS

All trends point to rising ESG integration over the next five years. In little over a decade, sustainability has moved from philanthropy to risk mitigation to growth strategy. Companies like Wal-Mart are making the business case for sustainability with a strategic approach to managing ESG performance. This has increased efficiency (think packaging, transportation and energy costs) and revenue growth from new products (think light bulbs), while lowering supply chain risks and improving reputation. On the flip side, documented safety problems at BP's operations over a multi-year period offered warning signs that most, though not all, investors ignored.

Mainstream institutional research is steadily incorporating ESG to respond to client demand and generate investment ideas. We see it everywhere. Bloomberg terminals now provide accessible tools for analyzing company and sector ESG data alongside financials. Goldman Sachs launched its GS Sustain research on the thesis that, while socially responsible investing (SRI) does not outperform on its own, strong ESG performance scores are a good indicator of the best-managed companies and can be used to identify businesses set to deliver industry-leading returns. UBS pairs industry analysts with ESG experts to produce sector-specific insights. T. Rowe Price, the \$400-billion mutual fund manager, is the latest institution to adopt the U.N. Principles of Responsible Investment. Even Mercer, the retirement plan consultant, now rates the asset managers of its pension fund clients on level of stock research ESG integration.

Reporting trends favor more ESG disclosure. In early 2010, the U.S. Securities and Exchange Commission issued guidelines requiring companies to disclose climate risks. In August, the International Integrated Reporting Committee (IIRC) was formed to develop a globally accepted framework for accounting for sustainability. With members including the U.S. Financial Accounting Standards Board (FASB), its international counterpart IASB, major accounting firms and the Global Reporting Initiative, IIRC's brief is to bring together "financial, environmental, social and governance information in a clear, concise, consistent and comparable format." Pfizer announced it will shift to an integrated report next year.

EMERGING IR PRACTICES OF SUSTAINABILITY LEADERS

When you put it all together, ESG integration is a trend investor relations will need to master. Encouragingly, a recent NIRI survey found that while IR has not played a leadership role on sustainability, 60 percent of IR officers strongly agree that "sustainability is more an opportunity than a threat." And why not? Sustainability can differentiate otherwise similar businesses

and help companies demonstrate themselves as efficient, well-run and positioned to deal successfully with industry issues and innovate for long-term success.

A good place to start would be to define material ESG issues – "what counts" for the business, its shareholders and other stakeholders. An increasing number of companies have developed ESG materiality processes to frame their sustainability strategies and communications. It's too soon to designate IR best practices, but let's review what some Dow Jones Sustainability Index and RiskMetrics Global ESG 100 companies are doing. Here are illustrative investor relations examples for five categories of ESG materiality.¹

1. LONG-TERM FINANCIAL IMPACTS AND RISKS

Thinking long-term is a credo of sustainability. Shell's, "Energy scenarios to 2050" offers insights into management's thinking by detailing two alternative timelines of industry developments from 2015 to 2050. Under the first scenario, policy-makers do too little too late, causing governments to compete over tight energy supplies, while climate shocks lead to political instability; the second assumes a better outlook for economic development, energy security, energy technologies and environmental impact. Shell says it uses these scenarios to

When you put it all together, ESG integration is a trend investor relations will need to master.

test its medium- and long-term strategies, though the link to its investment case is inferred rather than stated. In some IR presentations, CEO Peter Vosser also discusses strategic and financial fundamentals over a nearer-term horizon alongside ESG performance, including growth of renewable energy sources and metrics relating to safety, oil spills and human rights.

2. STAKEHOLDER CONCERNS AND SOCIAL TRENDS

Changing attitudes of consumers, employees and governments can alter a company's fate. At this year's investor day, CEO Indra Nooyi presented PepsiCo's strategy, "Performance with Purpose," against an industry operating environment that is being radically influenced by sustainability trends and stakeholder pressures. Among PepsiCo's imperatives for "delivering first quartile financial performance over the next decade," she focused on shifting the portfolio "from fun-for-you to better-for-you, while maintaining great taste" – reducing sugar, sodium and fat content to respond to changing consumer and government attitudes about health. Another imperative is to

¹ Harvard University Hauser Center and the Initiative for Responsible Investment, "From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues," based on previous materiality work by AccountAbility and the Global Reporting Initiative.

refresh the organization's capabilities to operate successfully in the new environment, with a focus on recruiting and developing talent over the next 10 years: "The new people coming only want to come to a company that stands for something," she said. "They say to us explicitly, 'tell us what you're doing to make the world a better place, then we'll come to work for PepsiCo.'"

3. POLICY, LEGAL AND REGULATORY DRIVERS

Government policies are a major influence on industries such as health care. Novo Nordisk is a leader in the treatment of diabetes, and investor presentations explain how its growth in the U.S. and Chinese markets is underpinned by stakeholder engagement to build policy-maker consensus on the diabetes crisis. Novo Nordisk details its policy leadership as a business issue – in health care reform debates, grassroots initiatives and education on diabetes' costs to the economy, links to obesity, solutions for improving health outcomes, and next-generation R&D on the health effects of climate change. Novo Nordisk is also an interesting example of a company that carries business-critical sustainability themes and data points throughout its communications. It reports on its progress against material ESG KPIs linked to business performance and compensation in both its annual report and IR presentations.

4. INDUSTRY-SPECIFIC RISKS AND IMPACTS

Water is a critical issue for the beverage business, and it has prompted collective industry action such as the new Water Disclosure Project. After protests related to water usage disrupted its operations in India several years ago, Coca-Cola has made global leadership in sustainable water use a strategic priority. Coke notes that within 20 years, two-thirds of the world's population may face severe water stress. IR presentations describe the company's sustainability agenda as a way to create competitive advantages, and Coke highlights its leadership on water through more than 250 community partnerships in 70 countries and 2012 target to improve water efficiency by 20 percent.

5. OPPORTUNITIES FOR INNOVATION

Not surprisingly, finding IR communication on growth from green(er) products and technologies is relatively easy. P&G is targeting \$50 billion in "green product" sales by 2012, while Philips just reached its targeted 30 percent of sales – three years ahead of schedule. Unilever takes investors through its process to embed sustainability into its brands, while SAP offers ERP solutions to help its customers manage and reduce environmental impact. United Technologies' integrated annual report focuses almost entirely on "products and technologies that take advantage of megatrends that will shape the world in coming decades, including rapid growth in emerging markets, urbanization and demand for energy-

efficient as well as environmentally sound solutions." Expect more IR stories highlighting sustainability as a growth driver and featuring innovations and targets.

IR TAKEAWAYS

So what's the IR payoff? It's fair to ask what impact ESG communications actually have on how investors view and value companies. Not all attempts to incorporate ESG into IR are equally rigorous or effective, and the lack of numbers and apples-to-apples comparisons can be frustrating. At best, integrating financial and ESG issues in fundamental analysis ought to add new pieces of information to the "analyst's mosaic." At least, a good sustainability story should strengthen an investor's understanding and confidence about a business. This might sound intangible – but that's not new in investor relations, where premium stock market valuation is often earned on intangibles such as management quality, brand value, risk profile, corporate culture and governance. ■

In the interest of evolving best practices, here are eight IR takeaways:

DO:

- Anchor your sustainability IR story in a long-term worldview of industry pressures and responses
- Build a business case around material ESG factors for the 'three Rs' – returns, risks and reputation
- Focus on sustainability embedded in strategic planning and innovative growth opportunities
- Monitor ESG reporting trends and discuss information needs with analysts and investors
- Be alert to warning signs that peripheral vision on ESG issues and stakeholders can offer IR

DON'T:

- Segregate IR and ESG in separate bubbles for separate stakeholder groups
- Artificially latch sustainability onto the IR story with a "me-too" green bullet or case study
- Just talk about the current quarter or the next quarter-century; aim for the five-year investor

**Excerpts from this article were featured in the November 2010 issue of IR Magazine and Inside Investor Relations in an advice column entitled, "Sustaining an Interest in ESG Matters."*

Some of the companies mentioned in this article are clients of APCO Worldwide.

Jeff Zelkowitz

senior vice president

APCO Worldwide

51 Madison Avenue, Suite 2510

New York, N.Y. 10010

U.S.A.

tel: +1.646.218.8744

jzelkowitz@apcoworldwide.com

APCO

worldwide®

apcoworldwide.com
