

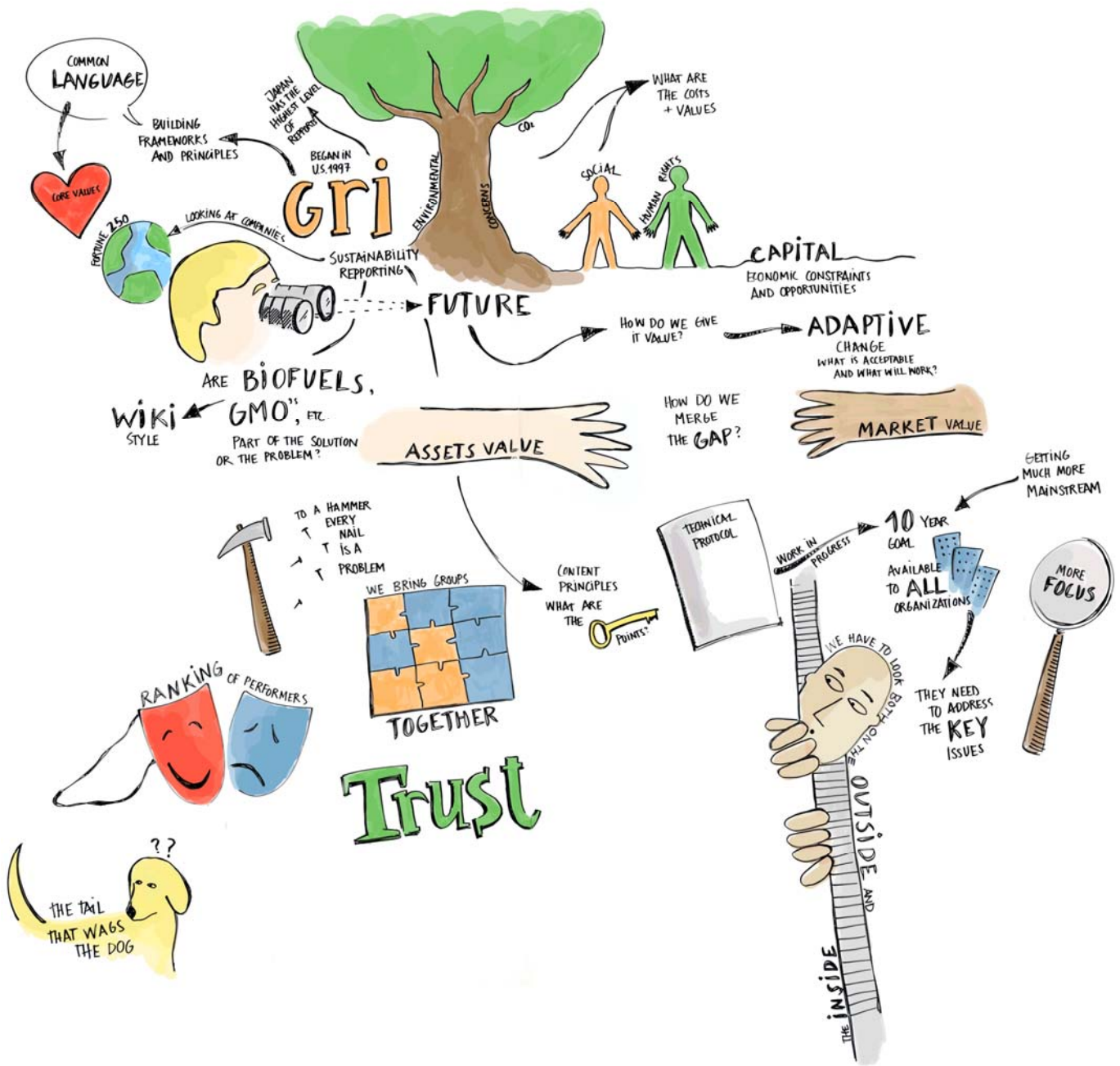
## **Session Four**

### **Measuring and Reporting on Responsible Investing**

Private Wealth Council

The Dolder Grand Hotel  
Zurich, Switzerland

29 September 2008



## Measuring and Reporting on Responsible Investing



Ernst Ligteringen

In the fourth session, Ernst Ligteringen, Chief Executive of the Global Reporting Initiative ('GRI'), introduced the concept of sustainability reporting in conjunction with his organization.

**« Is the business you want to invest in part of the solution or part of the problem? »**

### Looking at the Future

Mr Ligteringen started that sustainability reporting – also called corporate social responsibility reporting - is becoming increasingly relevant. For Mr Ligteringen, earlier discussions clearly showed that we should not be talking about yesterday's problems but about the future. And if we want to have companies that will be successful in the future, then those companies need to respond to future challenges that are reflected in the 10 Drivers of Change. For Mr Ligteringen, there is one central question: Is the kind of business that you are in part of the solution for the future or is it part of the problem? Sustainability reports can help to address this question.



### The Biofuel Case

About one year ago, biofuels had very good press. People thought that it was wonderful to be less oil dependent, to have less CO<sub>2</sub> emissions, to create employment in rural areas and to have a renewable source of energy. Suddenly, biofuels received the blame for the food crisis, lost credibility and went into bad press resulting in the question whether to abandon biofuels. A difficult question only possible to answer on a case by case basis requiring specific information such as: which crop is used and what are its other uses? Where is it grown, at what efficiency, and with how much water input? Where is it produced and how does the final product get to the market?

Many hotly debated future technologies bring forward the same questions. Is nuclear energy part of the solution or part of the problem? And what role do GMOs play in the future? Questions that have social, environmental, and economic consequences and can only be answered with information not found in conventional financial reporting.

*« If financial reporting is your principal window in measuring results, then every problem and solution appears to be financial. »*

*-- citing Al Gore*



Are we equipped for the future?

At a GRI conference in 2006, Al Gore explained that we are not particularly equipped for a different future, especially with respect to the current economic reporting system. Abraham Maslow once said: "If a hammer is your only tool, then every problem appears to be a nail." Therefore, if financial reporting is your principal window measuring results, then every problem and solution appears to be financial. That leaves you with enormous blinkers on.

The Indonesia Case

Indonesia has a great asset on its balance of payments due to its timber exports. Indonesia is capitalising on its opportunity. A smart thing to do looking at it solely from a financial perspective. But on a broader perspective it might be less smart as it is losing future opportunities. By losing many of its woods, Indonesia is also losing large CO<sub>2</sub> credits it could receive in future, biodiversity, and other natural resources that could be put into productive use.

Risk Exposure and Resulting Opportunities

Today, 51 out of the 100 largest economies are corporate organizations all facing similar questions as Indonesia does. If you look only through a financial perspective you miss a large part of your risks and opportunities. The same is true for smaller companies. In a world of increasing environmental constraints and social issues, companies need solid information on what is their risk exposure with their products, services and business models and on the resulting opportunities.

Sustainability reports help in a structured way to measure the effects a company has on the environment, society and the economy at large.



*« There is no free lunch. Increasingly things like water and CO<sub>2</sub> emissions appear on balance sheets. »*

#### Different Perspectives on Sustainability Reporting

There are two different users of sustainability reports. Those who look for the business case and those who look for the public policy case. Both are important because both have a legitimate interest and both look at the same information from different perspectives.

First, those who are looking at sustainability reports from a business case perspective are concerned about the robustness of the data. Often, the main problem for those is the difference between net asset value and market value. With the current information systems, it is not particularly easy to put an explanation and a robust figure on this value difference as it has to do with the quality of corporate governance and various intangibles such as the reputation of the company, its brand value, its license to operate, the trust of its stakeholders and the connected cost of capital. Issues that are difficult to measure, yet important for the sustainability of a company. Conventional reporting does not provide a full perspective on risks and opportunities, and the quest for integrated value reporting taking into account financial performance linked to the economic, environmental and social performance becomes increasingly important.

Second, those who are looking at sustainability reports from a public policy perspective think in the concept of social environmental capital which does not just disappear but is neither freely available. This represents a shift in thinking as often environmental and social capital was considered to be in the sphere of externalities. Until some decades ago, water, for example, could be used in a production process and afterwards simply disposed in the river. Today, these factors increasingly appear on balance sheets. However, the market still needs to learn and understand what are the real environmental and social cost of 'externalities'.

#### General Motors versus Fiat

Sustainability reporting is very costly and the question whether it helps a company is hence very legitimate. Mr Ligteringen recalled a visit some years ago to General Motor's headquarters in Detroit asking the Head of Corporate Social Responsibility how he can justify a product such as the Hammer. "We are responsible for thousands of jobs and this is what the markets want. I understand that it is not too popular and [the Hammer] has its problems but on balance, we feel that we have to do this. And if we don't, somebody else will do it." That was the position of General Motors at that moment.

*« Looking ahead at how the markets will be shaped by environmental, social and economic constraints and opportunities is becoming increasingly a business factor. »*

About half a year ago, General Motors did not want to use its option to buy more assets of Fiat than it already had. To the contrary, General Motors tried to sell all its stakes in Fiat as GM projected Fiat to continue with its bad financial performance. They did not pay attention to the analysis of the asset management company SAM that projected the carbon exposure of different car brands. In that analysis they could have seen, and according to Mr Ligteringen they clearly did, that General Motors was not positioned particularly well in that sense. Clearly, General Motors was not looking at whether the market is going to change. All justifications for the Hummer were with the logic of that time.

Today, General Motors has stopped the production of the Hummer and Fiat is profitable after several years of negative financial performance. This example showcases that, parallel to the conventional business analysis, looking ahead at how the markets will be shaped by environmental, social and economic constraints and opportunities is becoming increasingly a business factor.



#### Value and Values

Ronald Heifetz, Professor at Harvard Business School, wrote about 10 years ago an interesting book where he distinguishes between 2 different processes of change you see in society. Technological change and adaptive change.

Technological change is of a nature where society goes through a process we all know about. For such changes there are experts we can leave the problem to and they know exactly what to do. In medicine this can be compared to a minor problem such as appendicitis. It needs to be solved, you go to the doctor, they know what to do with it and you let them quickly resolve this medical problem with a standard solution.

*« A massive adaptive change process about how we want to organize our environment, our society and our economy in the future is what currently takes place. »*

Adaptive change is different, it takes place when society gets into new and unknown areas. Areas where knowledge is still to be built up, where value systems need to be redefined and where people might need to adjust their attitudes in order to come to a solution. This change is comparable to a medical condition that doesn't have an easy solution and where the solution also depends on the patient. At that moment, the patient should not leave it to the expert and will need to find out about how he really wants to approach this new condition.

That is the nature of adaptive change. Shifting to a world where we have to learn to live with more people as well as with resource constraints will require something more than technological fixes. It will require people around the world to newly evaluate their values and approaches, person by person, company by company. What is acceptable and what will work under new conditions? A massive adaptive change process about how we want to organize our environment, our society and our economy in the future is what currently takes place.

Sustainability reporting is aiming to help with adaptive change by making more and more information available that was hardly accessible. By helping people, whether investor or employee, to start to understand more about the relationship between what a company produces and the challenges the world is facing.

#### GRI's Ambition

The Global Reporting Initiative wants to help the world making sustainability reporting a normal practice because GRI thinks that time will demand it. The aim is to make economic, environmental and social information more robust and reliable and to help people and organization to gain experience about how to organize themselves with this information. GRI does this by building a framework with principles and indicators in order to gain more transparency and practicability in sustainability issues. For this, GRI aims to build a common language.

#### The GRI Guidelines

A principle output of the Global Reporting Initiative are the guidelines that are currently in the third generation called G3 and are freely downloadable on the internet. They consist of 4 principles on how to determine what should be in a sustainability report and 6 principles how to obtain good quality data. Particularly important is the principle of materiality that helps to determine the crucial data. Today, many sustainability reports focus on nice things, such as 'we switch of the lights when we leave' but for a car producer or an oil company this is not really where the company has its interface with key issues in the environmental, economic, and social sphere.

The core of the guidelines consists of 79 indicators that aim to capture by which measure a company should make information transparent and create consistency over time. Behind each indicator is a technical protocol providing references to the most widely used conventions, benchmarks and best practices in the industry. The GRI is not trying to reinvent a language, but to use conventional measures wherever possible.

Furthermore, there are sector specific supplements and country specific annexes. Currently, supplements are available for the sectors of automotive, telecommunications, financial services, tour operators, public agencies, mining and metals, logistics and transportation, and for energy utilities. Many other supplements are currently being developed and others are on the agenda for the near future.

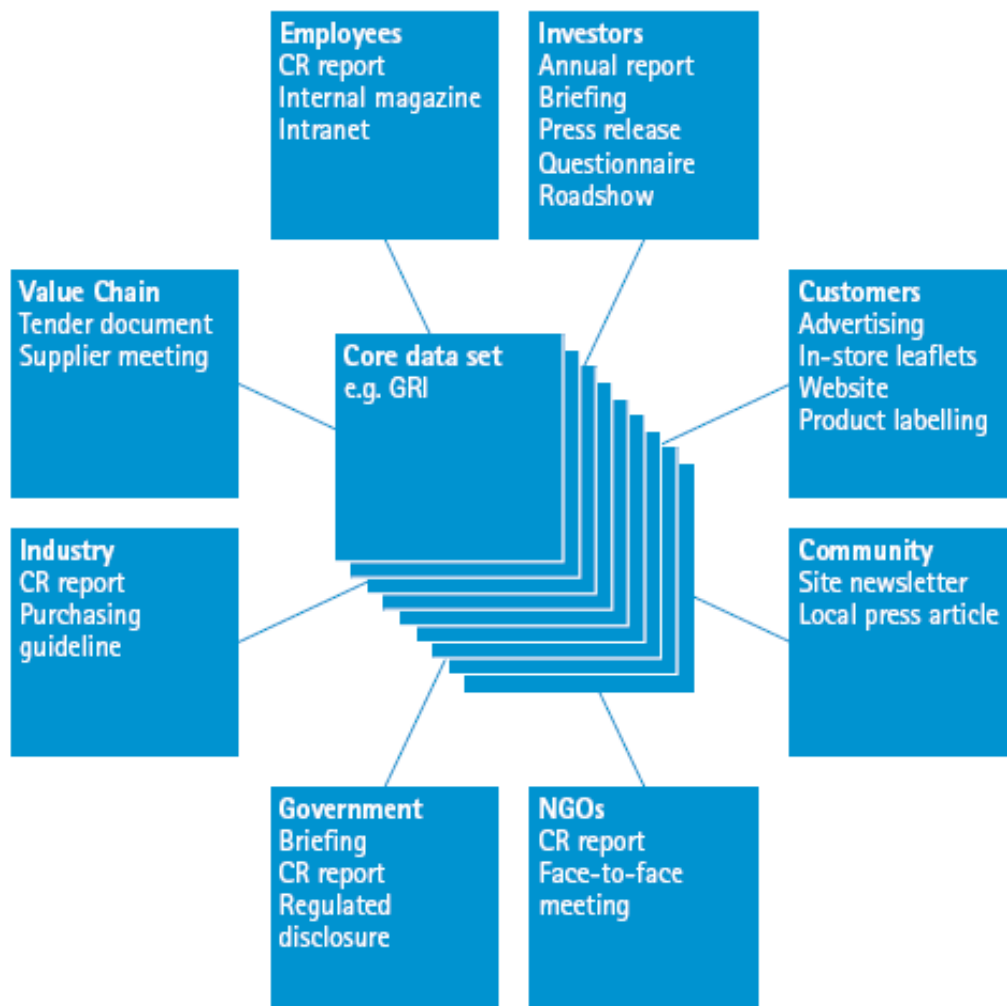
#### GRI and other Initiatives

Mr Ligteringen explains that often people are not sure whether they shall prioritize the GRI or the United Nations Global Compact being two different things as the mission of GRI is to be a common disclosure language to all kind of different initiatives. In today's world hardly anybody is satisfied with a expression of intend. The below shown initiatives promote expressions of intend to be signed by business organizations. The question is what difference does it actually make to be a signatory of these initiatives? In order to obtain clarity in this question, transparency is needed and GRI positions itself as a facilitator in the middle of these initiatives.



## Sustainability Communication Channels

The core value of the GRI Guidelines is that they represent a common disclosure language. They are not a template for one kind of report. A UK sustainability consultancy illustrated the concept with a core data set in the middle that needs to be maintained and collected in a consistent matter. Out of this core data set, different kinds of communication reports can be developed for specific target audiences.



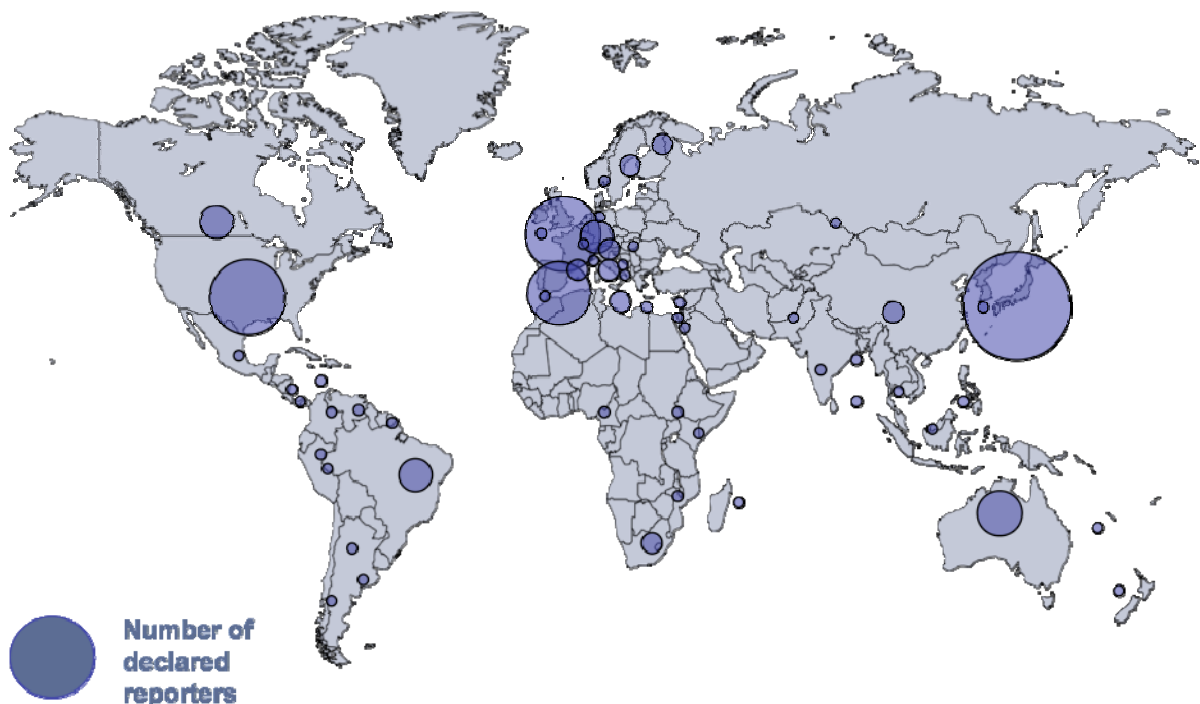
## Geographical Distribution

The GRI started in the United States in 1997 where a group of people jointly agreed to aim for a framework that brings together economic, environmental and social data. Acting as a network organization with about 25 employees in Amsterdam and over thousand contributors around the world, it has grown in a viral way.

Today a concentration of published sustainability reports using the GRI guidelines can be seen in the United States, Europe and Japan, from which the latter has the highest rate. Places that have an increasing rate of sustainability reports published are Brazil, India, South Africa, Mexico and Chile. The Chinese government issued a directive to its state owned enterprises earlier this year ordering that they have to get prepared to report on their social and environmental impact. China feels the increasing pressure to explain itself to the world. After all, the Chinese government is sending a signal to its state owned enterprises that they have to compete for resources, and perhaps for investors in the future.

## Readers Expectations

A GRI survey found that there are many different groups that read sustainability reports. However, the main finding was that sustainability reports are not read like a book. Readers are looking for specific information and expect this information to be available, often without realizing that what they are looking for is called a sustainability report.



## Relevance for Investors

Sustainability reports provide the investor with higher transparency about information that did not used to be available, in a structured common language and in an easy accessible way. Information that helps the investor to draw up a risk and opportunity profile. There are remarkable differences when it comes to risk exposure of different product portfolios that are being developed within one industry. By examining a sustainability report, an investor may find out how serious a company goes about non-financial factors that may have a large impact on the company. And finally, what a company is able to measure is what a company is able to manage.

## Future Evolution of Sustainability Reports

According to Mr Ligteringen, there will be more than today's approximately 3'000 companies that publish sustainability reports. The trend will go towards mainstreaming these reports as there is mounting pressure on finding out what is an externality and whether it is accepted as such. Furthermore, the direction goes towards full cost accounting. How does a company use common resources? Is it using these in a productive manner and are its products offering solutions for the future? Increasingly, markets and regulators are becoming intolerant of companies that are solely interested in ignorant short-term money-making.

Sustainability reports will also become more focused on specific issues as opposed to the currently available large reports that resemble telephone directories. These more focused reports will also be driven by the increased search how to link and integrate sustainability reports with financial reporting.

Mr Ligteringen estimates that in 10 years time, readers will not be looking for sustainability reports anymore, they will simple expect transparent data available in any form appropriate.