The Investor Rationale for Responsible Investment: Sustainability Reporting

As an institutional investor, Wespath Investment Management adheres to our obligation as a prudent fiduciary. As a division of the General Board of Pension and Health Benefits of The United Methodist Church, we also understand that financial transactions carry ethical implications. These two perspectives form the basis of our well-rounded investment strategy, which utilizes traditional financial metrics and also considers the impact of environmental, social and corporate governance (ESG) practices.

This paper, one of a series of Wespath research papers published at **wespath.com**, examines the relationship between shareholder value and corporate sustainability reporting.

Introduction

To produce a sustainability report, an organization will evaluate, quantify and report on the impact of its ESG practices on its business. Such disclosure of ESG policies, programs and performance allows investors to identify and evaluate potential sources of financial risks and/or opportunities within their portfolio. As shown under "The Investor Perspective," research supports our belief that ESG factors can be material to corporate financial performance.

Since 2003, we have encouraged companies in which we invest to evaluate the impact of their ESG policies and practices on the long-term sustainability of their business and to publicly report on their findings. These reports are commonly called "Sustainability Reports" or "Corporate Responsibility" reports, and are typically available on corporate websites.

The Investor Perspective

According to the Corporate Register (**www.corporateregister.com**), approximately 4,000 companies published sustainability reports in 2010, a 63% increase from just three years earlier. Nearly half of the companies are European, another 15% from North America and Asia, and the remainder from other continents.

Through the process of sustainability reporting, companies have stated they are often able to improve efficiencies and save millions of dollars in tangible areas such as:

1. Energy conservation
2. Water conservation
3. Better supply chain management
4. More efficient use of raw materials
5. Less waste

However, intangibles also play an important role in corporate finances. Strong ESG policies and practices can protect brand reputation, help recruit and retain talent, foster customer loyalty, and reduce the risk of lawsuits. In the *2009 Intel Corporate Responsibility Report*, Paul S. Otellini, president and CEO of the company, stated: “Our approach has created value not only for our stakeholders and society, but also for Intel. We have reduced costs through energy conservation investments, minimized risks by proactively working with our communities and supply chain, and enhanced our reputation as a leading corporate citizen by building trusted relationships around the world.”

The following studies and reports discuss the link between ESG factors and financial performance:

- The United Nations Environment Program Finance Initiative (UNEP FI) examined the publications of sell side research houses, asset managers and an investment consultant to determine if ESG factors affected company value. Among the findings:
    1. ESG issues are material; there is robust evidence that ESG issues affect shareholder value in both the short and long term.
    2. The impact of ESG issues on share price can be valued and quantified.
    3. Material ESG issues are becoming apparent, and their importance can vary between sectors.[1]

- In a 2010 survey of 1,500 global corporate executives, there was a strong consensus that sustainability is having — and will continue to have — a material impact on how corporate executives think and act. More than 92% of respondents said they were addressing sustainability in some way. Most were in the early stages of incorporating sustainability into their strategic planning; however, a small number are acting aggressively and reaping substantial rewards. Once companies begin to act, they tend to find more opportunity than expected, including tangible bottom-line impacts and new sources of competitive advantage.[2]

- After surveying nine major brokerage firms, such as ABN AMRO, HSBC, Deutsche Bank and Goldman Sachs, “There was agreement that environmental, social and corporate governance issues affect long-term shareholder value. In some cases those effects may be profound.”[3]

- A meta-analysis of 52 studies examining the link between corporate social performance and corporate financial performance found a positive correlation between the two. The relationship varied from modestly positive to highly positive, and carried across industries.[4]

United Methodist Instruction

In 1987, the World Commission on Environment and Development, also known as the Brundtland Commission, defined sustainability as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

Resolution 4071, *Investment Ethics*, provides the basic guidelines for all United Methodist investing. It specifically encourages the entities responsible to General Conference “to invest in corporations, companies, institutions, or funds…pursuing such targeted goals as…maintaining a commitment to sustainability so that current business practices do not detract from future viable business operations,” and “to persuade corporations to integrate responsible business practices on environmental, social, and governance issues into their operations and to be transparent in documenting these endeavors in public reports…”

United Methodism is keenly aware of the importance of stewardship and sustainability. In its very opening paragraphs (¶160), the Social Principles recognize “the responsibility of the church and its members to place a high priority on changes in economic, political, social, and technological lifestyles to support a more ecologically equitable and sustainable world leading to a higher quality of life for all of God's creation."

In ¶163D, the Principles call upon consumers to "evaluate their consumption of goods and services in the light of the need for enhanced quality of life rather than unlimited production of material goods" and to "express dissatisfaction with harmful economic, social, or ecological practices through such appropriate methods as boycott, letter writing, corporate resolution, and advertisement."

Recognizing that "corporations are responsible not only to their stockholders, but also to other stakeholders, their workers, suppliers, vendors, customers, the communities in which they do business, and for the earth, which supports them," …the Social Principles (¶163I) "support the public's right to know what impact corporations have in these various arenas…"

Resolution 4052, *Economic Justice for a New Millennium*, calls on "the general program agencies of the church and the General Board of Pension and Health Benefits to work with the Interfaith Center on Corporate Responsibility and support its *Principles for Global Corporate Responsibility*." The *Principles for Global Corporate Responsibility* attempt to establish benchmarks by which to measure corporate social responsibility "consistent with the responsibility to sustain the human community and all creation." Specifically, the Principles call for "a sustainable system of production and a more equitable system for the distribution of the economic benefits of production and environmental services."

Find Out More

If you would like more information on Wespath's investment products, services and commitment to responsible investing, please contact Derek Casteel at **1-847-866-4100** or via e-mail at **investmentinfo@wespath.com**.

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[1] Asset Management Working Group. Show Me the Money: Linking Environmental, Social and Governance Issues to Company Value, UNEP FI, Switzerland, 2006.

[2] The Business of Sustainability, MIT Sloan Management Review Special Report, http://www.mitsmr-ezine.com/busofsustainability/2009?#pg1, 2009.

[3] Brokerage House Analysts, CEO Briefing: The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing, UNEP FI, 2004.

[4] Marc Orlitsky, Frank Schmidt, and Sarah Rynes (2003). Corporate Social and Financial Performance: A meta-analysis. Organization Studies, 24 (3), 403-441.

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