Do investors care about sustainability?
Seven trends provide clues

March 2012

At a glance

More investors see a connection between corporate and community well-being.

They are using corporate sustainability reporting to enhance investment strategies.

Show investors how your sustainability initiatives link to growing shareholder value.

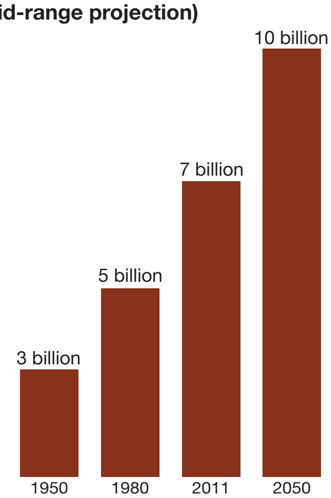
DO INVESTORS CARE ABOUT SUSTAINABILITY? CEOs aren't sure. Some find it perplexing that few questions about it are raised during quarterly conference calls or meetings with analysts and investors. But after reviewing current investor research—as well as examining trends within the investment community—we think there are reasons to look further. Here's why.

1. **Sustainability shareholder resolutions gaining traction**. In 2011, average support for environmental and social shareholder resolutions topped 20% for the first time, according to Institutional Shareholder Services. This figure is up from 18.1% in 2010 and 16.3% in 2009.[1] Moreover, shareholders are expressing interest beyond the proxy. In 2010, a Ceres survey of 44 asset owners and 46 asset managers with collective assets totaling more than $12 trillion found nearly all respondents viewed climate change as a material concern.[2] In 2011, a group of 285 major institutional investors issued a statement urging governments worldwide to adopt a binding international climate-change treaty.[3]

Investors are gaining interest in part because climate change risk is interconnected with projected changes in population and the growth of the middle class in emerging markets (Figure A). According to current forecasts, population and rise of the middle class are expected to lead to substantial demands on water, food, and energy and drive up most commodity prices (Figure B). One way companies are adapting is by taking an inventory of how they currently use natural resources. By doing so, these companies are better able to understand economic, social, and environmental risks and embed that knowledge into their overall business strategies.[4]

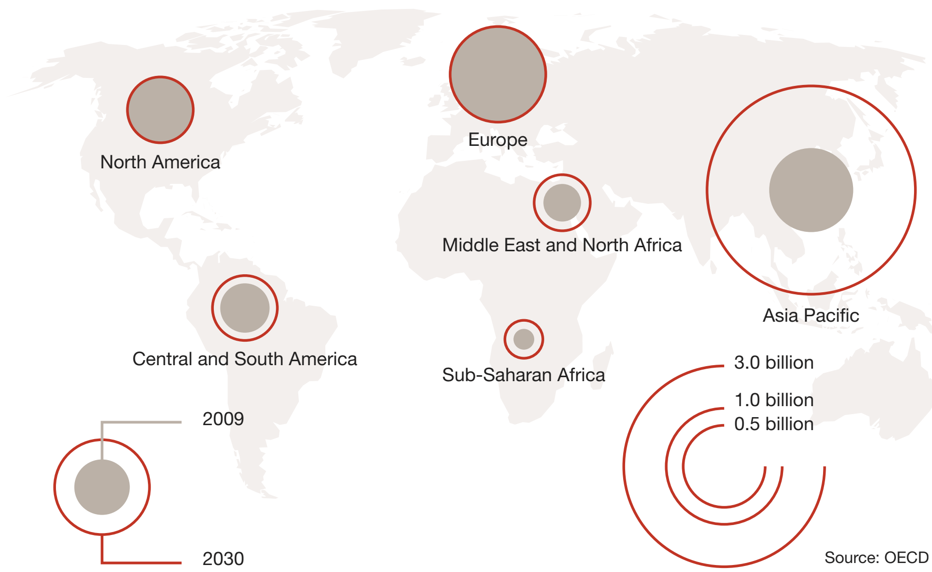
Figure A: Population growth and the rapid development of a middle class in emerging markets are expected to put heavy pressure on commodities and the environment

Estimated population of the world in 2050 (mid-range projection)



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat (2011). *World Population Prospects: The 2010 Revision*. New York: United Nations.

Global middle class, 2009 – 2030



Source: OECD

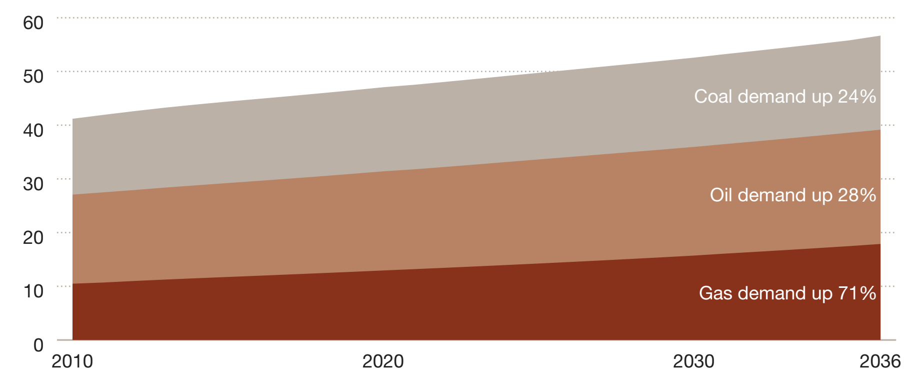
What is sustainable investment?

Assessing how financial, governance, environmental, and social risks and opportunities interact for the long-term viability of an investment.

Figure B: Companies are anticipating higher demand for energy, rising prices

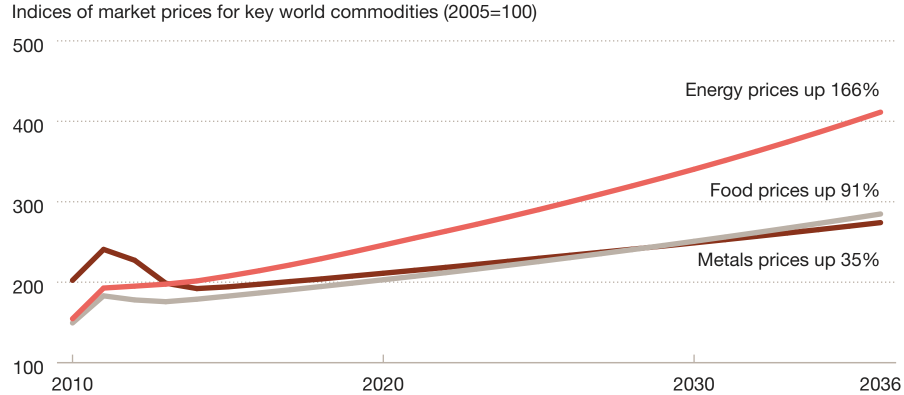
World demand for energy fuels, 2010 – 2036

Billion tons of oil equivalent



Key world commodity prices, 2010 – 2036

Indices of market prices for key world commodities (2005=100)

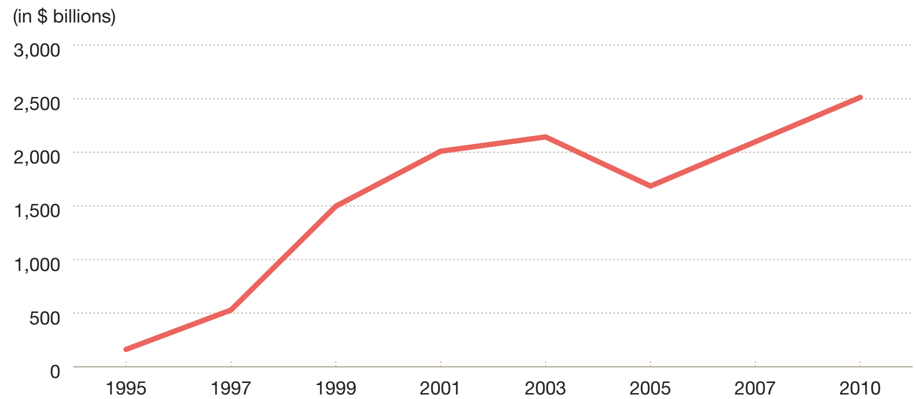


Source: Oxford Economics

2. **Steady growth in sustainable investment.** Sustainable investing in the United States has continued to grow at a faster pace than the broader universe of conventional investment assets under professional management. Nearly one out of every eight dollars under professional management in the United States today—12.2% of the $25.2 trillion in total assets under management tracked by Thomson Reuters—is involved in sustainable and responsible investing, according to the Social Investment Forum (SIF) Foundation's definition.

During the recent financial crisis, the overall universe of professionally managed assets remained roughly flat while SRI assets enjoyed healthy growth.[5]

Figure C: Sustainable investing in the United States has grown significantly in the past 15 years



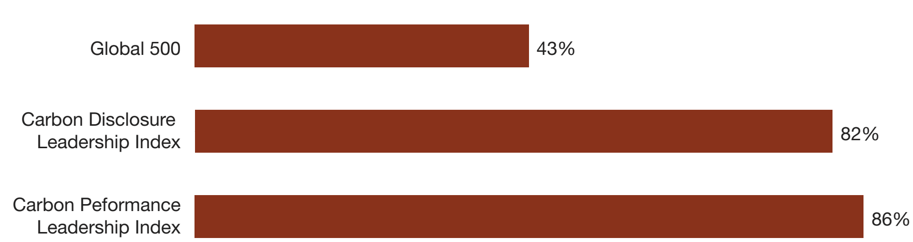
Source: Social Investment Forum

3. **Studies suggest positive relationships between environmental, social and governance factors (ESG) and financial performance.** Underlying the growth of sustainable investment is an increasing body of evidence that ESG factors can enhance investment value and/or mitigate risk. For example, the California Public Employees' Retirement System (CalPERS) engaged Mercer to examine the link between ESG issues and financial performance through existing academic and broker research. Of 36 studies Mercer reviewed through 2009, 86% show either a neutral or positive impact of ESG factors on risk and return.[6] According to the Carbon Disclosure Project's (CDP) 2011 global report, companies in its Carbon Disclosure Leadership Index (CDLI) and Carbon Performance Leadership Index (CPLI) provided approximately double the average total return of the Global 500 between January 2005 and May 2011. (These leadership indices recognize those companies with leading carbon disclosure practices and those that display strong performance related to climate protection. Total return includes interest, capital gains, dividends and distributions realized over a given period of time.)

A new Harvard Business School working paper recently affirmed this difference. It found that sustainability leaders tend to have better stock performance, lower volatility, and greater return on assets (ROA) and return on equity (ROE).[7] The authors suggest this outperformance is based on superior governance structures and better constructive engagement with stakeholders.

Figure D: Leaders in carbon disclosure and performance demonstrate strong total returns, relative to the Global 500

Total return % (US$) for Global 500 versus CDP leaders
January 2005 to May 2011



Source: Carbon Disclosure Project, Global 500 Report, 2011

4. **Financial institutions forming sustainability research departments.** The amount of potential investment dollars at stake has led large financial services firms to establish their own sustainability research departments. The Sustainable Investment Research Analyst Network (SIRAN) now supports more than 260 North American sustainable investment research analysts from more than 50 investment firms, research providers, and affiliated investor groups. These analysts use a variety of approaches to benchmark companies within their peer groups, including screening for "best in class," for example.

5. **Entry of well-funded financial information providers.** A flurry of recent acquisitions by well-funded financial information providers is making it easier to compare corporate financial and sustainability data and understand the relationship between the data. These new entrants are changing the game in sustainability research.

Thomson Reuters offers Quantitative Analytics, a tool for identifying a new range of stock signals. MSCI offers ESG Impact Monitor, which allows investors to analyze a company's social and environmental impacts and the company's ability to manage them. Bloomberg's new ESG Valuation Tool enables users to apply a financially-based methodology to assess and value the impact of ESG factors on a company's Earnings Before Interest & Tax (EBIT) performance and share price.

It's now easier to compare corporate financial and sustainability data and understand the relationship between the data.

Investors can:

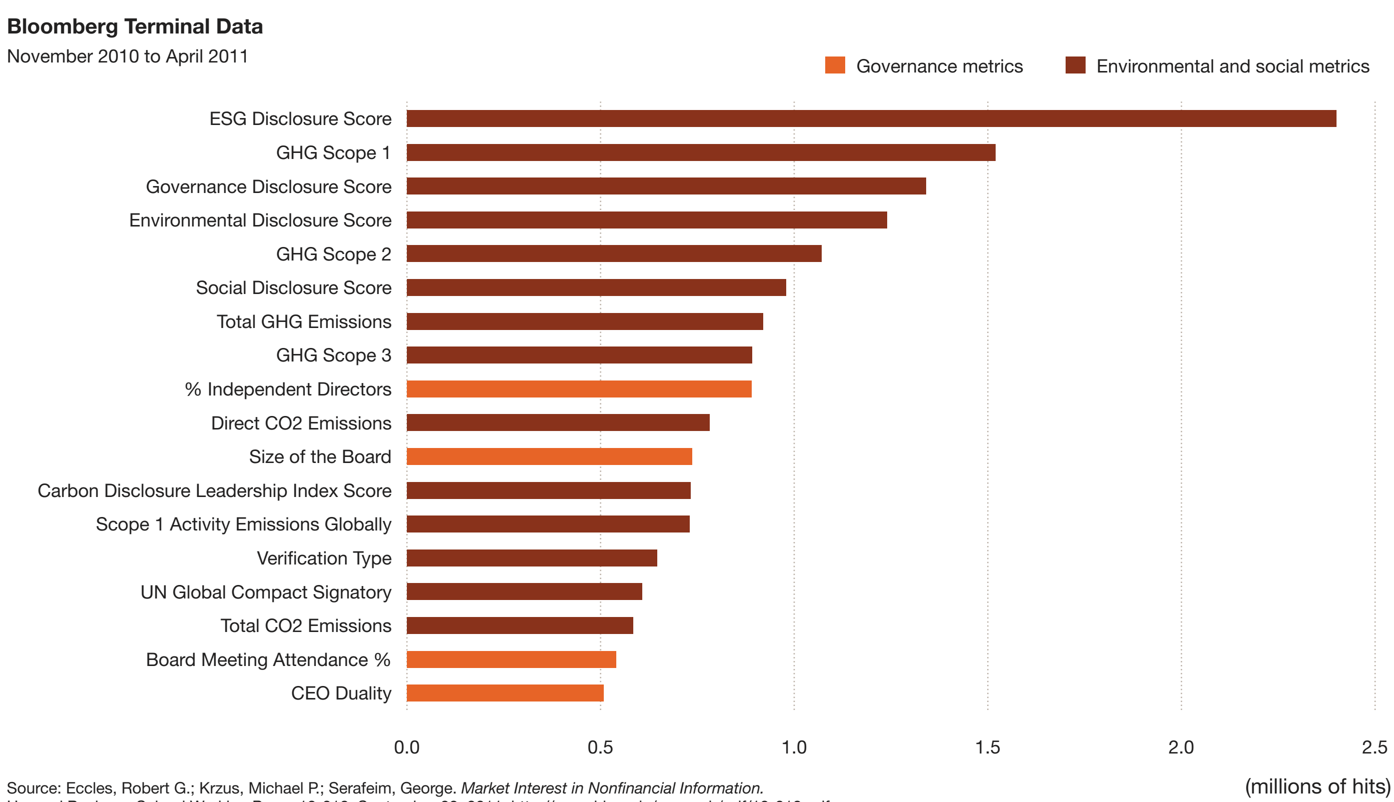
- *Analyze a company's social and environmental impacts*
- *Assess and value the impact of ESG factors on a company's EBIT performance and share price*

6. **Use of ESG data.** New research shows that investors are receptive to using ESG data. A September 2011 Harvard study, for example, relied on Bloomberg data to provide new insights into ESG data use at a level of granularity not previously available. Bloomberg allowed the study's authors to examine the web hits for each ESG data point over three bimonthly periods, beginning November 2010 and ending April 2011, totaling nearly 44 million hits.[8]

The authors found investor interest in ESG data, with sell-side firms primarily interested in greenhouse gas (GHG) emissions data and buy-side firms interested in a broad range of ESG information (Figure E).

Progressive companies are quietly differentiating themselves by upgrading their sustainability reporting processes and systems to provide high-quality, investment-grade information, which they know will be reported to investors and analysts via information providers. Longer term—as companies learn more about how to provide an integrated view of economic, environmental, and social performance—we expect an increased interest in different forms of corporate reporting that combine ESG and financial metrics.

Figure E: Over a six-month period, global interest in environmental and social metrics was higher than for governance issues



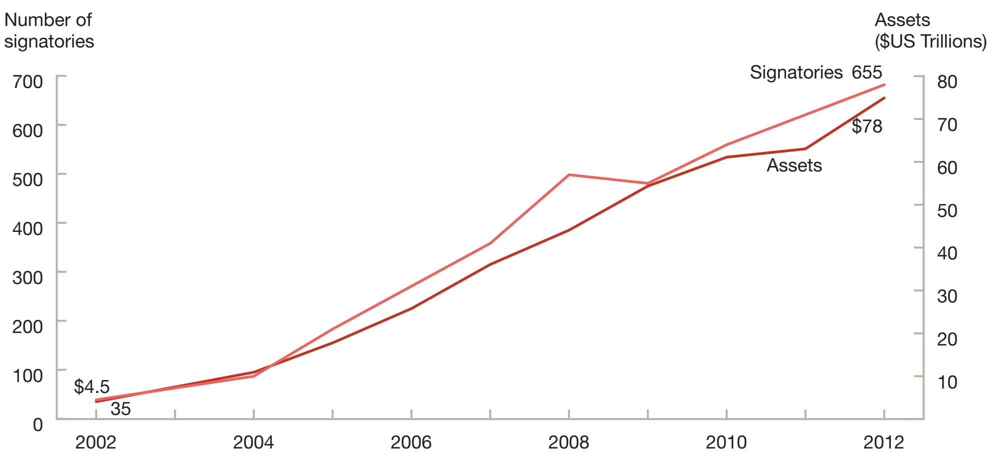
Source: Eccles, Robert G.; Krzus, Michael P.; Serafeim, George. *Market Interest in Nonfinancial Information.* Harvard Business School Working Paper 12-018, September 22, 2011. http://www.hbs.edu/research/pdf/12-018.pdf

7. Growing interest among institutional investors. In 2012, CDP is requesting climate risk disclosure on behalf of 655 institutional investors, holding US$78 trillion in assets under management. This represents an eighteen-fold increase in signatories (35) and assets ($4.5 billion) since 2002.

Cynics suggest these signatories participate simply to call attention to their “green” efforts. But the Harvard study revealed institutional investor use of ESG data, particularly among insurance firms and pension funds. According to the chart below, insurance firms had approximately 2.5 million Bloomberg ESG hits and pension funds more than 900,000 hits in a six-month window.

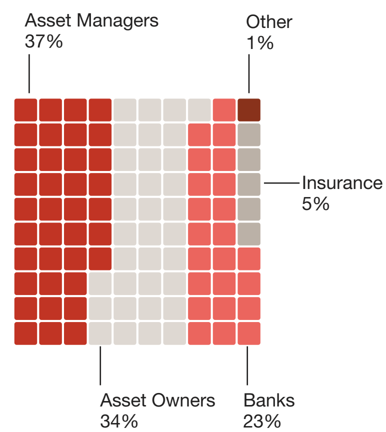
Figure F: Interest in climate change from institutional investors has grown eighteen-fold in the past decade

655 institutional investors holding US$78 trillion in assets request carbon disclosure



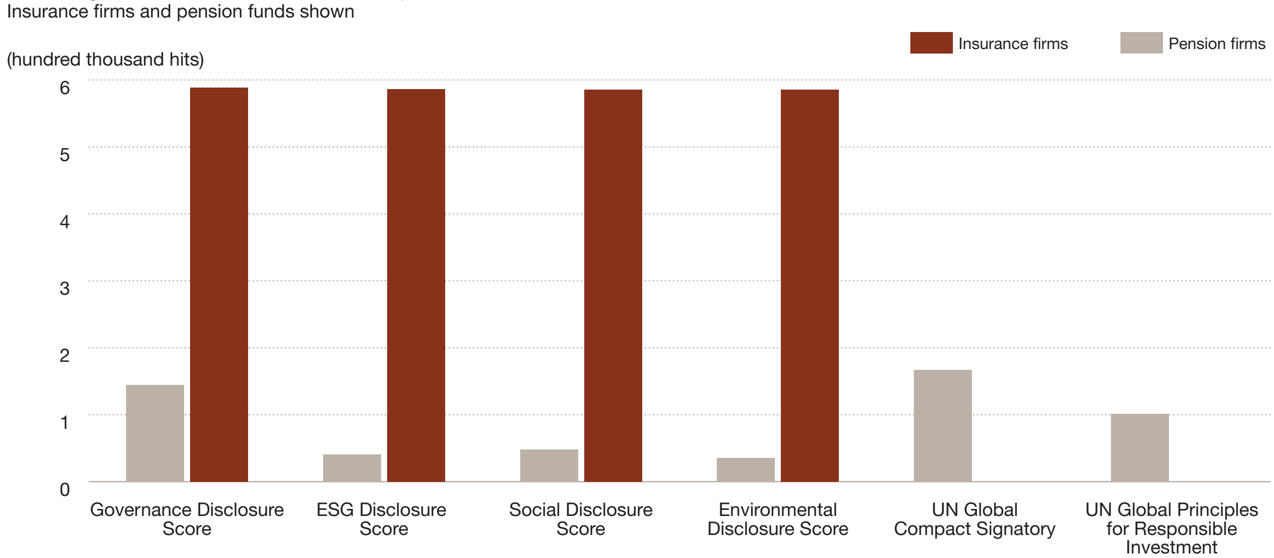
Source: Carbon Disclosure Project

CDP signatories include banks, pension funds, asset managers, insurance companies and foundations



New research shows institutional investors using ESG data from Bloomberg terminals

Bloomberg Terminal Data, November 2010 to April 2011
Insurance firms and pension funds shown



Eccles, Robert G.; Krzus, Michael P.; Serafeim, George. *Market Interest in Nonfinancial Information.* Harvard Business School Working Paper 12-018, September 22, 2011. http://www.hbs.edu/research/pdf/12-018.pdf

Investors see link between corporate and community well-being

Do investors care whether companies are responding to long-term sustainability trends? More and more, they do. Investors have begun to recognize that the social and environmental conditions in society can have a direct impact on the business operations of a company and its long-term viability. A beverage company, for example, must protect a long-term source of potable water in order to manufacture its product. A technology company must have a dependable electrical grid and affordable power sources. How a company protects the health and safety of its workers and the communities where it operates helps investors understand management's practices.

Investors care about the creation of value

The more important question may be whether sustainability investing will become a mainstream investment practice. To the extent analysts are able to explain the relationship between sustainability and stock performance and produce recommendations, the greater the likelihood that sustainability will move into the mainstream.

Many companies appear to appreciate at some level the importance of sustainability to various stakeholders, as more than 80% of the Global 500 responded to the CDP's 2011 request for carbon disclosure. Yet most businesses have struggled with how to measure and track the impact of their sustainability activities on core business metrics such as revenue growth, cost reduction, risk management and reputation. As a result, companies have difficulty explaining the benefits of a sustainable business strategy to stakeholders. In addition, corporate efforts are not communicated in terms that can be built into investor valuation models and ultimately rewarded by the market.

PwC believes these barriers can be overcome by developing the right strategy for issues that are of the highest concern; integrating practices throughout the organization that drive value from these issues; and communicating to investors how caring for these issues contributes to the bottom-line and helps the company to mitigate risk and maximize opportunities.

Notes

1 Erik Mell, "A Final Review of 2011 E&S Shareholder Proposals-Governance," ISS, January 2012.

2 Ceres, *2010 Global Investment Survey on Climate Change*, June 2011.

3 Institutional Investor's Group on Climate Change, Investor Network on Climate Risk, Investor Group on Climate Change, and UNEP Finance Initiative, 2011 *Global Investor Statement on Climate Change*, October 2011.

4 PwC, *10Minutes on Managing Water Scarcity*, February 2012.

5 Social Investment Forum Foundation, *2010 Report on Socially Responsible Investing Trends in the United States*, November 2010.

6 Mercer, *Responsible Investment's second decade: Summary report of the state of ESG integration, policy and reporting*, August 2011.

7 Eccles, Robert G.; Ioannou, Ioannis; Serafeim, George. *The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance.* Harvard Business School Working Paper 12-035, November 04, 2011. http://www.hbs.edu/research/pdf/12-035.pdf

8 Eccles, Robert G.; Krzus, Michael P.; Serafeim, George. *Market Interest in Nonfinancial Information.* Harvard Business School Working Paper 12-018, September 22, 2011. http://www.hbs.edu/research/pdf/12-018.pdf

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