With or Without You?
Investing in CSR: From Wall St. to Main St.

Graham Sinclair
sinclair.graham@gmail.com

ESG Architect and SRI Strategist Sinclair & Co. LLC
Adjunct Visiting Professor UNC Chapel Hill Kenan–Flagler Center for Sustainable Enterprise
Founder Chapter Leader, NetImpactBoston
www.kenan-flagler.unc.edu/KI/cse | elpnet.org | netimpactboston.org | siran.org

2006 = tipping point?
"Development that meets the needs of the present without compromising the ability of future generations to meet their own needs"


On Research & Analysis

- John Donne:
  '...On a huge hill
  Cragged and steepe, Truth stands, and he that will
  Reach her, about must, and about must go'

- "...true scholarship is the search for truth, and begins with an accurate assessment of human nature." David R. Young
Agenda

- Overview of Investment Value Chain
- SRI Marketplace
- Investment Management and ESG
- Critiques of SRI
- Signaling from Main St
- SRI in 2012
Takeaways

- ESG is material to "SRI" investors, and implicitly to mainstream investors, trending toward explicit. Differences between retail and institutional markets persist. Institutional shareholders becoming increasingly active, leading with climate change.
- Frameworks applied to assessing ESG performance differ. Global coverage is patchy, unreliable. Companies increasing volume of reporting CSR, but unrefined. No standardization, expensive, not material[?].
- Investment value chain has institutional friction to SRI, but wearing down on environment/climate change issues. Disconnect between what Main St. says and what Main St. invests in.
  - Where are you sending a signal?

Takeaways: Investing with ESG factors

- Incorporating ESG factors either in demand or supply side of investment value chain
  - Covers SRI [classic, faith-based], mostly retail [US], US$2.3 trillion
  - New efforts to mainstream [Responsible Investing, INCR, IGCC], mostly institutional, originally pension funds driven.
  - Mainstream shops looking for alpha, better betas, preparing for climate change context, pricing carbon
  - Increased demand for ESG supply-side research; increased number of explicit mandates referencing ESG, especially climate change.
- Mixed research on whether SRI or ESG-integrated outperforms; eco-efficiency paper suggest can identify sector specific environmental factors. [WestLB 3-factor model, small alpha].
- Company operations in 21st century social/environmental context; valuing investment seeking to capture intangibles, risks, opportunities. UBS: how much is already in the market price?
- When is SRI not SRI?
Takeaways: ESG Investment Analysis

• Incorporating ESG factors into current sector, industry and/or company coverage [UBS: Obesity, DB: Corporate Governance, Goldman Sachs: Water, WestLB: Automotive]

• Themes “sustainable investable themes” > investment ideas informed by SEE factors, from market failure, presenting LT risks to existing business models, creating new ones. Enable analysts today to identify anomalies.

• Integration
  - Driven from SRI or ESG specialist
  - Focused on “what does company ABC’s approach to sustainability identified issues inform analysis of fair value of shares”.
  - Understanding LT themes
  - Rationalize issues, identify timing and tipping points into current prices

• Lessons from European ETS CO2 mis-pricing and market in May 2006; utilities analysts rush to add knowledge of Kyoto, 2008 ETS.

Key challenges

• Converting growing awareness into action
• Provision of accurate, relevant and comparable information on which to base analysis
• Quality of analysis and links with financial performance
• Adoption by money managers into the DNA of the asset management
• Professionals capable of executing complex investment decision-making, informed advisors
• What are the unintended consequences?
Evolving Initiatives

- PRI > Principles for Responsible Investment
- EAI > Enhanced Analytics Initiative
- GRI > Global Reporting Initiative
- SIRAN > Social Investment Research Analysts Network
- INCR > Investor Network for Climate Risk
- CDP > Carbon Disclosure Project
- ICCR > Interfaith Center on Corporate Responsibility

SRI/ESG live!

J.P. Morgan Index Takes Green View

February 27, 2007

NEW YORK — J.P. Morgan Chase & Co. is launching a corporate-bond index that will take into account a company's exposure to toughening global-warming-emission rules when assigning an index weight to its bonds.

The launch of the index — called the J.P. Morgan Environmental Index—Carbon Beta index — reflects the bank's view of an intensifying effort to curb global warming will create "winners and losers," said Edward Mannix, head of investment-grade credit strategy.

The debt of FPL Group Inc. gets a higher weighting under the global-warming index than under the usual one. DTE Energy Co. gets a lower one; it burns a lot of coal. A DTE spokesman declined to comment, saying the firm wasn't familiar with the index.

URL for this article:
http://online.wsj.com/article/SB11731338993330254.html
SRI/ESG live!

- The New Greenmail
  - “Call it greenmail for a post-Kyoto world. The private-equity firms that just agreed to buy Texas utility TXU have scored something of a PR coup by getting Environmental Defense and other climate-change activists to fall in line with their purchase plans before the deal was announced. The question is what price shareholders are paying for this act of political correctness”.
  - “…the agitation of the greens may have helped bring down TXUs share price last year, so environmentalists probably did KKR and partners a big favor. There may even be a trend in the making here – environmental protesters bring down a stock, making private equity transaction look more attractive, and in return, the equity firm and its management partners buy off the greens with this or that environmental promise…we’d certainly be asking some pointed questions.”

Impact on TXU in the Market?

Impact on TXU in the Market?

Impact on TXU in the Market?

## Agenda

- Overview of Investment Value Chain
- SRI Marketplace
- Investment Management and ESG
- Critiques of SRI
- Signaling from Main St
- SRI in 2012
Imagine a World

- McKinsey & Co. study of 1,144 top global executives, 79% predicted at least some responsibility for dealing with future social and political issues would fall on corporations.
- Dozens of studies have looked for direct relationships between a company's social and environmental practices and its financial performance. So far the results are mixed, and Kiernan admits Inovest can't prove a causal link.
- That's little help to portfolio managers who must post good numbers by yearend. "The crux of the problem is that we are looking at things from the long term, but we're still under short-term review from our clients," says William H. Page, who oversees SRI for State Street Global Advisors.

ABN Amro: Business Case

Four Reasons an Accountant Advocates for Sustainability
1. New revenue opportunities
2. More productive staff, more engaged
3. Ethical, environmental, social and governance factors reduces risk to the business units
4. Help reduce costs

How each played out at ABN Amro
1. Won new commodities trading finance RFP
2. Especially 25–34 band, 6% increase in engagement
3. Vetoed participation in inline gaming IPO, later imploded.
4. Cooling at HQ, reduced costs 10%, emissions 70% p.a.

Is it scalable, replicable? Does the investment analyst value it?

Investment Value Chain

Each of you impact at least two points in chain.

- Investor contracts with Investment advisor/software
- Money Manager [MM]
  - Promises performance against benchmark, reports to investor
  - Trades securities, actively manages risk vs return

Investment involves complex, multi-faceted relationships. Advisor as gatekeeper. Where is CSR signaled?

Key Players in Investment Value Chain

- Companies
- Research organisations
- Fund managers
- Consultants
- Lawyers
- Retirement Plan
- Plan Members/You!
Agenda

- Overview of Investment Value Chain
- SRI Marketplace
- Investment Management and ESG
- Critiques of SRI
- Signaling from Main St
- SRI in 2012

Connect Back To Alumni

Weighing Social Responsibility Against Returns: which do you think is more important for endowment managers?

- Making socially responsible investments: 43%
- Making the highest possible returns: 47%
- Not sure: 10%

**Investment Priorities**

- Making investments designed to yield the highest possible returns: 70%
- Avoiding investments out of step with university’s values: tobacco/child labor: 64%
- Making socially responsible investments: enviro friendly: 44%
- Promoting diversity: gender, race, ethnic diversity in people managing fund: 36%

Source: Public Perceptions of University Endowments, Goldman Sachs Global Markets Institute Survey 2005. 306 telephone interviews were conducted from January 8 to 13, 2005.

**Driving SRI: Where are the other 45%?**

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Gen Pop</th>
<th>SRI Users</th>
<th>Interested In SRI</th>
<th>LOHAS Consumer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth</td>
<td>55.6%</td>
<td>76.1%</td>
<td>66.5%</td>
<td>59.3%</td>
</tr>
<tr>
<td>Total Return</td>
<td>47.5%</td>
<td>52.8%</td>
<td>54.9%</td>
<td>45.5%</td>
</tr>
<tr>
<td>Tax Advantages</td>
<td>41.5%</td>
<td>45.4%</td>
<td>46.6%</td>
<td>40.7%</td>
</tr>
<tr>
<td>Fair Labor Practices</td>
<td>36.9%</td>
<td>61.0%</td>
<td>50.6%</td>
<td>54.5%</td>
</tr>
<tr>
<td><strong>Good Environmental Record</strong></td>
<td>31.4%</td>
<td>55.5%</td>
<td>47.0%</td>
<td>54.2%</td>
</tr>
<tr>
<td>No Profits From Tobacco</td>
<td>20.4%</td>
<td>40.4%</td>
<td>28.2%</td>
<td>33.0%</td>
</tr>
<tr>
<td>No Profits From Alcohol</td>
<td>13.5%</td>
<td>22.9%</td>
<td>17.1%</td>
<td>20.9%</td>
</tr>
</tbody>
</table>

Investing in CSR must connect investment and ESG objectives.
Driving SRI: ELPer in the Real World

• “I remember reading about the Vanguard option a while ago, when I signed up for it, and I believe it is simply a screened "social investment" index fund”.
• “I should note that this fund was not an option with Vanguard when I started at IVY LEAGUE UNIVERSITY in 2001, but they added it as an option somewhere along the way, and I shifted 25% of my account into it.
  – This fund, as I remember, is the same as their other index funds, but without tobacco, munitions, and so forth.”
• “I don’t remember a proactive investment in alternative energy or other green companies, but I think I picked it as the best of the available choices.

Takeaway: “Hope this helps -- sounds like a great project. (My $2400 annually won’t change the world, but if 80 million Americans did the same thing.....) “


Pragmatism of investors, whether “green” or not: show me the money!
Friction against ESG in the supply chain, driven by investor.

Driving SRI: ELPer in the Real World

• “No. I’d be surprised if any traditionally-managed 401k plan offered it as an option. Ours is managed by Goldman-Sachs. All your standard growth equity, income, and bond plans”.
• “It is simply an option on the list of options. Frankly, it returns very badly and only one of our employees selected it”.

What’s Wrong With This Picture?

Signal failure: One in two in self-selected environmental leadership audience with investment choice did not have “green” nor SRI options.


Agenda

- Overview of Investment Value Chain
- SRI Marketplace
- Investment Management and ESG
- Critiques of SRI
- Signaling from Main St
- SRI in 2012
Envisioning SRI

- 1996>2001 “socially responsible investing (SRI) along with the related discipline of corporate social responsibility (CSR) have attracted worldwide attention”.
  - Strong momentum behind two movements implies “soon work their way into the mainstream of the financial, corporate worlds”.
- Precursors for major SRI and CSR initiatives 2001>2006
  - Corporate community (increased attention to mission, stakeholders and disclosure),
  - Institutional investors (increased responsibility for voting, public disclosure of social investment policies and increased intra-industry dialogue on social and corporate governance issues)
  - Financial/academic/SRI community, increased attention to education, training and the professionalization disciplines.
- 2007>2012…


Takeaways

- ESG is material to "SRI" investors, and implicitly to mainstream investors, trending toward explicit. Differences between retail and institutional markets persist. Institutional shareholders becoming increasingly active, leading with climate change.
- Frameworks applied to assessing ESG performance differ. Global coverage is patchy, unreliable. Companies increasing volume of reporting CSR, but unrefined. No standardization, expensive, not material[?].
- Investment value chain has institutional friction to SRI, but wearing down on environment/climate change issues. Disconnect between what Main St. says and what Main St. invests in.
  - Where are you sending a signal?
Further Resources

PRI.org  
UNEP.org  
socialfunds.com  
Socialinvest.org  
UKSIF.org  
Eurosif.org  
sristudies.org  
Siran.org  
Ceres.org  
Cdpproject.net  
Incr.com  
Sri-extra.blogspot.com

Your investment advisor!

With or Without You?
Investing in CSR: From Wall St. to Main St.

Graham Sinclair
sinclair.graham@gmail.com

ESG Architect and SRI Strategist Sinclair & Co. LLC  
Adjunct Visiting Professor UNC Chapel Hill Kenan–Flagler Center for Sustainable Enterprise  
Founder Chapter Leader, NetImpactBoston

www.kenan-flagler.unc.edu/KI/cse | elpnet.org | netimpactboston.org | siran.org