Principles for Responsible Investment

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PRI ACADEMIC NETWORK

RI QUARTERLY

UNLEASHING PERFORMANCE THROUGH REPORTING AND DISCLOSURE

IN THIS ISSUE

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The PRI Academic Research programme aims to engage and inform signatories and responsible investment practitioners with academic research that analyses current thinking and future trends, provides practical recommendations and is thought-provoking.

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The RI Quarterly extracts the essentials and distils key findings from research in a clear and concise manner for investment professionals. Every issue will focus on a number of papers around a theme selected by the PRI's Academic Network Steering Committee

EDITOR: Adam Aljewicz is a communications specialist and a former financial and economic journalist and editor, most recently with Dow Jones and The Wall Street Journal in London and South Africa.

INTRODUCTION

BACK

I am pleased to introduce the seventh issue of RI Quarterly: presenting key research findings to investment professionals, this time on the topic of reporting and disclosure.

The first article is an opinion piece by Danielle Chesebrough that makes a forceful argument for tangible investor presence in an active public policy process. All the signs are that investors would like to be more active, but that there are barriers ahead.

For that reason, the PRI is working with other UN institutions to find ways to overcome these barriers. The Sustainable Stock Exchanges initiative is particularly promising: my five years of fieldwork at the NYSE left me persuaded that exchanges are the key pipes of the global economy, and that shaping their policy is a promising way to shape the course of the financial system.

The second article looks at issue two of the International Integrated Reporting Council's *Creating Value* series. It covers one of the most attractive developments in responsible investment: integrated reporting.

The argument for integration is compelling. Corporations' problems with sustainability stem from: the inability of market prices to properly capture the impact of a decision; and the break-up of the decision hierarchy in the organisation. This fragmentation can be addressed by integrating sustainability reporting into mainstream financial reporting. The summarised account of the publication provided here marshals the report's impressive array of quantitative evidence about the benefits of integration.

The third article presents the findings of an important working paper that has already made an impact in academic circles and been downloaded more than 30,000 times. By giving a compelling argument for making corporate sustainability reporting mandatory, Ioannis Ioannou and George Serafeim touch on one of the holy grails of responsible investment: an active public policy to make information freely available to all market actors.

Article four looks at Stefanie Kleimeier and Michael Viehs's examination of the effects of CO_2 emissions disclosure on the cost of corporate debt. They find that companies that voluntarily reveal their CO_2 emissions paid significantly lower spreads on their bank loans. This is a powerful result, and one that should guide investors, managers and policy makers.

Michael Viehs has also been working hard with the Conference Committee on the upcoming PRI in Person and Academic Workshop. For more information and to register, please see page 15.

Daniel Beunza, Chair, *PRI Academic Network Steering Committee* and Assistant Professor of Management, *LSE*

The issue closes with Patricia Crifo, Vanina D. Forget and Sabrina Teyssier's experiment with private equity investors. Their study finds that businesses with poor ESG behaviour are likely to suffer limited access to private equity and to incur a higher cost of capital. The paper was published in the Journal of Corporate Finance and first presented at one of our own conferences, the PRI-CBERN Conference in Toronto in 2012.

I hope you enjoy reading this issue of RI Quarterly as much as we at the PRI learnt working with these fascinating papers.

FOREWORD

BACK

Corporate reporting reform is necessary to support the wider goals of financial stability and sustainable development. Given today's complex business models and operating environment, markets need high-quality information in order to allocate capital efficiently and productively.

Take the US$500 billion annual gap in infrastructure investment worldwide identified by Standard & Poor's: investors will need information that goes beyond the financials to commit to making the long-term investment decisions required for a solution.
Integrated reporting can help businesses meet these investor needs. It gives them vital insight into business strategy, performance, governance and prospects. Research indicates that investors use an increasing range of information when making investment decisions – information that has not typically appeared in traditional annual reports.

Investors come in various shapes and forms, and there will be some who are more natural users of integrated reports, and the wider sets of information they offer. However, investors are playing an increasingly substantial role in driving corporate governance reform, accountability and transparency. The advent of investor stewardship codes is providing a helpful pull in this direction.

Integrated reporting is the friend of movements seeking to align corporate reporting with long-term economic performance and sustainable development. This can happen through dialogue between investors and companies, based on a wider view of strategy and a plan to create value over time. The IIRC, in collaboration with the PRI, produced *Creating Value: Value to investors*, which examines this in further detail, drawing on evidence and commentary in the market to explain why integrated reporting is relevant to key capital markets participants, and what benefits they could gain from its widespread adoption.

The work of the PRI in building the bridge from reporting to investment decisions, and mobilising investors towards long-term value creation, is a vital component in creating the conditions for successful corporate reporting reform.

Neil Stevenson

Neil Stevenson
Managing Director, Global Implementation,
International Integrated Reporting Council

WHY INVESTOR PARTICIPATION IN PUBLIC POLICY IS ESSENTIAL FOR SUSTAINABLE MARKETS

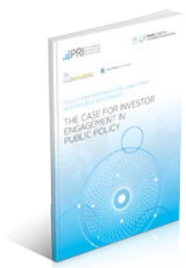
BACK

Effective public policy aligns the interests of the financial markets and society to drive sustainable development. It requires long-term vision and the full participation of all market participants, most notably investors and investee companies, because it directly and indirectly impacts investors' ability to deliver long-term, sustainable returns. Shaping what that policy looks like is therefore a natural and necessary extension of an investor's fiduciary duty to protect the interests of its beneficiaries. Influencing the frameworks that shape the entire marketplace is an effective complement to engaging with individual companies.

ENGAGEMENT

Policy engagement cuts across governmental bodies and international boundaries: as such the PRI is working hard to bring together signatories, policy makers and regulators. In September 2013 it established a policy work stream to address barriers to the development of a sustainable financial system.

In mid-2014, the PRI published a discussion paper on long-term mandates, building on existing research such as the International Corporate Governance Network's (ICGN) model mandate.



In November 2014, the PRI launched its first public policy report , guiding investors and policy makers on investor engagement in the process and proposing a five-step approach to better integrate investor perspectives on ESG factors.

It was based on a review of the experiences and lessons learned from five case studies of investors engaging in the policy-making process. Investors and policy makers were interviewed to understand the origins and motivations of their policy interventions, the engagement process, the influence of investors on the policy process, the lessons learned and, where available, the outcomes achieved.

CHALLENGES

Ten years ago, international law firm Freshfields published its report on fiduciary duty and its implications for integrating ESG issues into institutional investment. It argued that "integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions".

Nearly 1,400 signatories have committed to the PRI's six principles, demonstrating investors' broad recognition of this view of fiduciary duty. Many investors have made positive steps to incorporate ESG issues as part of their fiduciary duties, yet many PRI signatories are still not actively engaged with policy makers. That needs to change.

The 2014 PRI Reporting Framework revealed that, of 814 investor signatories, only 332 (40%) indicated that they, individually or in collaboration with others, had conducted dialogue with policy makers or standard setters in support of long-term investment in the previous year. This is despite 76% of respondents to a January 2014 PRI signatory survey saying that the PRI has a role to play in influencing public policy with regard to long-term investment, and 92% saying that the PRI should address the obstacles to sustainable financial markets that lie within market cultures, structures and regulations.

Investors' uncertainty may be rooted in a lack of understanding about how to influence the policy process, concerns

AUTHOR

Danielle Chesebrough

about the costs and timeframes involved in public policy engagement, or scepticism about whether public policy engagement can make a difference.

The PRI is working with the United Nations Environment Programme Finance Initiative (UNEP FI), the United Nations Conference on Trade and Development (UNCTAD) and the UN Global Compact to better understand why investors are not systematically integrating ESG as part of their fiduciary duty, and is compiling a report (to be launched September 2015) that will suggest practical actions for institutional investors and policy makers to overcome these barriers.

TRANSPARENCY

Establishing greater transparency in the financial system is essential to promoting sustainable development. Transparency helps capital markets actors identify risks and opportunities and improve dialogue between parties. The PRI, through its partnership with UNEP FI, UNCTAD and the UN Global Compact, is working to improve transparency through the Sustainable Stock Exchanges (SSE) initiative. Since 2009, PRI signatories have been engaging stock exchanges and their regulators to explore ways to improve global disclosure on ESG issues.

While challenges remain, over the past decade a credible body of long-term investors has emerged, seeking policy change that sets the rules of the

THE PRI IS CALLING ON ALL SIGNATORIES TO JOIN THE SSE INITIATIVE TO ENHANCE TRANSPARENCY IN ALL MARKETS

FIND OUT MORE

game in favour of sustainable value creation. These investors support policy measures that strengthen ESG integration, strengthen the stability and integrity of the finance sector, and deliver wider economic benefits. These goals align with the needs and interests of policy makers interested in long-term economic growth and sustainable development.

There is growing evidence that long-term investors can play a decisive role in delivering important policy changes, and policy makers need to hear from investors about how ESG issues affect the wider economy. If we are going to create a truly sustainable capital market, investor engagement in public policy is essential.

THE GROUNDSWELL OF SUPPORT TO BRING INTEGRATED REPORTING INTO THE MAINSTREAM

BACK

FULL REPORT

[Creating value – value to Investors]

AUTHOR

International Integrated Reporting Council (IIRC)

Since the global financial crisis in 2008, there has been a growing emphasis on the role of the investor as a steward or custodian of beneficiaries' capital, which in turn has meant investors placing greater emphasis on companies sharing more about their long-term strategies.

Investors increasingly want to ensure that the companies they invest in are financially stable and developing sustainably; they want a better understanding of a company's decision-making process to see how the strategy being pursued creates value over time.

Integrated reporting, or integrating non-financial information into traditional corporate reporting, is at the forefront of that vision, as more and better quality information could prevent a similar economic meltdown in the future. An integrated report concisely communicates how an organisation's strategy, governance, performance and prospects can create value in the short, medium and long-term.

Issue two of the International Integrated Reporting Council's (IIRC) *Creating Value* series, produced in collaboration with the PRI, outlines the move towards greater transparency and the arguments for implementing integrated reporting from major asset owners, auditors, regulators and academics.

"Integrated reporting aims to present non-financial information in ways that help understanding of performance potential."

Paul Druckman, CEO of the International Integrated Reporting Council (IIRC)

THE CASE FOR INTEGRATED REPORTING

PwC research of investment professionals from around the world found strong demand for operational as well as financial KPIs, and 87% of those surveyed said clear links between a company's strategic goals, risks, KPIs and financial statements help their analysis.

Colonial First State Global Asset Management (CFSGAM), one of the largest fund managers in Australia, says that integrated reporting helps it encourage better corporate performance, through proxy voting and engagement, on a range of ESG topics and on issues that could affect a company's social license to operate.

"More scrutiny from our key clients and stakeholders will flow through the investment chain and we may ask companies that we're putting those beneficiaries' capital into more about their activities than perhaps we've ever done before," says Pablo Berrutti, Head of Responsible Investment Asia Pacific at CFSGAM.

As scrutiny increases around their role, investors are also looking for new ways to report on their own activities and impact.

The Australian Institute of Superannuation Trustees (AIST) and the Australia Council of Superannuation Investors launched the IR Pension Fund Network in 2014 (in conjunction with the IIRC), which helps Australian super and pension funds enhance their reporting by sharing experiences with their international peers. The funds see integrated reporting as a tool to help them compete for privatised government assets and look for new infrastructure investment opportunities across the world.

Eva Scheerlinck, Executive Manager for Governance at AIST, told The Australian: "[The IR Pension Fund Network] provides funds with an opportunity to build a picture of their infrastructure investments – to highlight, for example, their environmental footprint, labour outcomes, social impact, etc. There are jurisdictions all over the world looking for Australian super fund involvement in their infrastructure projects. Integrated reporting allows firms to talk about the real value they bring, and not just about the dollars."

In 2013, the Association of Chartered Certified Accountants (ACCA) published a report that revealed a strong appetite for integrated reporting. More than 90% of investors polled for the report thought it would be "valuable for companies to combine financial and non-financial information into an integrated reporting model".

Investors identified the main benefit as being an "enhanced understanding of the long-term outlook of a company". More than two out of five investors believed that integrated reporting would provide a better explanation of the link between sustainability and long-term corporate performance, and a similar number thought it would provide greater information on how long-term risks, such as climate change, could affect a company's business model.

Guy Jubb from Standard Life Investments, says in ACCA's report: "A company's social responsibility and sustainability efforts are integral to the longer-term wealth and health of the company and reputation. Integrated reporting would be a big help here – identifying asset categories that are not captured in current reporting and the value aspects of the company, and providing a degree of accountability as well."

The link to long-termism was examined in a report from Harvard Business School, which found that, based on a sample of 1,066 US companies practicing degrees of integrated reporting, "more IR is associated with a more long-term investor base, defined as the difference in the percentage of shares held by dedicated and transient investors".

Amongst the regulators to have supported the effort is Japan's Financial Services Authority, which published a draft of Principles for Responsible Institutional Investors – Japan's Stewardship Code in 2013, setting out seven principles on a comply or explain basis "to promote sustainable growth of companies through investment and dialogue".

In Singapore, developments are closely linked with the ambitions of the Ministry of Finance to, in the words of Singapore Accountancy Commission Chairman Michael Lim, "transform Singapore into a leading global accounting hub for the Asia Pacific region by 2020". Dr Ernest Kan, Chairman of the Institute of Singapore Chartered Accountants IR Steering Committee, has stated that "integrated reporting is the future of corporate reporting".

THE ROLE OF STOCK EXCHANGES

Stock exchanges play a unique role in capital allocation, and have a mandate to promote good corporate governance and market stability to encourage investor participation. Good corporate reporting is central to that.

The Sustainable Stock Exchanges (SSE) initiative, co-convened by the PRI, UN Global Compact, UNEP-FI and UNCTAD in 2009, works with twenty exchanges committed to promoting long-term, sustainable investment and improving ESG disclosure and performance among companies listed on their exchanges.

To bring this commitment to action, the SSE is creating a *Model guidance for companies on reporting ESG information to investors* that exchanges globally can use as a baseline to create their own guide on reporting. It is doing this in collaboration with an advisory group (chaired by the London Stock Exchange), which counts 10 exchanges, as well as a number of investors, companies, academics and other experts, including the IIRC, as participants.

The SSE initiative believes that if all stock exchanges globally issued guidance to their issuers on reporting ESG issues, there would be a major shift toward greater transparency. As well as through collaboration with the SSE initiative, individual stock exchanges are finding ways to support the need for improved communication of ESG information between companies and investors.

Germany's Deutsche Börse was the first stock exchange to sign up to the IIRC's Pilot Programme to trial their IR Framework, citing the need to enhance trust between companies and investors. In Malaysia, the Securities Commission, together with professional bodies and other stakeholders, is exploring avenues to enhance the quality of information available to the capital markets, while in the US, NASDAQ's Vice Chairman, Meyer S Frucher says "the philosophies underpinning integrated reporting are very much aligned with our own".

In South Africa, a requirement to produce an integrated report formed part of the "King III" Corporate Governance Code, and was incorporated into the Johannesburg Stock Exchange listing rules in 2010. South Africa's Integrated Reporting Committee has expressed support for the IIRC's IR Framework and said it will converge practice in South Africa with the principles the framework sets out.

Research by PwC looking at the impact of integrated reporting in South Africa found that investors were benefiting from clearer understanding of the risks companies faced. Value Creation; The journey continues – A survey of JSE Top 40 companies' integrated reports, found that: "Investors have specifically identified clear reporting of the connection between the business strategy, performance and prospects as a benefit. In addition, investors focus on the disclosures provided around key risks and opportunities faced by the business and how its governance processes address these. Ultimately, better reporting leads to a reduction in the cost of capital."

REACHING THE MAINSTREAM

The *Creating Value* report concedes that not all investors follow investment philosophies that incline them to a long-term, value creation investment approach. Nevertheless, given the global debate about the dangers of short-termism in financial markets and the importance of investor stewardship, it suggests that integrated reporting is relevant to all investors – even if it may be more immediately relevant to some than others.

As integrated reporting becomes more widely adopted around the world, its impact may change the landscape in which investors of all types operate.

THE CONSEQUENCES OF MANDATORY CORPORATE SUSTAINABILITY REPORTING

BACK

Governments, regulators and stock exchanges worldwide are increasingly introducing compulsory disclosure requirements on companies in respect of sustainability information.

In this study, Ioannis Ioannou (Assistant Professor of Strategy and Entrepreneurship at London Business School) and George Serafeim (Jakurski Family Associate Professor of Business Administration at Harvard Business School) examine the effect of mandatory sustainability reporting by studying the disclosures and market valuation of companies in China, Denmark, Malaysia and South Africa immediately before, during and after the introduction of compulsory reporting legislation.

Their findings suggest that, contrary to popular belief that an increase in disclosure regulation imposes significant costs on companies and, therefore, has a negative impact on shareholders, the reality is that improved disclosure creates value for companies, not destroys it.

THE STUDY

The authors compared the levels of disclosure by companies in the four countries over the two years prior to, and the two years following, the introduction of mandatory reporting on environmental, social and governance (ESG) issues. They then mapped this against the valuation of the companies over the same period, using Tobin's Q (a measure of stock valuation that divides the market value of a company by the replacement value of a company's assets).

By comparing the results with separate control groups of US and worldwide companies, the authors found that mandatory sustainability reporting:

- significantly increases the level of ESG disclosure, even if regulations are on a comply or explain basis;
- increases the likelihood that companies will get their ESG information independently verified;
- increases the probability that companies will voluntarily adopt ESG reporting guidelines;
- improves the valuation for companies that respond to the regulation by increasing ESG disclosure.

> "[We] did not find any evidence that, on average, the disclosure regulations adversely affected shareholders."

Using Bloomberg ESG survey data, the authors identified a sample group of 317 companies across the four countries, with an aggregate market capitalisation of US$2,820 billion. Taking account of company size, profitability (return on assets), leverage (total liabilities over total assets), market expectations about growth opportunities (Tobin's Q), the level of ESG disclosure and industry membership (financial vs. non-financial sectors), they compared against a control group before and after the introduction of disclosure regulation.

STRONG RESPONSES

Even though the regulations often allowed companies, via comply or explain clauses, to choose not to make greater disclosure, there was a 30%-50% average increase in ESG disclosure as a result of the regulations being introduced (albeit from a low starting base). The greatest increase came in the first year of the regulations coming into force. All three types of disclosure – environmental, social and governance – increased.

Following regulation, companies are significantly more likely to get their disclosures verified (assured) by an external reviewer and adopt the reporting guidelines issued by the Global Reporting Initiative, irrespective of whether regulations instructed them to do so. This shows that companies not only increase disclosure following regulatory change, but also voluntarily look to improve the credibility and comparability of those disclosures.

The authors argue that companies deciding to incur the costs of external verification, even when not prescribed to do so "are more effective in signaling to stakeholders their commitment to sustainability and, therefore, in distinguishing themselves from other firms that may be green-washing".

Whilst there was an absolute increase in disclosure across the companies studied, those with already high levels of disclosure were more likely

FULL PAPER

[The consequences of mandatory corporate sustainability reporting: evidence from four countries (2015).]

AUTHORS

Ioannis Ioannou

George Serafeim

to seek independent verification or adopt reporting guidelines. The authors believe this to be driven by: a commitment to transparency and a desire to distinguish themselves from others once all companies are forced to disclose; and lower cost as they already have experience with ESG reporting so have systems for collecting and collating data already in place.

LEADERS AND LAGGARDS

The level of ESG disclosure prior to regulation varied widely, and the way companies responded when regulation came into effect differed between the three types of disclosure (environmental, social and governance).

Leaders in environmental disclosure further widened the gap over their rivals after regulation. Leaders in social disclosure maintained the existing gap over laggards. Laggards in governance disclosure increased significantly to catch up with the leaders.

This is likely because governance data is easier and cheaper to collect and release. For example, while information on board or compensation levels is readily available, information on environmental impact or employee metrics is more difficult to obtain.

The authors found significant results to indicate an increase in value (measured by Tobin's Q) for companies that increased disclosure following the regulation.

“By increasing disclosure and potentially affecting ESG management practices, the sustainability disclosure regulation generated long-run benefits for companies that responded by increasing disclosure”.

There is a stronger association with an increase in value for those companies with a lower level of disclosure prior to the regulation than their counterparts that already had high levels of ESG disclosure. This suggests the net benefit from additional ESG disclosure diminishes. However, this is not an excuse for complacency as companies were found to still be disclosing below the levels at which the costs would outweigh the benefits.

WHERE NEXT?

This paper paves the way for research into understanding how companies change resource allocations and investment decisions as a response to changes in disclosure regulations. While disclosure regulations in some cases increase the supply of such non-financial metrics, we still know little about how they affect the demand across different stakeholders.

CO_2 DISCLOSURE CUTS THE COST OF DEBT

BACK

FULL REPORT

[Carbon disclosure, emission levels, and the cost of debt](#)

AUTHORS

Stefanie Kleimeier

Michael Viehs

"By matching the lead arrangers to CDP's signatories, we were able to identify those loans that were arranged by an environmentally concerned investor. Our dataset provided us with a unique opportunity to directly observe the presence of environmentally concerned investors on the loan and then match it to the environmental performance of a specific borrower."

Energy, the lifeblood of any business, is a considerable cost, but being more transparent about emissions data could be a way for businesses to reduce some of that cost and create value for shareholders.

In Carbon disclosure, emission levels, and the cost of debt, Stefanie Kleimeier from Maastricht University and Michael Viehs from Oxford University examine the effects of voluntary CO_2 emissions disclosure, and actual emission levels, on the cost of corporate debt.

The authors found that companies choosing to voluntarily reveal their CO_2 emissions paid significantly lower spreads on their bank loans, and that higher actual emissions (adjusted for company size and compared to average emissions of the industry) significantly increased loan spreads when a signatory to the CDP (formerly known as the Carbon Disclosure Project) acted as lead arranger.

A UNIQUE STUDY

This research is unique because the authors studied actual CO_2 levels rather than indirect measures of environmental performance based on sustainability ratings. It also used a global sample of almost 4,000 organisations in 87 countries, whereas previous studies have focused mainly on the US market.

The data came from two main sources:

- CDP, a voluntary reporting framework with more than 822 signatories boasting a combined asset base of more than US$95 trillion. CDP uses information disclosure, including CO_2 emissions data, to improve the management of environmental risk.
- Dealscan, a Thomson Reuters LPC database containing information about bilateral and syndicated loans signed since 1987 by private and public borrowers worldwide. Published data includes the spreads on corporate loans and the identity of the loan's lead arrangers.

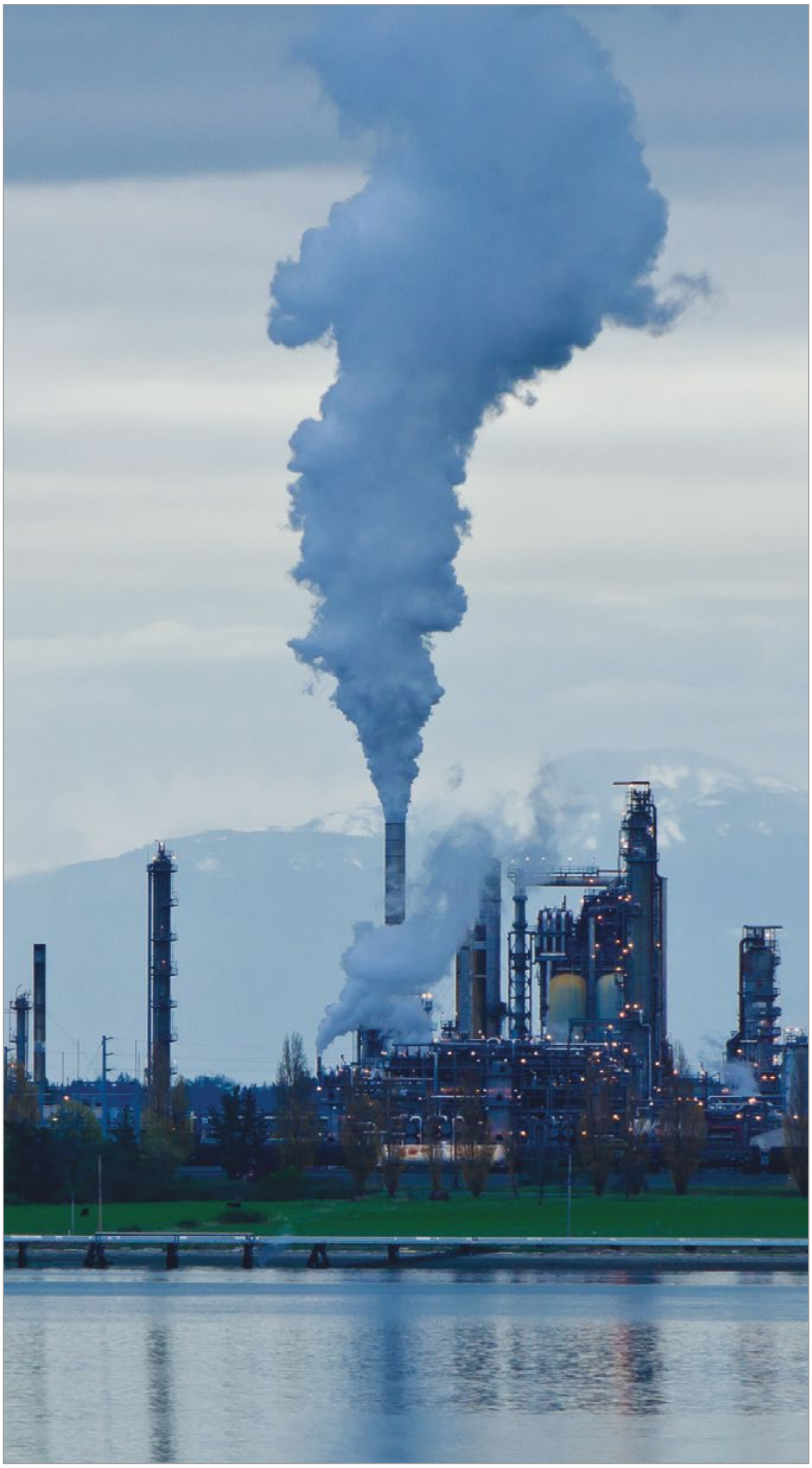
The authors classified any company that was a signatory to the CDP as "environmentally concerned". They then looked at the level of disclosure made by those companies to see if there was any correlation with the loan spreads on their corporate debt. They also studied the spread on loans where the lead arrangers themselves were signatories to the CDP, and therefore also classed as "environmentally concerned".

SAVING MONEY

The study found a significant difference in loan spreads between companies that completed the CDP questionnaire and disclosed CO_2 emissions and those that refused. Based on an average loan size in the sample of US$449 million, and an average spread of 250 basis points (bps) above Libor, the cost for an average company was US$11.2 million per year. Companies that answered the CDP questionnaire and, therefore, disclosed their CO_2 emissions, saved an average of US$1.5 million per year in interest costs.

When looking at the actual level of CO_2 emissions, the authors found a significant effect on loan spreads when the loan's lead arranger was environmentally concerned. Based on the same sample data, a 1% increase in CO_2 emissions led to an average increase in interest costs of approximately US$1.3 million per year.

"If CDP signatories are amongst the lead arrangers for loans to high-polluting companies, those companies have to pay significantly higher loan spreads, which can be thought of as being a 'reputational risk premium'."



BEYOND ETHICS

These results show that the decision to disclose CO_2 emissions data is not just an ethical one – it's a financial one, with companies that choose transparency making substantial interest savings on their corporate loans. The study also shows the impact environmentally concerned lenders acting as lead arrangers are having on the market, imposing risk premiums and pushing up loan spreads for high-polluting companies.

THE PRICE OF ESG DISCLOSURE: AN EXPERIMENT WITH PRIVATE EQUITY INVESTORS

BACK

In this experimental study ,Patricia Crifo, Vanina D. Forget and Sabrina Teyssier examine how disclosing good or bad environmental, social and governance (ESG) corporate behaviour is perceived by investors. It found that businesses with poor ESG behaviour are likely to suffer limited access to private equity, and incur a higher cost of capital, which could have implications for a company's fiduciary duty.

The study tested how private equity investors react to good or bad ESG disclosure and quantified the effect of their reactions on their likelihood to invest and their valuation of the company.

> "Improving environmental, social and governance practices could allow entrepreneurs to protect their firm price and access to private equity capital."

THE EXPERIMENT

Thirty-three French private equity investors (venture capital and buy-out) were given case studies of fictitious investment opportunities to assess: a large restaurant chain, a packaging provider to the agrifood industry and a producer and retailer of electronic components to the transport and aerospace industries. Each investor valued two of the three companies and said whether they would invest.

Four layers of additional information were then progressively provided – in particular about ESG practices. After each disclosure, investors were asked if the new information had altered their valuation or their decision on whether to invest.

In total 330 company valuations and 330 investment decisions were gathered, as well as substantial qualitative data. For each case study, the authors also broke down policies into those considered central to a company's core business (hard) or peripheral (soft), and measured the impact of each and the cumulative impact of both.

A soft practice, not core to the business and not needing many resources, could be saving energy at the head office building. A hard practice could be reducing toxic waste in the production process – requiring substantial resources and input of managerial time.

CREATING OR DESTROYING VALUE?

The results show that knowing about good ESG policies increases valuations, but by just 2-5%, whereas knowing about bad ESG policies lowers valuations by 10-15%.

For good practices, there was no significant difference in the change in valuations whether the ESG policies were hard or soft. However, when considering bad practices, disclosure of hard or soft practices depressed valuations significantly. Soft disclosures reduced valuations by approximately 3-5% and hard disclosures by approximately 8-10%.

THE INVESTMENT DECISION

Good ESG practices seem to have little effect on investment decisions, with the exception of environmental policies, which drove a 10% rise in decisions to invest. The disclosure of bad ESG practices, however, reduced the likelihood of investment 30%-50%, predominantly driven by hard factors.

Poor governance practices, either soft or hard, significantly drove down the number of investors wishing to invest. Perhaps this is unsurprising given that private equity stakeholders are usually deeply involved in governance when they do not have complete control of the board.

WHERE DO WE GO FROM HERE?

The experiment shows that when it comes to ESG performance, companies have more to lose from being bad than to gain from being good. Therefore, disclosing good ESG performance can be used as a defensive strategy, to protect company value and access to equity funding.

FULL REPORT

The price of environmental, social and governance practice disclosure: An experiment with professional private equity investors (2013)

AUTHORS

Patricia Crifo

Vanina D. Forget

Sabrina Teyssier

"Whereas good governance might not be paid for during the acquisition stage because it is expected, a firm poorly governed might be a risk well understood and to which investors strongly react."

Private equity investors are showing increasing demand for ESG information and, as they incorporate data into their own models, it is likely that companies seeking finance will need to more accurately and quantitatively demonstrate their ESG behaviour in future. If all investors demand greater ESG disclosure, the true risk and reward of each investment opportunity will be more transparent and can be priced accordingly.

In the meantime, the ability to properly evaluate the ESG performance of a target company will increasingly be a negotiating tool in the acquisition stages of a deal and, therefore, a potential lever to increase the profitability of any investment. However, there may be some way to go before the industry achieves this level of specialism.

PRI IN PERSON AND THE PRI ACADEMIC WORKSHOP 2015

BACK

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FROM AWARENESS TO IMPACT: MECHANISMS OF CHANGE IN RESPONSIBLE INVESTMENT

The Academic Network Conference will be part of PRI in Person for the first time, with a full stream dedicated to panel discussions of innovative academic research. The conference, on 8-10 September at ICC ExCeL London, will enable academics and investors to engage, learn and discuss the latest insights, and to network.

The PRI is proud to collaborate with The Systemic Risk Centre, based at the London School of Economics and Political Science for the PRI Academic Workshop. This additional event on 11 September will offer investors and academics sessions examining original academic papers in a more intimate, community setting.

THE SYCOMORE AND PRI PRIZE FOR THE MOST OUTSTANDING RESEARCH IN RESPONSIBLE INVESTMENT

Both PRI in Person and the Academic Workshop will highlight selected research from the call for papers, and this year there are three prize categories: most outstanding qualitative paper; most outstanding quantitative paper and the best paper by a student.

Supported by:

SYCOMORE ASSET MANAGEMENT

The theme is moving from awareness to impact, focusing on mechanisms that effect change and exert influence within organisations and in financial markets.

The misalignment of interests and incentives, a general loss of trust in financial institutions and the ongoing allocation of capital to businesses that may prove unsustainable over the longer term continues to undermine value creation for asset owners and their ultimate beneficiaries. These market failures and inefficiencies cannot be addressed by investors or institutions acting alone.

Martin Skancke Chair, PRI Advisory Council

PRI in Person

Don't miss the opportunity to participate in the largest PRI in Person yet.

Learn | Network | Collaborate

+800 DELEGATES

+40 PANELS

We will examine the following:

ESG INTEGRATION

- How do organisations integrate ESG?
- What are the barriers and enablers of ESG integration in the investment value chain? How is this communicated within organisations?
- The outcome of ESG integration – does it make a difference?

LONG-TERM INVESTMENT

- Market issues and structural inefficiencies - how can the bar be raised for the investment community as a whole rather than being focused on picking winners?
- How to address barriers institutional investors and policy makers face integrating ESG as part of their fiduciary duty
- Behavioural finance and investment biases
- Sovereign debt and ESG criteria

ESG ENGAGEMENT

- What approach works best for engagement, individual or collaborative?
- What are the barriers to acting in concert and how can they be addressed?
- The impact of engagement

PRI DATA – ACCESS OPPORTUNITIES FOR ACADEMICS

The PRI's Principle Six commits all signatories to report on activities and progress towards implementing the principles. This dataset is available to academics undertaking research on responsible investment.

The PRI Reporting Framework seeks to create a common language around responsible investment, and encourage more structured dialogue between asset owners, investment managers and others in the investment chain. By the end of June 2015, over 900 RI Transparency Reports from the latest reporting cycle will be freely available on PRI's website, containing detailed information on how signatories approach responsible investment.

Good reporting supports investment decision-making and is crucial for promotion and acceptance of responsible investment.

Please contact Alyssa Heath, Reporting & Assessment Senior Manager, Data Analysis and Management for more information by emailing alyssa.heath@unpri.org.

We believe that the future of responsible asset management will be driven by innovative ideas. As a responsible company we feel that our duty is to spread thinking that will shape new models, build new perspectives, shift paradigms. Let's all support academic research -- let's reinvent the investing world of tomorrow.

Christine Kolb, Founding Partner, Sycomore Asset Management

FINANCIAL PERFORMANCE

- How is high performance achieved?
- How do organisations do well in responsible investment for their beneficiaries and other stakeholders?
- Risk management and competitiveness

ESG IMPACT

- How to measure impact
- Linkages between investment and its impact
- The intention of investors and the thinking behind their investment decisions

Please contact Nikola Sobot, Head of Partnerships, for information on sponsorship opportunities by emailing: nikola.sobot@unpri.org

Visit our website to find out about research events around the world, such as our regulation and effective governance strategies debate at Copenhagen Business School on 16 June 2015 around the TBLI Conference, and a research, innovation and stewardship event on 25 June in New York. http://www.unpri.org/events/

The next issue of RI Quarterly will be the conference special, featuring the winning research papers and highlights from PRI in Person and the Academic Workshop.

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP Finance Initiative
Changing finance, financing change

UN Global Compact

Launched in 2000, the United Nations Global Compact is a both a policy platform and a practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact