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Sustainability Continues to Grow in Prominence in 2012

Corporate sustainability strategies and annual public disclosure helps promote transparency and enables companies to identify and address key issues of stakeholder concern, bolstering both accountability and profitability. A growing number of investors are viewing a company's sustainability and climate change performance as a proxy for the overall quality of its risk and opportunity management systems. This issue brief highlights the results of the Carbon Disclosure Project (CDP) and Dow Jones Sustainability Index (DJSI) surveys, while offering some background on the key drivers and trends around corporate environmental, social and governance (ESG) reporting, also known as sustainability reporting.

Background

Voluntary corporate disclosure of ESG metrics can be achieved through the issuance of annual sustainability reports as well as through solicited voluntary disclosure or reporting programs operated by third parties. Solicited disclosure, driven largely by socially responsible investors or other parties, is a request for corporate information through a program facilitated by a non-governmental organization. These programs include the Carbon Disclosure Project (CDP), the Dow Jones Sustainability Indexes (DJSI), and the Global Reporting Initiative (GRI), among others. Investors are increasingly acknowledging that integrating sustainability metrics into business strategy is essential for financial stability, and also helps positively influence public opinion of corporate environmental and social performance.

In recent years, voluntary ESG reporting has grown to include specific climate change metrics, including corporate greenhouse gas (GHG) emissions, investments in emissions reduction activities and the development of business strategies to mitigate and adapt to climate change. In fact, the majority of companies that report to the CDP now have a corporate greenhouse gas reduction strategy in place. Voluntary reporting of climate-related information, largely driven by investor pressure, continues to be the primary means of disclosure.

The presence of existing mandatory disclosure requirements have helped to drive ESG reporting. For example, the Securities and Exchange Commission (SEC) requirements called for public companies to report potential environmental costs and liabilities in the Sarbanes-Oxley Act of 2002. In response to requests from investors, in January of 2010, the SEC issued guidance mandating specific disclosure of climate-related risk and issuing formal guidance for companies regarding the climate risk information they should disclose in their annual and quarterly filings. This announcement was the first time the SEC specifically cited climate change as a source of business risk, giving further credence to the concept that climate change represents a material business risk to companies. In fact, some companies are moving from yearly reporting of sustainability metrics to quarterly reporting, tying climate change reporting to the typical corporate accounting calendar.

Corporate disclosure of water-related risks is also seeing an increase in interest from key industries, investors and policymakers given the recent climate trends related to sea-level rise, flooding, drought and water scarcity. Accordingly, companies are increasingly putting measures in place to ensure they are well-positioned to adapt to future water risks and any financial repercussions. Recognizing the need for sustainable water management practices, the CDP carried out a Water Disclosure Pilot in 2008, the first complete Water Disclosure Global Report in 2010, and the first US Water Disclosure Report focused on S&P 500 companies this month.

Investors are also increasingly interested in disclosure of supply chain risks and opportunities, as illustrated by the strategic changes to the DJSI criterion on this matter. Companies are not only outsourcing production, services and business processes but also corporate responsibilities and reputational risks. Accordingly, risks and opportunities associated with the supply chain need to be managed and assessed carefully.

2012 CDP and DJSI Results

In September 2012, the results of two annual voluntary corporate disclosure surveys were released from the Carbon Disclosure Project (CDP) and the Dow Jones Sustainability Indexes (DJSI), highlighting the commitment of some of the world's top corporate leaders to sustainability.

The Carbon Disclosure Project (CDP)

Founded in 2000, the Carbon Disclosure Project (CDP) is an independent not-for-profit organization that sends out standardized questionnaires annually on behalf of 655 institutional investors holding US$78 trillion in assets to help reveal the risk in their investment portfolios. CDP works with investors globally to advance the investment opportunities and reduce the risks posed by climate change by asking almost 6,000 of the world's largest companies to report on their climate strategies, GHG emissions and energy use in the standardized Investor CDP format. One of the key principles behind the CDP is transparency, as a public response can be viewed by current and potential investors, customers and any other interested party. CDP scores responses, ranks companies and releases the results publicly in September every year.

Those companies responding to the Investor CDP Program with the highest scores for disclosure and/or performance are ranked in the Carbon Disclosure Leadership Index (CDLI) and the Carbon Performance Leadership Index (CPLI). According to CDP's 2012 results, these companies are making progress in emissions reduction, disclosure, and assurance at faster rates than their peers. The 2012 results of the CDP leadership indexes are available here.

CDP has developed three surveys for company disclosure:

1. The first and most widely-reported is the Investor CDP Program focused on climate change. This survey requests information on greenhouse gas emissions, energy use, and the risks and opportunities from climate change from thousands of the world's largest companies.
2. The second is the CDP Supply Chain Program, which is in its fourth year. Responses to CDP's Supply Chain Program were scored beginning in 2011.
3. The third is the CDP Water Disclosure Program, which was launched in 2010. There is currently no scoring methodology for CDP's Water Disclosure Program, but CDP plans to develop methodology to benchmark companies on their water use and performance by 2014.
4. For 2013, CDP is soliciting members for its new Supply Chain and Water Program, which will encourage companies to actively monitor water-related risks in their supply chain by requiring key suppliers to report water use, risks, and management plans.

Dow Jones Sustainability Indexes (DJSI)

The DJSI are the first global indexes tracking the world's 2,500 largest companies from 58 sectors based on their sustainability performance. The DJSI enables investors to integrate sustainability considerations into their investment portfolios while also providing an effective platform for encouraging companies to adopt sustainable best practices. The results of the 2012 review provide an in-depth analysis of economic, environmental and social criteria, such as corporate governance, supply-chain management, water-related risks and stakeholder relations, with a focus on industry-specific risks and opportunities.

In 2012, some key changes to the general criteria were made in order to help better assess corporate sustainability commitment and performance. For example, recognizing that companies are inherently linked to the risks and opportunities faced by their suppliers, there was an overhaul of the previous criterion, such that the new criterion focuses explicitly on supply chain management. The new framework consists of four major parts: supply chain awareness and risk exposure, risk management, sustainability strategy and opportunities in the supply chain and transparency with regards to supply chain risks and performance. The 2012 results for the DJSI annual review are available here.

The Global Reporting Initiative

In addition to investor-backed surveys such as CDP and DJSI, corporate sustainability guidelines are also available to use as a framework for annual corporate sustainability reporting. The most widely-used framework for corporate sustainability reporting was developed by the Global Reporting Initiative (GRI), a non-profit organization formed by Ceres and the Tellus Institute in 1997. GRI is an internationally accepted framework for corporate reporting on social, environmental, and economic performance.

GRI provides guidance on three elements of standard disclosure: 1) *Profile Disclosures*, which include strategy, profile, and governance, 2) *Disclosures on Management Approach*, which provides context for understanding a company's performance, and 3) *Performance Indicators*, which elicit comparable information on the economic, environmental, and social performance of the organization. GRI also includes sector-specific supplements to aid major sectors in sustainability reporting by providing tailored versions of GRI's reporting guidelines. For example, the GRI Electric Utilities Sector Supplement content is developed to be globally applicable to electric utilities regardless of their type of generation, size, ownership or range of activities within the sector.

The Sustainability Reporting Guidelines are the foundation of GRI's Framework and are now in their third generation. The fourth edition of GRI's Sustainability Reporting Guidelines are currently in development and will be launched in May 2013. The most recent information on GRI's G4 Reporting Guidelines are available here.

Key Takeaways

The majority of large corporate entities are currently engaged in varying levels of voluntary sustainability reporting. Over the past few years, MJB&A has observed key issues and trends emerging among reporting indexes such as CDP and DJSI, annual corporate sustainability reports and corporate sustainability strategies. The following list includes key takeaways from our involvement in these issues:

- Investors continue to drive sustainability disclosure in order to make better informed short- and long-term investment decisions. Major areas of investor concern include climate change, energy and water use, and supply chain risk.

- Reputation and stakeholder engagement continue to be strong drivers for action. Companies are increasingly aware of the benefits beyond short-term financial returns or savings, such as customer loyalty and investor confidence. Increased transparency also helps companies support finance-raising for long-term investment in emissions reductions strategies.
- More companies are demonstrating an awareness of the strategic opportunities associated with acting on climate change. For example, companies are identifying the longer-term financial opportunities associated with developing a low-carbon brand and emerging new areas of business including renewable energy and energy efficiency.
- Extreme weather and natural disasters have forced companies to increase their level of understanding of the timeframes associated with climate change. For example, physical risks (e.g. destructive weather events, water scarcity, rising air and water temperatures and sea level) are viewed as tangible and present with a direct impact to companies' operations, supply chains and business planning.
- The electric power sector is particularly impacted by water risks; utilities ranked decreasing availability of water resources as the most important environmental trend affecting them in the near term and identified it as the second most important trend overall, just behind the economic crisis, according to a new study by the Water Research Foundation.
- A recent Harvard Business School working paper found that leading companies tend to financially outperform their counterparts, suggesting a correlation between financial performance and good climate change performance and disclosure. This assertion is supported by continued investor interest and support of corporate sustainability disclosure and performance.

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About Us

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