The state of responsible business: Global corporate response to environmental, social and governance (ESG) challenges

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The state of responsible business: Global corporate response to environmental, social and governance (ESG) challenges

A report by Ethical Investment Research Services (EIRIS)

Written by Bob Gordon with special thanks to Stephen Hine and Niaz Alam

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The EIRIS Foundation is a charity that supports and encourages responsible investment. It promotes research into the social and ethical aspects of companies and provides other charities with information and advice to enable them to choose investments which do not conflict with their objectives. The Foundation funds specific projects to achieve these charitable aims.

Ethical Investment Research Services (EIRIS) Ltd is a non-profit, independent research organisation which has been conducting environmental, social and governance (ESG) research on publicly listed companies for nearly 25 years. EIRIS Ltd provides research on corporate ESG and other ethical performance indicators to more than 100 institutional investors. It is a†wholly-owned subsidiary of the EIRIS Foundation.

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Contents

EXECUTIVE SUMMARY 6

1 INTRODUCTION 12

2 WHAT SHAPES RESPONSIBLE BUSINESS PRACTICES? 15

2.1 LEGISLATION AND REGULATION 15

2.2 THE BUSINESS CASE FOR RESPONSIBLE BUSINESS 17

2.3 RESPONSIBLE INVESTMENT 18

2.4 RESPONSIBLE INVESTMENT AROUND THE WORLD 20

2.4.1 Europe 20

2.4.2 North America 21

2.4.3 Asia-Pacific 21

2.4.4 Emerging Markets 22

3 CORPORATE RESPONSIBILITY AROUND THE WORLD: A SNAPSHOT 23

3.1 METHODOLOGY 23

3.2 CORPORATE GOVERNANCE 25

3.2.1 Independence of directors 26

3.2.2 Director's remuneration 28

3.2.3 Separation of chair and chief executive 29

3.3 EQUAL OPPORTUNITIES AND WOMEN ON THE BOARD 31

3.3.1 Equal opportunities policy 32

3.3.2 Equal opportunities systems 33

3.3.3 Women on the Board 34

3.4 HUMAN RIGHTS 36

3.4.1 Countries of concern for human rights 37

3.4.2 Human rights policy 39

3.4.3 Human rights systems 41

3.4.4 Human rights reporting 43

3.4.5 The effect of market capitalisation 44

3.5 SUPPLY CHAIN LABOUR STANDARDS 46

3.5.1 Supply chain risk exposure 46

3.5.2 Supply chain policy 47

3.5.3 Supply chain systems 49

3.5.4 Supply chain reporting 50

3.6 ENVIRONMENTAL RESPONSIBILITY 53

3.6.1 Overview of global environmental practices 55

3.6.2 Environmental policy 58
3.6.3 Environmental systems 59
3.6.4 Environmental reporting 61
3.6.5 Environmental performance 63
3.7 COMMUNITY INVOLVEMENT – CORPORATE GIVING 66
3.8 NUCLEAR POWER 68
3.9 PROVISION OF WEAPONS 70
4 CURRENT HOT TOPICS 72
4.1 CLIMATE CHANGE 72
4.2 HIV/AIDS AND CORPORATE RESPONSIBILITY 73
4.3 INTERNATIONAL CONVENTIONS 74
4.4 TAXATION AND TRANSPARENCY 77
4.5 RESPONSIBLE BUSINESS PRACTICES IN EMERGING MARKETS 77
4.6 OTHER EMERGING ISSUES 78
4.6.1 Access to water 78
4.6.2 Nanotechnology 78
4.6.3 Private Equity 79
5 CONCLUSION 80
5.1 CURRENT TRENDS IN RESPONSIBLE BUSINESS 80
5.2 THE FUTURE OF RESPONSIBLE BUSINESS 82
5.3 ACHIEVING SUSTAINABILITY 83
5.4 DELIVERING MEANINGFUL ESG DATA 84
5.5 CONCLUDING REMARKS 84
APPENDIX A: HUMAN RIGHTS COUNTRY LISTS 85
APPENDIX B: EIRIS RESEARCH AND RESEARCH PARTNERS 86
APPENDIX C: EIRIS CLIENTS 90
APPENDIX D: OTHER SOURCES OF INFORMATION 92
APPENDIX E: ACRONYMS AND ABBREVIATIONS 95

Figures

Figure 1: Percentage of companies with more than 33% independent directors	27
Figure 2: Percentage of companies disclosing directors' remuneration	28
Figure 3: Percentage of companies separating the roles of CEO and Chair	29
Figure 4: Percentage of companies adopting equal opportunities policies	32
Figure 5: Percentage of companies adopting equal opportunities systems	33
Figure 6: Percentage of board directors who are women	34
Figure 7: Percentage of companies with large or small operations in high risk countries	38
Figure 8: Percentage of companies with a large presence in high risk countries adopting human rights policies	39
Figure 9: Percentage of companies with a large presence in high risk countries adopting human rights systems	41
Figure 10: Percentage of companies with a large presence in high risk countries reporting on human rights	43
Figure 11: Human rights policies by proportion of companies and proportion of market capitalisation	44
Figure 12: Exposure to potential labour rights violations in the supply chain	47
Figure 13: Percentage of companies adopting a supply chain policy	48
Figure 14: Supply chain systems levels by region	49
Figure 15: Supply chain reporting levels by region	51
Figure 16: Percentage of companies globally adopting environmental policies, systems and reports	55
Figure 17: Percentage of high impact companies globally adopting environmental policies, systems and reports	56
Figure 18: Proportion of market capitalisation adopting environmental policies, systems and reports	57
Figure 19: Percentage of high impact companies with environmental policies	58
Figure 20: Percentage of high impact companies adopting Environmental Management Systems	59
Figure 21: Percentage of high impact companies demonstrating an environmental reporting commitment	61
Figure 22: Percentage of companies demonstrating an improvement in environmental performance	63
Figure 23: Environmental performance by proportion of companies and proportion of market capitalisation, for high impact companies only	64
Figure 24: Percentage of companies adopting community involvement strategies	67
Figure 25: Percentage of companies producing nuclear power	69
Figure 26: Percentage of companies supplying weapons or parts of weapons to military organisations	70

Tables

Table 1: Sample of companies examined	24
Table 2: High, medium and low environmental impact sector classifications	54
Table 3: Allegations of breaches of key international conventions	76

Executive Summary

This report provides an overview of the extent to which companies are addressing their environmental, social and governance (ESG) impacts. The companies examined are constituents of the FTSE All-World Developed Index and the data presented was extracted from databases maintained by EIRIS in March 2007[1]. The data is presented by country/region and contextual analysis is provided. The issues covered are corporate governance, equal opportunities, human rights, supply chain labour standards, environmental responsibility and community involvement. The report focuses on these issues because they illustrate a cross section of key ESG risks that companies face and key sustainability issues of interest to clients. Other topics examined include climate change, HIV/AIDS and responsible business approaches in emerging markets.

EIRIS is a leading global provider of independent research into the social, environmental and governance (ESG) performance of companies. Over the past quarter of a century EIRIS has conducted detailed research on the issue of corporate social responsibility (CSR) on behalf of investors in the UK and abroad. During this time, the proportion of companies reporting ESG information has risen significantly. When EIRIS was founded in 1983 only a handful of companies reported anything publicly on their corporate responsibility activities. The first stand-alone environmental reports emerged in the late 1980's and by the 1990's social data was included as well. As the demand from investors for more information on CSR has grown, there has been an increase in the number of company CSR reports, as well as the volume of information contained in the reports. Reporting that started as a description of philanthropic activities has risen sharply over the past 25 years into a description of responsible business practices. EIRIS expects that corporate responsibility reporting will continue to grow, meeting the needs of all stakeholders whilst ensuring that investor needs are increasingly central.

Today EIRIS provides research on corporate ESG and other ethical performance indicators for approximately 3,000 companies worldwide. EIRIS currently has over 100 clients ranging from those who use the research for stock selection or exclusion, to pension funds and other institutional investors applying an engagement or responsible investment overlay to their investment strategy. The range and depth of issues covered, transparent research methodology and focus on providing research and consulting services exclusively to investors, makes EIRIS unique among independent research organizations. EIRIS' growth over the past 25 years reflects both the growth of responsible investment generally, as well as its widely recognized expertise and quality as providers of research on 'extra-financial' issues.

Company reporting on ESG issues has risen significantly over the past 10-20 years. A wide range of factors have influenced corporate approaches to ESG issues including regulation, NGO activity and responsible investment. Responsible investment is most developed in Europe, although there is also significant investment of this type in North America and Australia/New Zealand. Responsible investment in Japan has also risen consistently since 1999, however it is at a lower level. Responsible investment is less well developed in emerging markets, although this is changing as investors are increasingly considering ESG issues in their emerging market investments and several responsible investment funds have been launched in emerging markets. The value of responsible investment funds has grown dramatically in the last ten years, with around USD 4 trillion of funds incorporating an analysis of ESG factors now being managed globally[2].

1 The EIRIS database holds ESG data on a set of approximately 3,000 companies from across the world.
2 Calculation made by EIRIS using information published by the Social Investment Forums in the US, Canada, Europe and Australia/New Zealand.

EIRIS' experience of researching ESG issues for nearly 25 years suggests that investor appetite for increased responsiveness to ESG issues by companies will continue to grow. One should expect to witness an increase in the value of assets managed according to ESG and responsible criteria. The value of assets represented by the signatories of the Principles for Responsible Investment (PRI) already exceeds USD 8 trillion[3], a figure that is likely to increase. In addition, recent evidence suggests that incorporation of ESG issues into investment analyses can help fund managers better understand the future performance of companies in the long term. Customer demand, competitive pressures, increased transparency and a growing number of initiatives encouraging responsible business practices are likely to work together to continue to raise expectations of the standards adopted by companies. In particular the continued growth of responsible investment will drive companies to improve their responsible business strategies.

Main findings

- Over the past 25 years EIRIS has seen CSR evolve from a mainly philanthropic activity to a more mainstream approach that integrates responsible business principles into core business activities.
- Responsible business practices are increasingly being adopted by companies worldwide though there are significant differences between regions.
- European companies have well developed responsible business practices across a broad range of issues. This is due to a sophisticated responsible investment market, NGO pressure and a strong regulatory environment.
- Japanese companies demonstrate strong performance on environmental issues, although need to make progress on other areas to match European levels.
- Beyond a core of companies which have adopted responsible business practices, North American companies significantly lag behind their European counterparts across all the areas researched.
- Large companies are more likely to adopt responsible business practices than smaller companies. Larger companies by market capitalisation are more likely to adopt human rights policies and demonstrate environmental performance improvements
- Continued growth in responsible investment especially amongst 'mainstream' investors, driven by a belief that environmental, social and governance issues affect financial performance, is expected to drive greater corporate take up of and reporting on these issues.

Additional findings

- European and Japanese companies are clear leaders with respect to managing environmental impacts. Over 90% of high impact companies in Europe and Japan have developed basic or advanced policies, compared with 75% in Australia/New Zealand, 67% in the US and 15% in Asia ex-Japan.
- Progress is not as good with respect to human rights approaches both in companies' owned operations and in the supply chain, particularly in countries outside Europe. Nearly 75% of European companies operating in high risk countries have developed a basic or advanced human rights policy compared with less than 40% of North American companies and around a sixth of Asian companies. Over 50% of European companies have adopted a basic or advanced supply chain policy where relevant, however less than 20% of North American companies and less than 10% of Asian companies have done the same.

3 The Principles for Responsible Investment www.unpri.org

- Corporate governance practices are converging globally. Governance codes are being revised to improve levels of transparency and independence, and the proportion of companies adopting Western board structure models is increasing. The proportion of independent directors is on the rise, as are disclosure of director remuneration and the proportion of women on the board.
- Companies in Asia ex-Japan are least likely to have adopted responsible business practices in relation to all the criteria examined, although this may be set to change as NGO presence is increasing in Asia and investors are becoming more interested in emerging markets.
- Australian, New Zealand and Canadian companies do not perform exceptionally on any issues compared to their peers in other countries.
- Large companies are more likely to adopt responsible business practices. 56% of all companies in the FTSE All World Developed Index have adopted an environmental policy meeting at least basic. These companies represent 77% of the value of the index. Similarly, 43% of all companies operating in high impact countries have developed at least basic human rights policies and these companies represent 70% of the value of those companies in the index.
- A number of factors have driven the rise of responsible business practices, including regulation, ethical consumerism, brand reputation management, process improvements and responsible investment.

Summary findings in relation to each of the ESG issues examined are provided below[4]:

Corporate governance

- 62% of the companies studied have boards containing more than a third of independent directors. However the proportion of independent directors varies greatly between countries. Over 90% of companies in North America, UK, Switzerland, the Netherlands, Norway, Finland and Australia have more than a third of independent directors, compared with less than 10% in Germany, Austria and Japan.
- Disclosure of directors' remuneration is consistently high, with 96% of all companies disclosing this information.
- In half of the countries studied over 90% of companies separate the roles of chair and chief executive. However rates of separation are lower in the US (30%), Japan (54%) and France (56%).
- These differences are driven by the fact that companies largely adhere to their relevant national Corporate Governance guidelines.
- However corporate governance practices are converging. Governance codes are being revised to improve levels of transparency and independence, and the proportion of companies adopting Western models of board structure is increasing.

Equal opportunities/Women on the board

- Increasingly, companies view equal opportunities less as a way to avoid criticism or lawsuits, but more as a means to build reputation and gain competitive advantage by accessing a broader skill set.
- Around 90% of companies in North America (94%), Europe (88%) and Australia/New Zealand (87%) have basic or advanced equal opportunities policies. Conversely, just over 50% of Japanese and less than 25% of companies in Asia ex-Japan meet these standards.

4 These have been included because they illustrate a cross section of key ESG risks that companies face and key sustainability issues of interest to clients. However EIRIS examines over 60 different social, environmental and governance areas.

- The pattern is slightly different for equal opportunities management systems. The criterion includes disclosure of staff demographics in relation to women and ethnic minorities as well as the presence of flexible working policies. Europe and Australia/New Zealand both perform well, with around 80% and 70% respectively demonstrating at least basic systems. Performance amongst Japanese companies is also strong at 60%, whereas it is weaker amongst US companies at 25%. In the US, companies are less inclined to disclose this information, possibly due to fear of litigation.
- Worldwide, only 8.1% of board members are women. Representation of women on the board continues to be lowest in Japan at less than 1% and remains generally low in Mediterranean countries. These low levels are driven by a mixture of cultural factors including a history of fewer women in formal employment combined with weak legislative encouragement.
- The highest rate of 33% is seen in Norway where the government has enforced a quota for a minimum of 40% board members to be women by the end of 2007. The number of women on the board is set to increase in Spain as the Spanish government has recently established a quota similar to that imposed in Norway.

Human rights

- NGO campaigns have placed the spotlight on companies operating in countries where human rights are seen to be at risk. In addition, responsible investors are increasingly considering human rights and labour standards in their investment decisions. These factors are forcing corporations to better manage the risk and challenges of operating in such countries and their potential impact on the human rights of their employees and the wider community.
- In particular, investors look for proof of compliance with standards of fundamental human rights as recognised in the Universal Declaration of Human Rights and related international conventions.
- Companies in Norway, the Netherlands, the UK and Finland are more likely to have developed advanced human rights policies; 50% or more of companies in these countries with large operations in high risk countries have an advanced human rights policy.
- In contrast, a low proportion of US and Japanese companies operating in high risk countries have developed advanced policies, less than 5% in each case.
- Less than 5% of relevant companies in Hong Kong, and none of the companies in Singapore or Portugal have developed even a basic human rights policy, system or report.
- The low proportion of US companies achieving an advanced grade may be explained by the frequent omission of freedom of association and collective bargaining from human rights policies.
- The low proportion of Asian companies achieving an advanced grade may be explained by differences in their perceptions of what constitutes human rights, as well as relatively lower levels of NGO and responsible investor activity in Asian countries.
- Large companies are more likely to address their human rights risks. 15% of all companies in the FTSE All World Developed Index operating in high risk countries have adopted an advanced policy. These companies represent 27% of the value of those companies in the index. Similarly, 43% of all companies have developed either basic or advanced policies and these companies represent 70% of the value of those companies in the index.

Supply chain labour standards

- Companies are increasingly sourcing products from developing countries as supply chains become more globalised. As a result they are under increasing pressure from responsible investors and NGOs to demonstrate that their products are manufactured employing acceptable labour standards.
- Across all regions, with the exception of Europe, the majority of companies with a significant degree of reliance on global supply chains show little or no evidence of having a supply chain labour standards policy. Over 80% of companies in North America and Australia/New Zealand and over 90% of Asian companies do not demonstrate any evidence of a supply chain labour standards policy.
- Conversely, over 50% of relevant European companies have developed a basic or advanced supply chain policy.
- This pattern is repeated for supply chain systems and reporting mechanisms.

Environmental responsibility

- Public concern about environmental degradation has grown in recent years, particularly due to growing public awareness of climate change.
- 57% of all companies have a publicly available environmental policy statement in place. A similar percentage of companies have implemented environmental management systems (58%), although a much smaller proportion (29%) report their environmental performance.
- A greater proportion of companies with a high impact on the environment have environmental policies, systems and reports (78%, 81% and 57% respectively).
- Large companies are more likely to address their environmental impacts. 56% of all companies in the FTSE All World Developed Index have adopted an environmental policy meeting at least basic. These companies represent 77% of the value of the index.
- Over 90% of high impact companies in Europe and Japan have developed basic or advanced policies for managing environmental impacts, compared with 75% in Australia/New Zealand, 67% in the US and 15% in Asia ex-Japan.
- Environmental performance is strongest amongst companies in Europe and Japan, however performance in Asia ex-Japan and the US is less encouraging. 7% of Asia ex-Japan and 18% of high impact US companies demonstrate an improvement in environmental performance, compared with over 50% for companies in Japan and in several European countries.
- A number of factors drive the strong performance demonstrated by European companies including strict EU regulation and a high level of pressure on companies to adopt sustainable environmental practices from investors, NGOs and civil society.
- Performance is strong in Japan as ISO 14001 has been widely adopted, championed by the government as a way of providing customer assurance and as a means to avoid losing export business to certified firms elsewhere.

Community involvement

- Community involvement can range from simple donations of money to donations of expertise, time and resources.
- Community involvement is widely used in all regions of the world as a means to build reputation. In all the countries covered, at least 50% of companies score basic or advanced (Europe 85%, Australia/New Zealand 77%, North America 70%, Japan 66%, Asia ex-Japan 60%). Even in the lowest performing country, Hong Kong, 58% of companies meet at least the basic level.
- Differential tax rates and incentives for charitable giving between different countries play a part in affecting the average amount donated from country to country.

Ethical Investment Research Services (EIRIS)

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1 Introduction

Ethical Investment Research Services (EIRIS) Ltd is an independent, non-profit research organisation which has been conducting detailed research on the issue of corporate social responsibility (CSR) on behalf of investors in the UK and abroad over the past quarter of a century. EIRIS was established in 1983 as a collaborative venture by a group of churches and charities that were concerned by their investments in companies involved in the Apartheid-era regime in South Africa.

EIRIS Ltd is a wholly-owned subsidiary of the EIRIS Foundation. The EIRIS Foundation is a charity that supports and encourages responsible investment. It promotes research into the social and ethical aspects of companies and provides other charities with information and advice to enable them to choose investments which do not conflict with their objectives. EIRIS Ltd helps to deliver these charitable aims and provides research and consulting services on corporate environmental, social and governance (ESG) and other ethical performance issues to investors.

EIRIS does not offer consulting services to companies, and does not advise on or endorse campaigns by NGOs or other bodies related to companies' ESG performance, ensuring that it remains a trusted and objective source of information on ESG issues. EIRIS' independence from both companies and their critics ensures that it remains objective in its assessment of companies' approaches to ESG issues.

EIRIS Ltd provides research on corporate ESG and other ethical performance indicators to more than 100 clients. It assists a broad range of investors including retail and institutional fund managers, pension funds, foundations and private client investment managers in the development and implementation of responsible investment strategies. Over the past 25 years EIRIS has dramatically expanded both the breadth of its company coverage and the range of issues it researches. From an initial focus on 'involvements', traditionally used for negative screening strategies, EIRIS now researches a comprehensive list of ESG and related ethical issues for approximately 3,000 companies worldwide, covering over 60 different issues in the areas of environment, corporate governance, human and labour rights, business ethics, social performance and risk management. EIRIS data supports a wide variety of responsible investment strategies.

When EIRIS was founded in 1983 as the pioneer of responsible investment research in Europe only a handful of companies reported anything publicly on their corporate responsibility activities. Most of these were limited to a brief description of their philanthropic activities. By placing questions before companies on their broader social and environmental policies and practices, EIRIS was part of a process that raised corporate consciousness of CSR issues, reflecting public and investor concerns. As a result companies started reporting on some of their key impacts, especially environmental matters. The first stand-alone environmental reports emerged in the late 1980's and by the 1990's social data was included as well. As responsible investment grew in popularity in the UK, continental Europe and beyond, the demand from investors for more information on CSR also grew. EIRIS witnessed an increase in the number of company CSR reports, as well as an increase in the volume of information contained in the reports. Companies from across Europe and North America also began to improve the range of sustainability issues covered. Reporting that had started as a description of philanthropic activities had evolved into a description of responsible business practices.

EIRIS research evolved to meet the demands of investors developing investment products with more sophisticated and nuanced approaches to analysing corporate responsibility. However although the quantity of information had increased, the quality and usefulness of information contained in company reports did not increase proportionately. Many company reports remain public relations tools and many gaps remain in terms of identifying appropriate indicators, reporting how key issues are being addressed and how targets are being implemented. In addition, many companies have yet to produce any meaningful information in relation to the ESG issues they face. However through voluntary projects such as the Global Reporting Initiative and limited regulation, companies have been offered frameworks to assist improvements in their reporting. Input by EIRIS and others helped to make sure that the views of investors were met in the creation of such frameworks. Thus in recent years company reports have become more focused on explaining their key ESG impacts and what they are doing to meet the core sustainability and responsibility challenges faced. This information better serves the needs of investors.

There can be little doubt that reporting has risen sharply over the past 25 years. In two separate studies, Context and KPMG report that in 2005, 80% of top companies had Corporate Responsibility reports compared with 50% in 2002. Context state that reporting is on the rise globally, although reporting was lower in the US than in Europe in 2006, with 59% and 90% of the top 100 companies reporting respectively[5]. The KPMG findings state that Japan is the highest corporate responsibility reporting region, with 80% of companies producing CR reports, followed by 71% of UK companies, and the US substantially lower with only 32% of companies reporting[6]. EIRIS expects that corporate responsibility reporting will continue to improve in addressing the needs of all stakeholders whilst ensuring that investor needs are increasingly central.

Over the last 25 years the growing interest of investors in ESG issues is encouraging more and more companies to publicly adopt a pro-active approach to corporate responsibility issues. NGOs and governments in turn are responding to public concerns about corporate behaviour by interacting more with investors on ESG issues as a way of encouraging corporate responsibility. The terms corporate social responsibility (CSR), corporate responsibility and corporate sustainability are increasingly prevalent in business discourse, as business awareness of the phenomenon has grown dramatically. These terms typically embrace a wide range of social, environmental and governance issues. However the term 'responsible business' has been chosen in this report as the terms mentioned above are often associated with corporate philanthropy, and although community involvement is considered in this report, the focus is on adopting responsible business practices.

The report illustrates how companies from different countries score against several key ESG risks. All figures are based on information extracted from databases maintained by EIRIS as of March 2007. The data contained in this study relates to the FTSE All-World Developed Index, covering a total of 1,996 companies. EIRIS research is compiled using company annual reports, sustainability/CSR reports, company websites, EIRIS survey responses and a variety of non-company sources. The data has been collated to help highlight key issues and to provide a simple snapshot of the state of responsible business around the world. In compiling these figures, EIRIS has noted some of the main factors influencing corporate behaviour in relation to key ESG issues.

5 Context 2006 *Global Corporate Responsibility reporting trends: Reporting in Context 2006* Available at www.econtext.co.uk
6 KMPG 2005 KPMG International Survey of Corporate Responsibility Reporting 2005 Available at www.kpmg.com/NR/rdonlyres/66422F7F-35AD-4256-9BF8-FACCA9164/0/KPMGIntlCRSurvey2005.pdf

The purpose of this report, commissioned by the EIRIS Foundation, is to provide an overview of how seriously companies across the world are taking their ESG responsibilities. It provides a unique snapshot of how companies in different countries are responding to key corporate responsibility topics.

The report is broken down into four sections. Chapter 2 provides an insight into the range of influences on responsible business activities. It charts the rise of corporate responsibility over the past 25 years, focusing on various drivers of the emergence of the phenomenon. Factors examined include globalisation, increasing regulation and oversight (from both government and civil society), encroachment by the private sector into public sector responsibilities, and the role of responsible investment.

Chapter 3 forms the major part of this report. It uses EIRIS data to provide a country-by-country breakdown of how companies from different regions perform across a selection of the most widely used responsible investment criteria as follows:

- Corporate Governance
- Equal Opportunities
- Human Rights
- Supply Chain
- Environmental Responsibility
- Community Involvement
- Nuclear Power
- Military Involvement

Each section contains further background on definitions, illustrating graphs, and commentary on key differences observed. It also notes the relevant methodology and definitions applied by EIRIS to these topics[7].

Chapter 4 examines some of the hot topics and emerging issues that are shaping responsible investment, as well as discussing potential future trends in company approaches to responsible business and disclosure. These include climate change, HIV/AIDS, international conventions, taxation and transparency and responsible business approaches in emerging markets as well as water shortages, nanotechnology and private equity.

Finally, chapter 5 provides some concluding remarks on the future of corporate responsibility and sustainability.

7 Further information on EIRIS' research methods are summarised in Appendix B.

2 What shapes responsible business practices?

Historically, the private sector has primarily focused on the pursuit of profit without paying significant regard to business externalities, such as the social and environmental implications of their activities. Milton Friedman famously argued that "the only social responsibility of business is to increase its profits" and therefore companies should neither be adopting business practices that do not directly maximise profits nor donating money to philanthropic causes; a widely supported view, as little as 20 years ago[8]. However, a number of processes, including investor pressure on companies and high profile NGO campaigns exposing corporate activities, have driven a paradigm shift. For example, resource companies have faced significant pressure with regard to indigenous rights and environmental degradation and apparel companies have faced pressure with regard to labour rights within their supply chains.

The 'information age' and the concept of a 'global village' are factors in the emergence of responsible business practices. The growth of global access to the Internet has facilitated knowledge-sharing both across global boundaries and within smaller timeframes[9]. This has contributed to increased public awareness and facilitated campaigning activities. As a result, corporations are subjected to increased scrutiny, greater NGO pressure and more informed consumer attitudes[10].

Furthermore, we are entering an era where the responsibilities of corporations and governments are blurring and overlapping[11]. Government-controlled businesses have been privatised, industries have been deregulated, and there is a global take up of free market mechanisms, whereby governments provide a framework within which companies have the freedom to operate[12]. It is difficult to hold many corporations accountable via national legislation as they operate globally, and the current global governance frameworks do not transcend international boundaries. As an alternative, stakeholders have put pressure on corporations to adopt responsible business practices voluntarily; which may be considered as a type of self-regulation[13]. Numerous international voluntary standards organisations and initiatives have emerged that facilitate adoption of broadly recognised standards that go beyond regulatory requirements. These include the UN Global Compact, World Business Council for Sustainable Development (WBCSD), the Equator Principles (HYPERLINK "http://www.equator-principles.com/" www.equator-principles.com) and the internationally recognised International Organization for Standardization (ISO) standards. In addition, the Global Reporting Index (GRI) has developed a framework for companies to comply with when reporting (see Appendix C for more details).

2.1 Legislation and regulation

Regulatory requirements and commonly adopted industry standards can be highly influential in ensuring quality and consistency of reporting, raising reporting levels and improving corporate approaches with respect to ESG issues. For example, governmental environmental reporting requirements ensure that companies gather and report environmental data. However, voluntary initiatives can be seen as a means to deflect pressure from NGO's, governments and other stakeholders whilst avoiding potentially more

8 Porter, M. and Kramer, M. 2003 *The competitive advantage of corporate philanthropy* in The Harvard Business Review on Corporate Responsibility pp 27-65 Harvard Business School

9 Elkington, J. 1997 *Cannibals with forks: the triple bottom line of 21st Century business* Capstone, Oxford

10 Jenkins, R. 2005 *Globalisation, Corporate Social Responsibility and Poverty* International Affairs 81, 3 525-540

11 Zadek, S. Pruzan, P. and Evans, R. 1999 *Building Corporate AccountAbility: Emerging practices in social and ethical accounting, auditing and reporting* Earthscan, London

12 Savitz, A. and Weber, K. 2006 *The Triple Bottom Line* Jossey-Bass San Francisco

13 Hopkins, M. 2006 *The planetary Bargain: Corporate Social Responsibility Matters* Earthscan, London; Elkington, J. 1997 *Cannibals with forks: the triple bottom line of 21st Century business* Capstone, Oxford

stringent regulatory requirements[14]. Indeed, CORE[15] (the Corporate Responsibility coalition) and Save the Children recently concluded in a report about the impacts of CSR that voluntary codes to improve responsible business practices amongst corporations have only worked effectively in instances where there has been strong governmental involvement through legislation and enforcement[16].

Conversely it can be argued that mandatory reporting requirements are not essential as companies are increasingly reporting for business reasons. Many businesses are improving their disclosure since they see a potential competitive advantage by doing so. Some commentators believe that improvements in reporting are encouraged by advocating the business advantages, whereas regulation is deemed to be a less progressive approach[17]. Unsurprisingly, businesses have a tendency to advocate this stance. Voluntary disclosure of information can provide the responsible investment community with the necessary information to make comparisons across countries and sectors. For example in 2000 the London Stock Exchange (LSE) implemented the Turnbull report, which urged the boards of companies to focus on risk management and control. Although the recommendations were voluntary, risk was interpreted in a broad sense to include environmental and social matters[18]. As a result, there has been some progress amongst some companies in terms of improving the implementation and disclosure of their risk management strategies.

The most widely recognised voluntary reporting guidelines are provided by the Global Reporting Initiative (GRI), which has developed a sustainability reporting framework to facilitate the provision of voluntarily provided consistent and high quality data[19]. In addition, the Carbon Disclosure Project (CDP) is also a widely adopted voluntary reporting mechanism providing consistent and transparent reporting[20].

Legislation and regulation regarding ESG issues is largely determined at a country level. Although regulatory standards are not set at consistent levels globally, there are some similarities between the standards set by different countries. One such area with relative global consistency is corporate governance, where many countries have developed a corporate governance code; a set of guidelines advising the expected approach to governance issues[21]. Although these codes are generally not mandated by law, there is a general expectation that companies will either comply with expectations or explain why they have not complied. It is accepted that not all companies will comply but that companies should offer sufficient explanation as to why they have not.

However, some regulatory reporting initiatives go beyond the national level. The EU Accounts Modernisation Directive (AMD) requires companies to produce a business risk review that includes reporting information relevant to environmental and employee matters. The AMD applies to all large and medium sized companies in the EU and was effective as of April 1st 2005. The AMD is intended to increase the comparability between companies in the EU through a common reporting framework[22]. In the UK the AMD has been implemented via the Companies Act of 2006[23], effective as of 1st October 2007.

14 Adams, C. and Zutshi, A. 2005 *Corporate Disclosure and Auditing* in Harrison, R. Newholm, T. and Shaw, D. 2005 *The Ethical Consumer* Sage, London; Zadek, S. Pruzan, P. and Evans, R. 1999 *Building Corporate AccountAbility: Emerging practices in social and ethical accounting, auditing and reporting* Earthscan, London
15 See www.corporate-responsibility.org/
Doane, D. and Holder, A. *Why Corporate Social Responsibility is failing Children* Published by Save the Children and The Corporate Responsibility (CORE) Coalition Available at www.corporateresponsibility. org/module_images/WhyCSRpagesHR.pdf
17 Bakan, J. 2004 *The Corporation: The Pathological Pursuit of Profit and Power* Free Press; The Economist Intelligence Unit 2005 *Reputation: Risk of risks. An Economist Intelligence Unit white paper* Available at www.eiu.com
18 Centre for Business Performance 1999, *Implementing Turnbull: a boardroom briefing* The Institute of Chartered Accountants, London.
19 The Global Reporting Initiative (GRI) www.globalreporting.org
20 The Carbon Disclosure Project (CDP) www.cdproject.net
21 European Corporate Governance Institute Index of Codes www.ecgi.org/codes/all_codes.php
22 EU Accounts Modernisation Directive www.businessandbiodiversity.org/pdf/EU%20Accounts%20and%20Modernization%20Directive.pdf
23 Companies Act 2006 www.opsi.gov.uk/ACTS/acts2006/pdf/ukpga_20060046_en.pdf

Companies must act with consideration to ESG factors such as the interest of employees, and the impact of business operations on the community and the environment. The Act also extends to taking into consideration the long term consequences of any decision, which will encourage increased attention on ESG issues.

Networks of responsible investors such as the UK Social Investment Forum and Eurosif[24] and active campaigners such as CORE see legislative developments as crucial to developing the impact of and market for responsible investing. Campaigners and investors alike have a common interest in encouraging common approaches to reporting requirements. This is because numerous national differences in reporting requirements for companies in different countries sometimes limit the extent to which there is a 'level playing field of information' available with which to make comparisons between companies on key issues.

In short, both regulation and voluntary initiatives that encourage standardisation have the potential to minimise inconsistencies in quality of information as well as raising companies' minimum reporting standards. Standardisation of regulatory requirements and data reporting facilitates the provision of high quality comparable corporate responsibility data, which is important to provide responsible investors with the necessary information to make informed decisions about their investments.

2.2 The business case for responsible business

For certain companies there is undoubtedly a positive financial case for adopting and enhancing responsible business practices. Companies may increase sales and profitability by increasing their appeal in the ethical consumer market. The numbers of consumers making ethical purchases is on the rise therefore generating an ethical brand image may attract a greater number of consumers[25]. In addition, responsible business has the potential to improve financial performance by delivering improvements in staff attitudes and productivity and enhancements to internal processes. Lowering operating costs can also be achieved alongside environmental performance improvements. As a straightforward example, cutting energy usage decreases both costs and CO2 emissions[26].

Arguably the most influential driver to adopt responsible business practices is the need to establish and maintain brand integrity and customer trust. Reputation has emerged as one of the most important corporate assets, and responsible business is a highly effective way to build reputation[27]. The issue of maintaining a strong image of responsibility is more relevant for the largest companies, because building brand value and developing trust are crucial components of a successful large business. However, companies' intentions may be to avoid reputational damage rather than develop a specifically ethical business model. Indeed, a recent survey found that 73% of business executives believe that demonstrating corporate responsibility is one of the most effective means of building reputation[28]. Therefore one might

24 See www.uksif.org and www.eurosif.org

25 CSR Monitor 2006 *Global public opinion on the changing role of companies* www.globescan.com/pdf/csr_monitor_brochure_2006.pdf; Kleanthous, A. and Peck, J. 2005 *Let them eat cake: Satisfying the new consumer appetite for responsible brands* Abridged Version A World Wildlife Fund Report Available at www.wwf.org.uk/filelibrary/pdf/let_them_eat_cake_abridged.pdf

26 Baker, M. 2006 *So what's the business case for Corporate Social Responsibility?* Business Respect, Issue Number 101, 13 Aug 2006; Business for Social Responsibility www.BSR.org *Overview of Corporate Social Responsibility* Available at www.bsr.org/CSRResources/IssueBriefDetail.cfm?DocumentID=48809

27 The Economist Intelligence Unit 2005 *Reputation: Risk of risks. An Economist Intelligence Unit white paper* www.eiu.com; Holliday, C. Schmidheiny, S. and Watts, P. 2002 *Walking the Talk: The Business Case for Sustainable Development* Greenleaf, Sheffield

28 Weber Shandwick Company 2006 *Safeguarding Reputation* www.webershandwick.com/pub/content/reputation.pdf

expect companies to adopt responsible business practices sufficient to deflect negative publicity without establishing more ambitious sustainability goals.

The evidence that responsible business practices provide competitive advantage is neither consistent nor conclusive. Contradictory evidence exists in relation to the financial case for responsible business, demonstrating both competitive advantage and disadvantage[29]. However, a growing number of companies and investors see significant overlaps between long-term profitability and a pro-active approach to managing ESG issues. Proponents of responsible investment infer that a company's approach to sustainability or ESG risk can become a proxy for overall good and disciplined management, which is an important factor considered by investors in deciding whether to invest in a company[30]. In fact, recent evidence shows that incorporation of ESG issues into investment analyses can indicate which companies are likely to outperform the average in the long term[31].

2.3 Responsible Investment

EIRIS defines responsible investment as follows:

'Responsible investment (as well as ethical, socially responsible and sustainable investment) is a term used to describe any area of the financial sector where the social, environmental, governance and ethical principles of the investor (whether an individual or institution) influence which organisation or venture they choose to place their money with. It also encompasses how an investor might use their power as a shareholder to encourage better environmental and social behaviour from the companies they invest in'.

The language used to refer to and define investments based on ESG matters is evolving. The term 'responsible investment' is used here to refer to both values-based investing and investment strategies considering ESG matters. However, investors also refer to 'sustainable investment', particularly in Europe. Increasing numbers of investors in the US are also referring to sustainable investment rather than 'socially responsible' investment as the concept of responsible investment continues to evolve. The distinction goes beyond semantic differences as more investors seek to integrate sustainability and ESG factors into the investment decision-making process. This is because some consider these factors to have a material impact on the value of the investment. However, it is worth noting that if only ESG issues that are considered material are included in the investment decision-making process, some sustainability challenges will remain unaddressed.

There are many responsible investment strategies, including:

- exclusions and simple screens, based on excluding sectors based on criteria such as tobacco or weapons
- positive screening, based on a commitment to responsible business practices
- pioneer screening, based on identifying companies that are at the forefront of addressing environmental and social challenges

29 For example Laffer, A. et al. 2004 *Does Corporate Social Responsibility Enhance Business Profitability?* Laffer Associates Available at www.csrwatch.com/Sub/Resources/CSRProfitabilityStudy.pdf; Baker, M. 2006 *Holding your company in trust* Business Respect, Issue Number 104, 8 Oct 2006; James, C. Her, M. and Phillips, M. 2005 *When It's 'Good', It's Good; When It's 'Bad', It's Better.* Working Paper. Dept. of Home and Family Living, Brigham Young University. May 2005

30 Savitz, A. and Weber, K. 2006 *The Triple Bottom Line* Jossey-Bass San Francisco

31 *An Introduction to GS Sustain* Available at www.unglobalcompact.org/docs/summit2007/gs_esg_embargoed_until030707pdf.pdf

- norms-based screening, based on compliance with international standards and norms
- best-in-class approach, where the leading companies from each sector or industry group are identified according to ESG criteria
- engagement, or entering into dialogue with companies on issues of concern
- integration of ESG issues into traditional financial analysis.

Investors often implement more than one of these strategies – for example combining exclusions and best of sector in specific responsible investment funds whilst applying an ESG engagement overlay on all their investments.

Shareholder activism is also seen as a key part of responsible investment. This is a process whereby shareholders exercise their right to both propose and vote on shareholder resolutions to influence corporations' ESG related policies and practices. Shareholder activism has risen significantly in the last five years, where votes of up to 30% on global warming issues are not uncommon, compared with significantly lower votes of around 3% on the majority of non-ESG issues[32].

Since the early 1980's, the assets under management with policies on social, environmental and other ethical issues has grown dramatically, with trillions of dollars now being managed with reference to ESG factors[33]. The popularity and continuing growth of responsible investment has played a significant part in persuading more companies to respond to ESG concerns. Pressure groups, unions and other NGOs have helped to shape the development of corporate responsibility further by bringing ESG issues to the attention of a wider group of investors (as well as the general public). As a result a greater number of investors are now seeking ways to invest responsibly. The increase in the number of active investors and the high level of media attention given to corporate responsibility issues has persuaded greater numbers of companies that taking a pro-active approach to corporate responsibility generates value by increasing shareholder value, building brand image or helping to avoid controversies and scandals[34].

The value of responsible investment funds under management has grown rapidly in the past ten years[35]. Indeed, some have claimed that responsible investment has been the fastest growing financial instrument in the US and Europe over the past ten years[36]. In addition, increasing numbers of mainstream investors are beginning to incorporate consideration of ESG factors into their investment decisions. Consequently, companies are motivated to behave responsibly in order to access this growing volume of investment funds[37]. Numerous studies have been conducted to ascertain whether responsible investment is a superior approach, or whether fund managers are compromising their fiduciary duty to maximise returns for their clients. There is increasing evidence that considering ESG issues in investment analyses can improve the performance of funds[38].

32 Rowland, C. 2005 *Greening of the boardroom: Socially conscious investors get results on global warming* The Boston Globe March 31st 2005 Available at www.boston.com/business/globe/articles/2005/03/31/greening_of_the_boardroom/
33 USD 8 trillion are managed by signatories to the PRI alone. See www.unpri.org/
34 Appendix B provides an introductory list of websites and related sources of information for investors and businesses seeking guidance on initiatives to improve CSR practices
35 Eurosif *European SRI Study 2006* Available at www.eurosif.org/publications/sri_studies; Social Investment Forum 2005 *Report on Socially Responsible Investing Trends in the United States: 10 year review* Available at www.socialinvest.org/areas/research/trends/SRI_Trends_Report_2005.pdf
36 Hopkins, M. 2006 *The Rise and Rise of CSR* Available at www.mhcinternational.com/The%20rise%20and%20rise%20of%20CSR.htm
37 Kotler, P. and Lee, N. 2005 *Corporate Social Responsibility: Doing the most good for your company and your cause* John Wiley and Sons, Inc. New Jersey; Business for Social Responsibility *Overview of Corporate Social Responsibility* Available at www.bsr.org/CSRResources/IssueBriefDetail.cfm?DocumentID=48809
38 See *Studies of Socially Responsible Investing* at www.sristudies.org and *An Introduction to GS Sustain* Available at www.unglobalcompact.org/docs/summit2007/gs_esg_embargoed_until030707pdf.pd

2.4 Responsible investment around the world

The Principles for Responsible Investment (PRI) initiative, founded by the United Nations Environment Programme Finance Initiative and the UN Global Compact, launched in 2006. Within its first year the PRI attracted over 180 institutional signatories globally, representing in excess of USD 8 trillion in assets under management[39]. Responsible investment continues to develop around the world, from the largest and most mature responsible investment markets in North America and Europe, to Australia and Japan and the emerging markets of Latin America, South Africa and the Asia Pacific region.

2.4.1 Europe

The European Social Investment Forum (Eurosif) reports that responsible investment is increasingly being accepted by the mainstream financial sector. Eurosif calculates institutional responsible investment among European investors at EUR 1,138 billion in Assets Under Management (AUM)[40], excluding the Nordic region. In reality the figure is significantly larger, as the Norwegian pension fund (The Petroleum Fund) alone is worth EUR 175 billion. The responsible investment market in Europe is estimated to be around 10-15% of total European funds under management[41]. This figure includes a wide range of responsible investment strategies, from simple exclusions to engagement and integration of ESG issues into the traditional financial analysis. According to Eurosif, responsible investment is most developed in the UK, where over EUR 800 billion was invested using a responsible investment strategy at December 31st 2005. Belgium is the second largest, valuing EUR 158.5 billion, and the Netherlands is the third largest market, valuing EUR 89 billion.

Engagement and integration of ESG issues into traditional financial analysis are the most widely adopted strategies. Engagement is most prevalent in the UK, where the responsible investment market has matured, although it is also increasingly common in some other European countries such as the Netherlands, Belgium and Switzerland. EUR 700 billion is invested using an engagement strategy in the UK, compared against EUR 15 billion in the Netherlands, EUR 7.5 billion in Belgium and EUR 3 billion in Switzerland. EUR 619 billion is invested using an integration strategy in the UK, compared against EUR 10 billion in the Netherlands, EUR 5 billion in France and EUR 2.2 billion in Italy[42]. Simple screens are also a popular strategy, as EUR 266 billion is managed using this approach throughout Europe. The number of actors employing this strategy remains limited, but the value has grown due to its adoption by large institutional investors. The value of AUM in simple screened funds is largest in Belgium (EUR 148.5 billion), then the UK (EUR 85.5 billion), and Spain (EUR 23 billion).

The European responsible investment market is dominated by institutional investors, who account for 94% of European AUM, whereas retail funds account for 6%. However, there are differences between the approaches taken in different countries. For example, responsible investment is carried out primarily by the retail market in Italy, whereas it is lead by institutional investors in the UK.

39 www.unpri.org/
40 Eurosif *European SRI Study* 2006 www.eurosif.org/publications/sri_studies
41 Ibid
42 total AUM using engagement and integration strategies totals more than EUR1 trillion due to overlap in strategies.EUR594 billion is invested in a combination of Integration and Engagement.

2.4.2 North America

According to the US Social Investment Forum, in 2005 USD 2.29 trillion was managed in the US using responsible investment strategies, accounting for 10% of total US assets under management. This figure represented a rise of 358% from USD 639 billion 10 years ago. Socially screened separate accounts accounted for the majority at approximately USD 1.5 trillion in assets, while assets in mutual funds and other pooled products represented USD 179 billion. A large proportion of these socially screened accounts employ exclusion screens on the traditional 'sins stocks', particularly tobacco, alcohol, arms and abortion services. However since 2003, institutional client assets have declined somewhat as single-issue screening has waned and institutional investors have preferred to use shareholder advocacy to raise issues of concern. Additionally, mainstream investors are beginning to incorporate screening on ESG issues such as environmental practices and presence in repressive regimes, particularly Burma, Sudan and 'terrorist' states. Shareholder resolutions on social and environmental issues have also increased significantly in the past 10 years. Institutional investors that filed or co-filed resolutions on social or environmental issues controlled nearly USD 703 billion in assets in 2005, a 49% rise over the USD 473 billion in assets in 1995[43].

According to Canada's Social Investment Organisation (SIO), the value of assets managed responsibly in Canada rose approximately 570% from 2004 to 2006. CAD 504 billion was managed according to responsible guidelines as of June 30, 2006[44] compared with CAD 65 billion in 2004. The vast majority of this increase is due to the recent adoption of responsible investment practices by several major pension funds, mostly in the public sector. There was also strong growth in the responsible investment retail fund sub-category, increasing from CAD 14.8 billion in 2004 to CAD 18.1 billion in 2006.

2.4.3 Asia-Pacific

Although responsible investment has traditionally been more prevalent in North America and Europe, it has been growing rapidly in Japan and the Asia Pacific region. According to the Association for Sustainable & Responsible Investment in Asia (ASrIA) USD 2.5 billion is currently invested responsibly in Asia. Australia and Japan are the largest markets for a responsible investment approach. There is also growing international interest in the number of pioneering approaches being taken in the region towards Islamic investment[45].

In Australia, responsible investment portfolios grew by 56% during the 2006 financial year from USD 7.67 billion in 2005 to USD 11.98 billion[46]. In the six years from 2000 through to 2006 the value of responsible investment portfolios grew by 3,587% (or 36 times) from USD 325 million to USD 11.98 billion. In New Zealand responsible investment assets were estimated be USD 37.2 million in 2006, an increase of 18% on the previous year. Part of this is attributed to the fact that the New Zealand Superannuation Fund now utilises a responsible investment strategy. Japan has the most developed responsible investment market in Asia outside Australia and New Zealand. Japan's first responsible investment product "Nikko Eco Fund" was launched in 1999. As of August 2006, responsible investment retail funds in Japan valued JPY 300

43 Social Investment Forum. 2005 *Report on Socially Responsible Investing Trends in the United States: 10 year review* Available at www.socialinvest.org/areas/research/trends/SRI_Trends_Report_2005.pdf
44 Social Investment Organisation (SIO). *Canadian Socially Responsible Investment Review 2006: A comprehensive survey of socially responsible investment in Canada* Available at www.socialinvestment.ca/documents/SRIReview.pdf
45 Notably in Malaysia and Singapore
46 Ethical Investment Association. *Sustainable Responsible Investment in Australia – 2006: A benchmarking survey conducted for the Ethical Investment Association by Corporate Monitor.* Available at www.eia.org.au/files/PF5QGPZHO2/SRI%20Benchmarking%20Report%202006%20EIA.pdf

billion (USD 2.5 billion), which accounts for less than 1% of the total assets of AUM of all investment trusts in Japan[47].

2.4.4 Emerging Markets

Although responsible investment is growing globally, it remains predominantly concentrated in developed countries. Responsible investment in emerging markets was estimated at USD 2.7 billion in 2003, representing around 0.1% of worldwide responsible investment. Of this, about USD 1.5 billion was held by developed-country investors and about USD 1.2 billion by emerging-market investors[48]. Demand for responsible investment information on emerging markets companies was originally driven by investors from developed world markets but increasingly investors within emerging markets have started to develop responsible investment products though the extent to which this occurs varies significantly between different countries. Responsible investment has grown fastest in South Africa, with relatively fast growth in Asia ex-Japan, however growth has been slower in other markets such as Latin America, with the exception of Brazil.

South Africa boasts the most developed responsible investment market in Africa. In May 2004 the Stock Exchange in Johannesburg (JSE) launched its first responsible investment index, measuring companies' performance in relation to environmental, economic and social sustainability. At the time of writing the JSE was revising its methodology. The criteria include environmental, social, stakeholder and governance & economic criteria, including HIV/AIDS and black economic empowerment indicators. Israel also has a responsible investment index[49].

In Asia ex-Japan, growth of responsible investment has not occurred on the same scale as in more developed markets, although growth has been relatively rapid in comparison to some other emerging market economies. There is no easily accessible measure for the value of responsible investment funds. The following countries have now established ethical funds (the number of funds is indicated in brackets): Indonesia (1); China (2)[50]; Hong Kong (4); Singapore (11); Malaysia (68)[51]; Korea (13); Japan (47); India (2); and Taiwan (3)[52]. However, engaging with Asian companies on social and ethical issues often meets resistance in part for cultural reasons and therefore Asian companies are not as responsive to questions relating to these issues. As a result the criteria used by Asian funds differ substantially from those of their Western counterparts, especially relating to non-environmental criteria.

Growth of responsible investment in Latin America has been slow, and as a result responsible business practices remain relatively weak and vary considerably by country, with very few companies adopting a formal responsible business agenda that addresses issues such as labour conditions and environment. Apart from corporate philanthropy, which is implemented at local community and national levels, observers report there is still much to do in promoting real implementation and in disseminating the social and economic benefits of responsible business practices[53]. Brazil is leading the development of responsible investment in the region. Bovespa (The São Paulo Stock Exchange) launched a responsible investment index (called the Bovespa Corporate Sustainability Index or Índice de Sustentabilidade Empresarial (ISE)[54]) which tracks the financial, corporate governance, environmental and social performance of leading companies listed on the Exchange in December 2005.

47 Calculated by Nomura based on data obtained from www.morningstar.co.jp/sri/rt_info/jpn_srifunds.htm

48 De Sousa-Shields, M. (Ed) 2003 *Towards Sustainable and Responsible Investment in Emerging Markets: A Review and Inventory of the Social Investment Industry's Activities and Potential in Emerging Markets* Available at www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_sri/$FILE/SRI_IFC.pdf

49 A list of constituents is available here www.maala.org.il/galleries/dynamic/userUploadFiles/File/MaalaRanking/MaalaRanking2007_Table_English.pdf

50 although some argue that the criteria for the fund is ESG risk related rather than responsible investment

51 Figures for Singapore and Malaysia are high because of the large number of funds utilising faith-based criteria

52 ASrIA SRI Funds Portal - *SRI Funds at a glance* www.asria.org/portal/SRI_Fund/screen

53 Peinado-Vara, E. 2004 *Corporate social responsibility in Latin America and the Caribbean: CSR is still in its infancy in Latin America and the Caribbean* Inter-American Development Bank (IDB/IADB). Available at www.eldis.org/go/display/?id=15793&type=Document

54 Bovespa Corporate Sustainability Index www.ifc.org/ifcext/home.nsf/AttachmentsByTitle/Brazil_Corp_Sus_Index/$FILE/Brazil_Corp_Sus_Index.pd

3 Corporate responsibility around the world: A snapshot

3.1 Methodology

This section forms the major part of this report. It is devoted to illustrating how companies from different countries score against several of the key ESG risks that companies face and key sustainability issues of interest to clients as follows:

- Corporate Governance
- Equal Opportunities
- Human Rights
- Supply Chain
- Environmental Responsibility
- Community Involvement
- Nuclear Power
- Military Involvement

Only a partial subset of the EIRIS research criteria and company coverage is considered here. EIRIS research covers over 60 areas, including numerous employee and other stakeholder issues which have not been included here. In total, EIRIS covers approximately 3,000 companies, and the information is updated on an ongoing basis. The data examined here relates to 1,996 companies in the FTSE All-World Developed index[55]. All figures are based on information extracted from the EIRIS databases as of March 2007. The breakdown of the sample by country, region, and risk exposure for human rights, environment and supply chain is shown in table 1.

55 Details of the index rules are available here: www.ftse.com/Indices/FTSE_All_World_Index_Series/index.jsp

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Table 1: Sample of companies examined

Region	Country	Total number of companies	Large operations in high risk countries for human rights (Figure 7)	High/medium supply chain exposure (Figure 12)*	High environmental impact (Figure 16)
Asia Pacific	Japan	484	105	73	188
	Australia	116	6	6	54
	Hong Kong	106	50	21	33
	Singapore	47	10	4	15
	New Zealand	15	-	1	5
Europe	UK	132	34	20	52
	France	72	38	7	30
	Germany	48	21	7	28
	Italy	41	8	1	10
	Spain	33	12	3	14
	Switzerland	29	11	4	12
	Sweden	27	10	4	8
	Netherlands	21	8	3	8
	Belgium/Luxembourg	16	3	4	6
	Greece	12	2	-	4
	Austria	11	1	1	5
	Denmark	11	2	1	6
	Finland	11	6	1	6
	Norway	11	3	2	5
	Portugal	8	1	-	3
	Ireland	8	-	1	3
North America	USA	680	85	110	199
	Canada	57	8	6	26
Total	Global	1996	424	280	720

* Due to low base sizes, data has been reported by region rather than by country.

EIRIS assesses companies primarily by looking at information published by the company, including annual reports, sustainability/CSR reports, company documents and company websites, as well as EIRIS surveys. In cases where regulatory or voluntarily disclosed data is available via a third party, EIRIS also uses this in its assessment.

The EIRIS methodology compares companies on a three, four or five point scale, where levels are defined in each case to relate specifically to the relevant issue. However, for the purposes of this report, data has been aggregated into one of three levels: 'little or no evidence', 'basic' and 'advanced'. Those companies graded as having little or no evidence do not provide sufficient evidence of having policies or systems in place. Basic captures companies that are doing something, but have not demonstrated best practice and advanced represents best practice. The proportions of companies that score basic and advanced are shown in the graphs, however companies that score little or no evidence have been excluded.

3.2 Corporate governance

While corporate governance can be defined in a variety of ways, it generally refers to the mechanisms by which company directors are held accountable for corporate conduct and performance. In principle, good practice in the way in which boards are structured and how directors apportion accountability should facilitate good corporate performance by ensuring that a company is managed in the best interests of its owners. Although improved governance practices and procedures cannot provide a foolproof safeguard against deliberate fraud or financial collapse, many investors see their existence as evidence of sound management practice within a company.

Corporate scandals such as those relating to Ahold and Parmalat in Europe, and Enron and WorldCom in the US have prompted much global debate about corporate governance. Governments, financial authorities and shareholder bodies have in turn initiated a plethora of inquiries, new legislation and revised codes of practice.

Internationally, the Organisation for Economic Cooperation and Development (OECD) updated its Principles of Corporate Governance in 2004. The US has opted for high profile legislative action with the Sarbanes-Oxley Act while European and Asian countries have mainly moved to strengthen voluntary codes. Numerous national updates have taken place over the past five years, including changes to the codes in Indonesia and Slovenia in 2007, as well as changes to codes in Austria, Finland, Germany, Italy, Jamaica, Lebanon, Norway, Portugal, Spain, Sri Lanka, Thailand and the UK in 2006[56].

National codes can vary significantly in quality. In some countries, especially where codes have only recently been adopted, there remains a discrepancy between code recommendations in principle and corporate governance standards in practice. National differences are mainly caused by different approaches to company law and regulation. For example, Asian companies normally adopt a different board structure to the Western model. However in 2004 the Tokyo Stock Exchange (TSE) announced plans to toughen disclosure rules to force executives to certify company financial statements and bring reporting requirements in Japan closer to those in the US[57]. The Japanese Commercial Code was revised

56 Changes have also been made to countries' company codes outside those covered by EIRIS. Full details of revisions and newly released codes can be found here www.ecgi.org/codes/new_codes.php
57 Tokyo Stock Exchange 2004 *Principles of Corporate Governance for Listed Companies* Available at http://www.ethosfund.ch/pdf/Code_Japan_principles.pdf

in 2005 to allow firms to introduce a new corporate governance system, called the Board with Committees. In addition, in May 2006 the Company Law, which emphasises the strengthening of corporate governance, was instituted enabling Japanese companies to adopt more Western board structures. Japan has made such allowances in order to satisfy the governance structure expectations of Western investors, although other Asian countries and emerging markets may not adopt the same flexibility.

Historically Western board structures have been perceived to be more effective because of independence of the board. The concept that separation of powers is desirable to increase accountability is an underlying principle of most Western codes. For instance, non-executive directors who do not participate in the day to day management of a company are considered especially helpful in exercising the critical monitoring and oversight role that all directors have over the operations of a company. Non-executive directors are perceived to be more effective at this role because they are independent from direct involvement with and influence by the company.

Because a lot of the pressure for improved corporate governance arises from US and UK based investors, some indicators, such as the requirement for independent directors on audit committees, do not translate as readily to countries with different company governance models. For example Germany and Austria, which incorporate elected employee representation at director level within their systems of dual supervisory and management boards, because employees are not regarded as independent directors. Not all national codes insist on fully independent non-executive directors, so certain countries are expected to perform at a lower level than others against this indicator. It is noteworthy though that even in countries where board structures place less emphasis on the independence of directors, there is a strong push towards separating the roles of the chair and chief executive within boards of directors, with the exception of the US.

EIRIS's research on governance seeks to answer four fundamental questions:

- Is there more than 33% of independent non- executives on the board?
- Does the company disclose the remuneration of its directors?
- Does the company separate the roles of chair and chief executive?
- Does the audit committee comprise a majority of independent directors?[58]

It should be noted that not all investors would necessarily want to apply all the different indicators. National differences in economic structure and reporting requirements mean that the more governance indicators considered or required by an investor, the greater the degree of variation the investor will find between countries. If an investor was interested in applying all the various elements, Ireland, Netherlands and the UK would score best overall with more than 70% of all companies in these countries meeting the four core elements, whilst less than 2% of Japanese companies would meet all four core criteria.

3.2.1 Independence of directors

According to the EIRIS methodology, a non-executive is not considered independent if he/she has served

59 Commission communication *Modernising company law and enhancing corporate governance in the European Union - A plan to move forward*: COM(2003) 284; Bull. 5-2003, point 1.3.40 Available at http://europa.eu/bulletin/en/200410/p103034.htm

the same company for a long period (over ten years), has close family relationships with executive directors of the company, represents a major shareholder/supplier/customer of the company, has a close consultancy or advisory relationship or contract with the company, or is otherwise employed by the company or one of its subsidiaries at any level within the previous three years.

Figure 1: Percentage of companies with more than 33% independent directors

N=1996

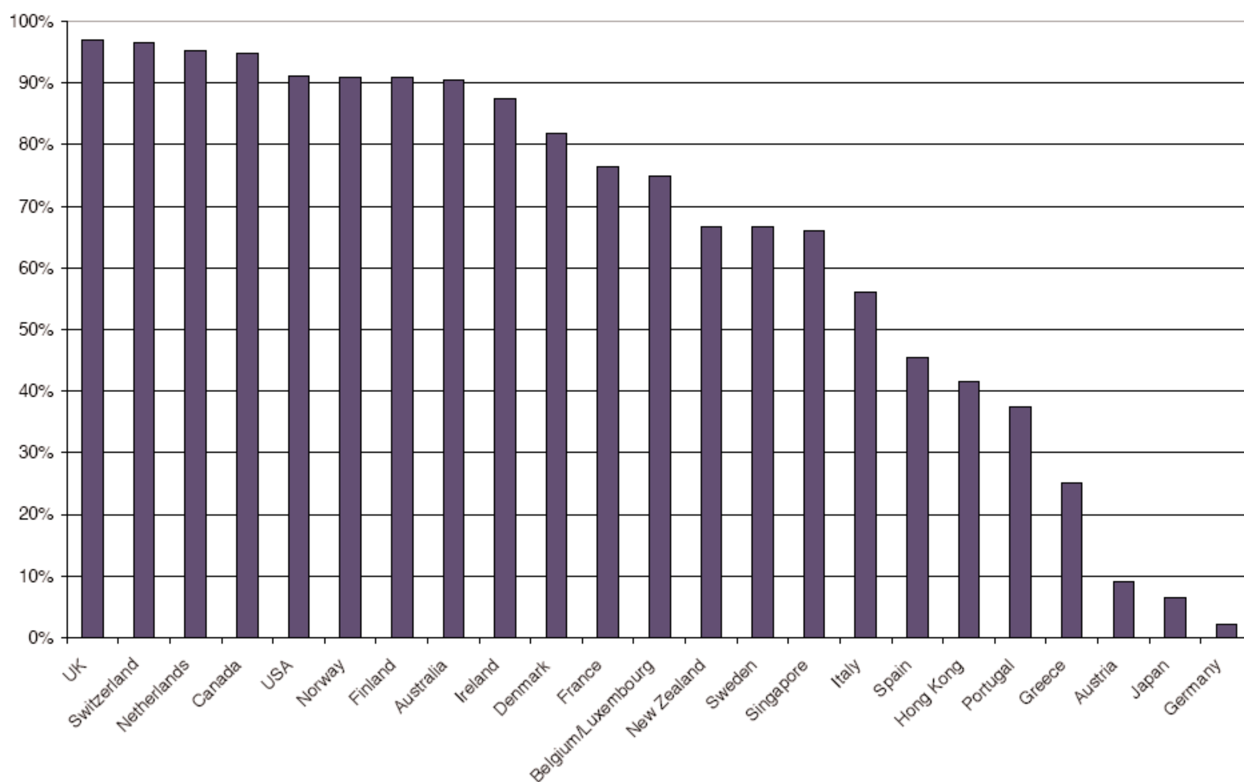


Figure 1 shows a wide degree of variation in the proportion of independent directors from one country to another. The UK and Switzerland lead the list with both having over 95% of companies with more than 33% independent directors. The proportion of companies with independent non-executive directors on boards of directors is lowest in Germany (2%), Japan (6%) and Austria (9%).

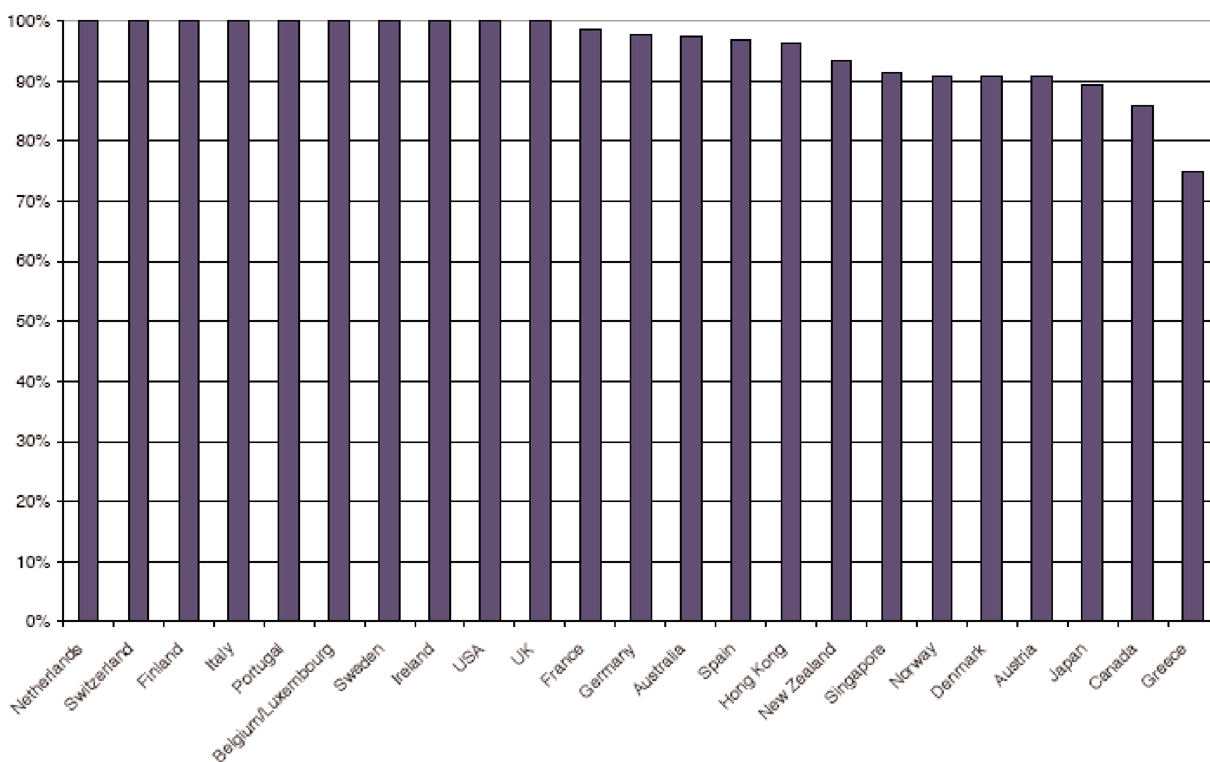
A combination of legislative and cultural differences affects the two extremes. As noted above, laws in Austria and Germany require employee representation on the supervisory board for all companies above a set size, directly limiting the possibility for many companies to have fully independent boards. In Japan, a combination of a large number of conglomerate structures and companies dominated by particular families or owners means that a lot of directors are not considered independent because they may be perceived as representing a particular set of shareholders. A preference for continuity also means that more Japanese directors tend to serve longer than ten years and are therefore excluded from counting as independent.

In the US, since 2004 both the New York Stock Exchange and the Nasdaq Stock Market have introduced new listing rules that establish a stricter, more detailed definition of independence for directors and require that a majority of board members be independent. In other countries as well, great efforts have been exerted to strengthen board independence, particularly regarding board composition, leadership, and committees. In the area of board composition, the corporate governance codes in Australia, New Zealand, Canada, Finland, Sweden and the UK now recommend majority-independent boards. Variations in performance between these countries may be explained by a number of factors including the different pace of development and implementation of governance codes, different levels of cross ownership and different levels of employee representation.

3.2.2 Director's remuneration

Figure 2: Percentage of companies disclosing directors' remuneration

N=1996



Most countries perform well in this area, with 92% of the nearly 2,000 companies analysed disclosing their directors' remuneration and in the worst case, three quarters of Greek companies disclosing directors' remuneration. A high level of media and public interest in this issue, often backed by calls for increased transparency and the threat of shareholder resolutions on remuneration issues, ensures a wide tendency towards disclosure across all the countries covered by EIRIS.

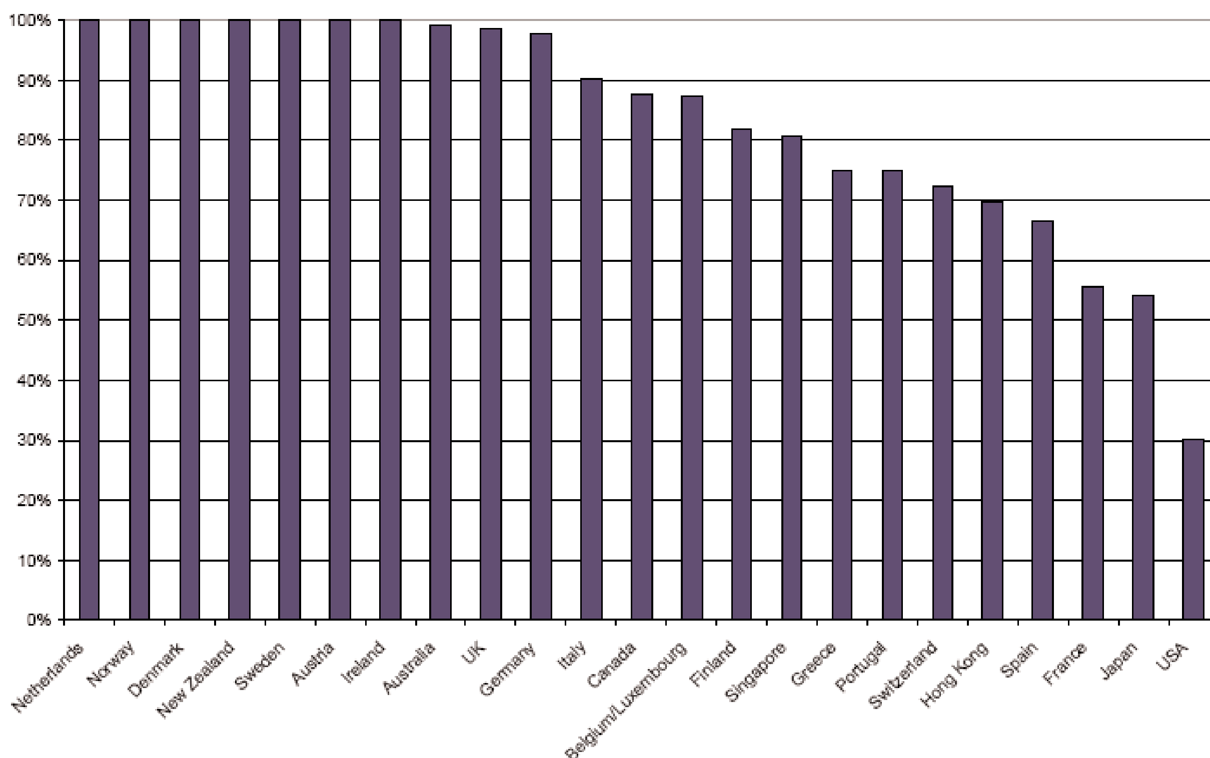
Globally, even in countries such as Japan, Canada and Greece, where less than 90% of companies currently disclose remuneration, there is general trend of shareholder and media pressure encouraging companies to disclose as fully as possible on directors' pay levels. The European Commission published new guidelines in October 2004 which are designed to improve transparency and increase information for shareholders on the remuneration of companies' directors[59]. In particular, these seek to give shareholders more influence over these matters at shareholder meetings.

3.2.3 Separation of chair and chief executive

Separation of the chair and chief executive roles is generally recommended to provide greater independent board leadership. Many investors advocate separation to help embed independence in the decision-making process and reinforce control procedures.

Figure 3: Percentage of companies separating the roles of CEO and Chair

N=1996



Separation of roles is common, with above 90% compliance in a wide range of countries, including countries where the legal structure requires a two-tier board, such as Austria, Germany and the Netherlands and those with a unitary structure such as Australia, New Zealand and the UK. In countries with a two-tier board structure such as Austria, moves to strengthen good practice are focused on encouraging more independence by, for example, ensuring that companies do not habitually appoint a

former CEO to chair their supervisory board. In general the splitting of roles is becoming more prevalent, and there is a trend towards separation in all countries with the exception of the US. Indeed, Singapore and Hong Kong, which do not score well against the majority of issues covered, have 81% and 70% of companies respectively separating the roles.

Reasons commonly given by companies for resisting the splitting of the roles of chair and chief executive usually relate to the particular history of ownership and/or growth of a particular company, for instance where it is still led by the founder-owner or their family. Globally, the percentage of US companies with a split leadership structure remains lowest of the countries being compared, at around 30%.

The importance of a country's corporate governance guidelines is clearly demonstrated as the following three examples show: in the Netherlands, guidelines stipulate the separation of chair and CEO and 100% of companies separate the role. In Canada, the corporate governance code calls for companies to have an independent lead director, although specifies nothing about separating the roles of chair and CEO; yet 87% do separate them. The US guidelines do not offer any guidance relating to either an independent lead director or separating the roles of chair and CEO, and only 30% of companies separate the positions.

In the wake of recent scandals, shareholders have been pushing for more US companies to divide the two roles, which they hope would better protect against mismanagement and rogue behaviour. However, although some companies have responded, separation of the roles is still not widely adopted amongst US companies. Many US companies have resisted calls for them to split the roles of chair and CEO because they believe that such a division of power would harm their business development. In response to shareholder concerns, some companies appoint a lead independent director to liaise with the CEO/chair and to chair some sessions of the board without the presence of management.

In summary, the varied pressures of legal and regulatory requirements in different countries elicit varying responses from companies. Although the majority of companies in all countries disclose the remuneration of directors, the pattern is slightly more varied for the level of independence of directors and separation of chair and CEO. However, worldwide the approach to corporate governance seems to be converging as corporate governance codes and governance practices are becoming increasingly similar in large part due to investor pressure.

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3.3 Equal opportunities and women on the board

Employers increasingly recognise employee discrimination as being bad for business because it limits the skills pool from which they can draw talent and creates a closed mindset towards developing new markets and opportunities. For example, by not discriminating on the grounds of age, a company can take advantage of highly experienced staff who are often overlooked in the marketplace. Companies can achieve similar results by being pro active in combating discrimination on the grounds of religion or sexual orientation and moreover, use this to their advantage in helping to market their products or services more widely. Increasing numbers of companies therefore now see improving diversity not just as a way to avoid criticism or lawsuits, but as a means of building reputation and gaining competitive advantage.

Equal opportunity in relation to ethnic or other minorities is interpreted differently around the world. In Australia, for example, the notion is applied to non-English speakers, and issues associated with the indigenous, aboriginal population are seen separately. In much of North America the focus is on diversity policies and the need to create a diverse workforce, whilst in Japan the issue is usually only acknowledged by more global companies, and discrimination is largely perceived as a gender issue.

The case for gender equality attracts most attention worldwide and in principle, at least, is most widely accepted. In practice, however, social practices, legislation, and public opinion all differ greatly. There are also indications that the glass ceiling operates differently according to the size and nature of the company concerned. For instance, even though the UK has a high level of female participation in the workforce and growing numbers of women in senior management, surveys consistently show a low number of women directors in major companies and a gender pay gap. By contrast, in Norway, companies are legally required to have at least 40% women directors and in response the number of women directors has grown most quickly towards gender parity. Despite an evident business case for diversity, it appears that progress is sometimes most rapidly stimulated by the existence or threat of legislation. National regulatory requirements also influence the type of disclosure made by companies, so for example within Northern Ireland, equal opportunities legislation requires significant disclosure of the religious and racial compositions of their workforce, whilst in other countries such as France and Belgium, the reporting of such statistics based on ethnicity is illegal.

Without effective systems in place to monitor and improve a company’s practices on this issue, it can often be difficult for the company to bring about real change for the better and a policy commitment on its own may have limited value. The existence of adequate monitoring systems is therefore very important to investors seeking quantitative evidence of the companies’ performance on this issue.

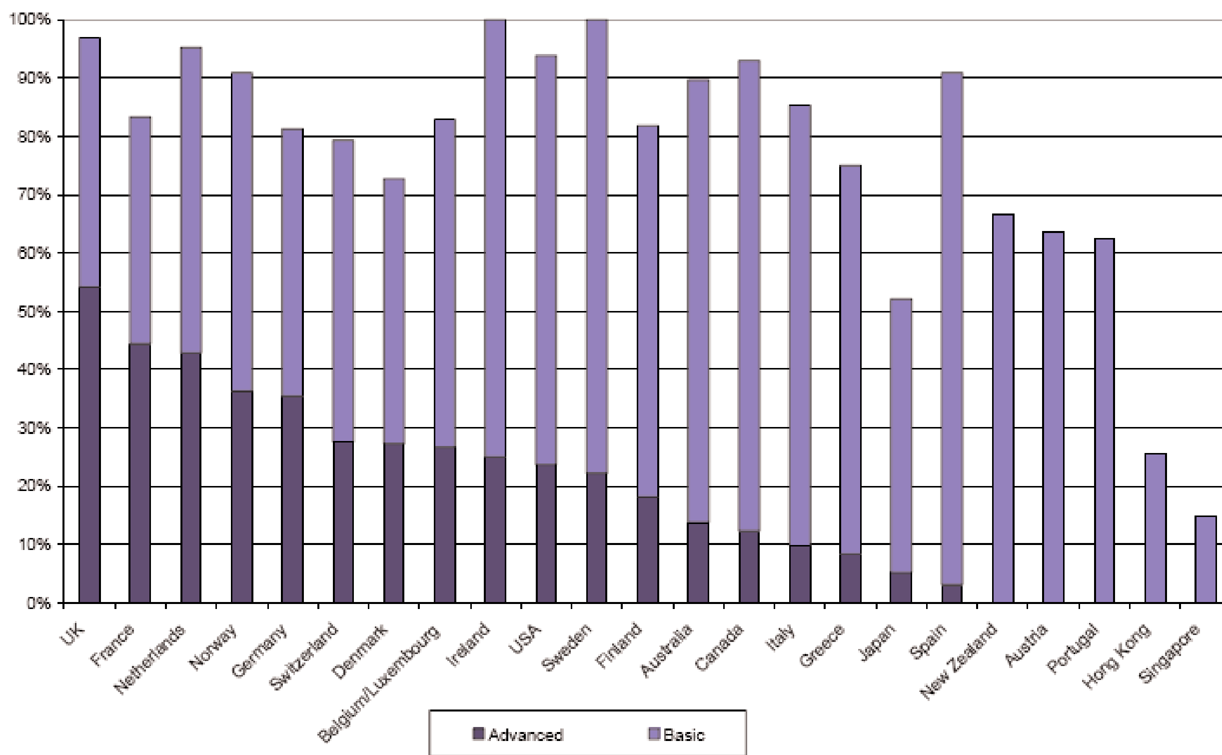
There are two EIRIS criteria for equal opportunities, namely policy and systems. The policy criteria includes an assessment of whether the company has a publicly disclosed policy relating to race, gender, disability, religion, ethnic origin, age, sexual orientation and other groups potentially discriminated against, whether it is globally applicable to all staff, and whether the company has adopted mentoring and support networks for minority groups. Companies are regarded as having a basic policy if they have made public a general non-discrimination statement, and advanced if they go beyond this requirement. The systems criterion contains a combination of indicators including the presence of opportunities for flexible working and family friendly policies, and the reporting of employee demographics and managerial proportions of ethnic

minorities and women. This primarily relates to the systems for monitoring diversity, but some note is also taken of one aspect of performance, namely whether or not the proportion of women and ethnic minority managers match or exceed the representation of these groups throughout the company.

3.3.1 Equal opportunities policy

Figure 4: Percentage of companies adopting equal opportunities policies

N=1996



It must be noted that although in many countries observing equal opportunities standards is obligatory, EIRIS criteria measure disclosure of equal opportunities policies and systems. The UK is the only country where over 50% of companies have disclosed sufficient information to be graded as having an advanced equal opportunity policy. Despite the high degree of media attention given to equal opportunities, the majority of companies globally only disclose enough information to achieve a score of basic. This trend may be due to companies only implementing policies in countries where equal opportunities are a high profile issue. Arguably companies may not be disclosing a policy for fear of litigation when individuals feel they have been discriminated against, particularly so in more litigious societies such as the US.

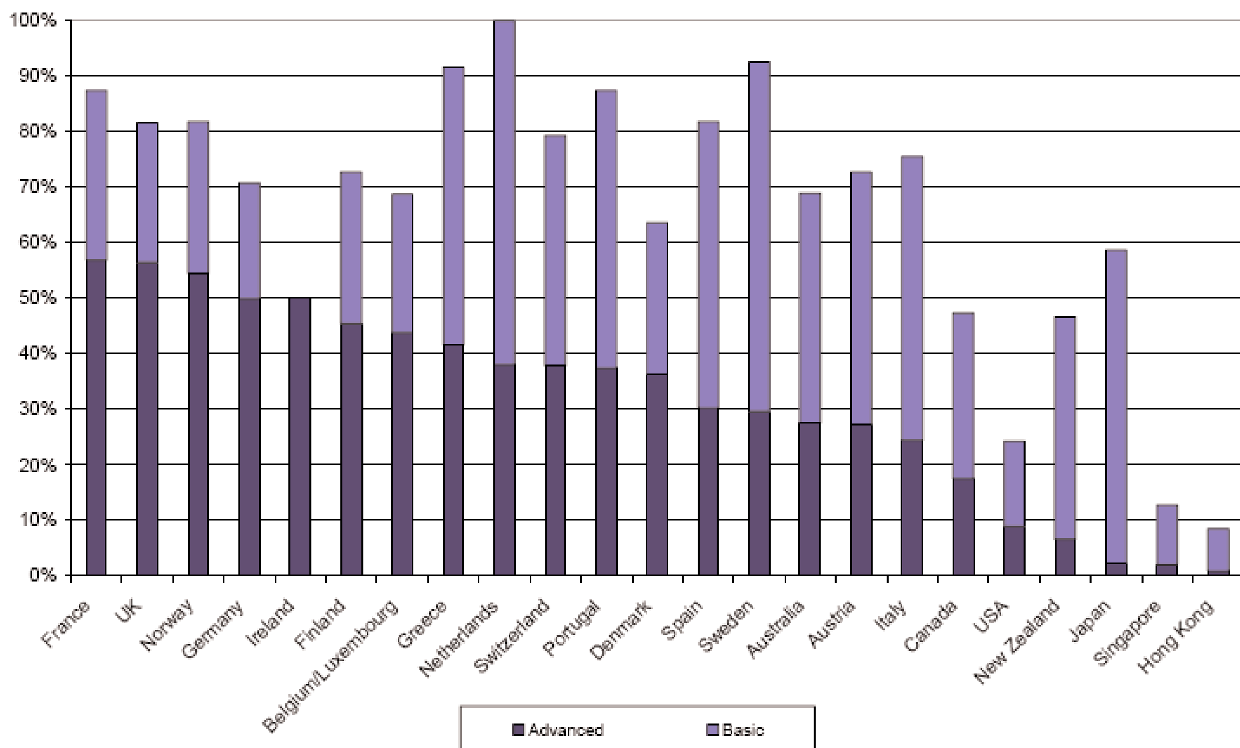
The majority of countries, with the exception of Singapore, Hong Kong, Austria, Portugal and New Zealand, have at least some companies assessed as having an advanced policy on diversity. Hong Kong and

Singapore are the only places where less than half of companies can demonstrate at least a basic policy, with a quarter or less having disclosed sufficient policies. The poor performance of the companies in Asia ex-Japan reflects a looser legislative framework towards equal opportunities and a traditionally lower proportion of women in the home country workforce compared to Western companies. In addition, a higher than average proportion of companies in these countries refer only to women in the statement, rather than a range of equal opportunities beyond gender and race, such as age, disability and sexual orientation.

3.3.2 Equal opportunities systems

Figure 5: Percentage of companies adopting equal opportunities systems

N=1996



To meet the advanced level, companies must report data relating to either the proportion of women or ethnic minorities in the workforce and employed at managerial level, which the majority of companies do not disclose in their publicly available material. Companies are more likely to disclose their flexible working policies and family friendly policies, however many have not adopted the necessary level of commitment to flexible working to meet the required criteria. The only countries where over three quarters of companies have equal opportunities systems meeting at least basic standards are European. As with equal opportunity policies, companies in Asia ex-Japan have the lowest levels of systems, with around 10% of companies attaining at least a basic grade for equal opportunity systems. In addition, neither Japan nor New Zealand perform well in comparison to other countries. The poor performance amongst Asia-Pacific

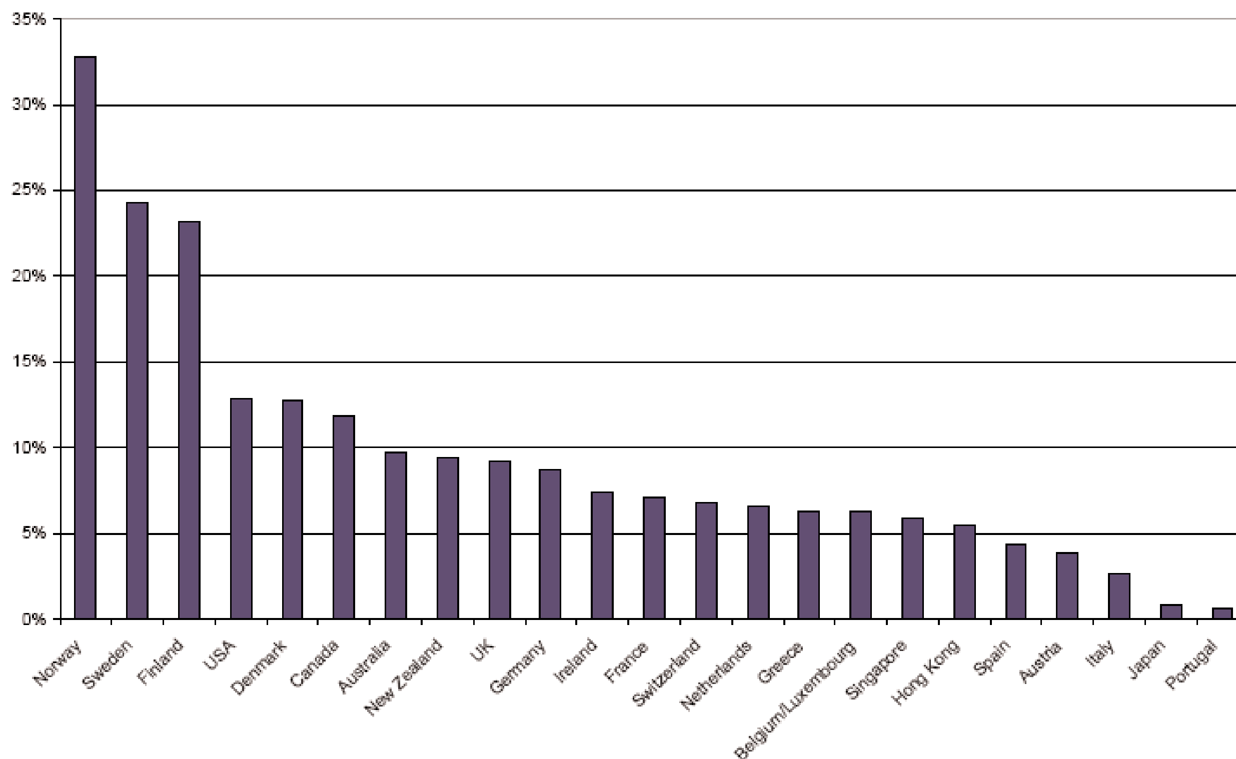
companies is a reflection of their history of lower legislative requirements and expectations, as well as an understanding of equal opportunities primarily in terms of gender. French companies score well against the equal opportunities systems criteria because a high proportion report the gender composition of the workforce and their flexible working arrangements.

Interestingly, less than a quarter of US companies achieve a basic or advanced grade, despite the fact that equal opportunities laws have been implemented at federal and state level dating back to the 1960s, including the Civil Rights Act of 1964 and the Age Discrimination in Employment Act of 1967[60]. As demonstrated in figure 4, over 90% of US companies disclose an equal opportunities policy, and many have mentoring networks supporting minority groups. However, far fewer companies publish the demographic make-up of their employees and proportions of managerial level women and ethnic minorities, potentially for fear of litigation. In addition, standard employee benefits in the US relate to medical insurance and paid time off rather than offering flexible working and job sharing opportunities and parental leave packages beyond the legal requirement, although some do offer childcare facilities and assistance.

3.3.3 Women on the Board

Figure 6: Percentage of board directors who are women

N=1996



60 US Equal Employment Opportunity Commission www.eeoc.gov

About 8% of board members of all the companies covered by EIRIS in early 2007 were women. This is slightly up on a snapshot of EIRIS data at the end of 2004, when 7.5% of board members were women. As demonstrated by figure 6, the highest rate of female board members was seen in Norway, Sweden and Finland with 33%, 24% and 23% women on the board respectively. Norway is a leader because the Norwegian government set a quota of 40% of women on the board by the end of 2007. Companies failing to meet this requirement by end of 2007 are being threatened with being de-listed. In Norway, state-owned companies are already obliged to comply and now have 45% female representation on their boards[61]. The number of women on the board is set to increase in Spain as the Spanish government has recently established a quota similar to that imposed in Norway[62]. Both US and Canadan companies are more likely to have women on the board than non-Nordic Europe as more than 10% of board members are women in these countries. Positive action and legislation again have contributed, but it also suggests that the relatively high level of visibility given to diversity issues by regulators and investor groups in North America has had an effect in positively influencing companies. The lowest levels were seen in Japan and Portugal with less than 1% and less than 5% in Spain, Austria and Italy. A mixture of cultural factors, including a history of fewer women in formal employment combined with weaker legislative requirements, means that corporate representation of women on the board continues to be low in Asian and Mediterranean countries.

In summary, the proportion of companies adopting an equal opportunities policy is high amongst European, North American and Australian companies. However, the proportion of companies in Asia is lower, at around a half in Japan and less than a quarter in Asia ex-Japan. The proportion adopting systems is lower, particularly in North America, where companies are less likely to report employee demographics, possibly for fear of litigation. Nordic companies have a greater proportion of women on the board. North American companies have a slightly greater proportion of women on the board compared with non-Nordic European companies, as over 10% of board members are women. The proportion of women on the board is lowest in Asia; below 1% in Japan and around 5% in Asia ex-Japan, where historically women have not served in high level positions.

61 *Board quota legislation works for women* www.expatica.com/actual/article.asp?subchannel_id=155&story_id=30728
62 www.mtas.es/destacados/es/150307leydeigualdad.htm

3.4 Human rights

Human rights are central to research into corporate responsibility and sustainability issues. Globalisation has had a significant affect on a large number of companies' approach to human rights, as corporations are being asked to consider whether their involvement in a particular country reinforces or undermines the human rights of their employees and the wider community. Many high profile campaigns that have contributed to awareness of responsible investment and corporate responsibility have related to human rights. Most famously, concerns about investment in apartheid-era South Africa in the 1980s and more recently controversies about commercial relations with Burma, Sudan and elsewhere have often placed the spotlight on companies investing in countries where human rights are seen as at risk.

While governments have the primary legal responsibility to promote and protect human rights, businesses are also recognised as having responsibility, particularly in relation to the conduct and influence of their own operations. Hence more and more global companies are being examined by investors looking for proof of compliance with standards of fundamental human rights as recognised in the Universal Declaration of Human Rights and related international conventions. However, despite pressure from investors and NGOs, most corporations firmly opposed the proposed 'Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights' produced in 2003 by the United Nations[63]. This is because some companies have sought to avoid being monitored and audited by independent bodies for compliance with international standards on the issue.

Some investors may simply choose to avoid investment in particular countries with poor human rights records. Traditionally responsible investors have boycotted certain countries, but increasingly it is argued that countries need investment to improve basic social and economic rights. For example, Mary Robinson, the former UN High Commissioner on Human Rights has highlighted extreme poverty as a major human rights violation. Consequentially, investors are increasingly focusing on companies' approaches to human rights rather than whether they are operating in any particular country. Companies face potential damage to their reputation and brand if they are accused of being complicit in the violation of human rights. For both investor and company such a risk is increased if that company operates in a high risk country and therefore EIRIS analyses the human rights strategies adopted by companies operating in high risk countries.

The issues and standards chosen by EIRIS to provide benchmarks for human rights research are based on internationally endorsed conventions, notably the UN Universal Declaration of Human Rights and the core Conventions of the International Labour Organisation. The key conventions considered under the heading of human rights relate to the core labour standards covering child labour, forced labour, freedom of association and collective bargaining, and equal opportunities. These standards largely relate to how responsible a company is as an employer within a country of concern, as labour standards are most closely within a company's sphere of influence.

63 Ruggie, J. G. 2007 *Business and Human Rights: The Evolving International Agenda*
Available at www.ksg.harvard.edu/m-rcbg/CSRI/publications/workingpaper_38_ruggie.pdf

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Because of its particularly high level of risk, the oil, gas and mining sector is a focus of special analysis by EIRIS. Responsible investors expect resource companies operating in high risk countries to meet higher human rights standards and to have more comprehensive policies and systems in place than companies in other sectors. For example, if a resource company employs security guards because it is operating in a conflict zone, EIRIS considers whether measures are in place to comply with United Nations standards of best practice on the use of firearms and whether security guards are trained to meet these standards[65].

3.4.1 Countries of concern for human rights

Whilst noting that human rights violations can occur in all countries, EIRIS focuses its research on particular countries where human rights are seen as most at risk. EIRIS divides countries of concern into two categories of intensity of human rights abuses; high risk and medium risk. High risk highlights the countries of most concern for human rights issues. Medium risk lists all other countries of general concern for having medium risk of human rights abuses[66]. Investors concerned about human rights often require higher standards of companies with a significant presence in high risk states.

The human rights high and medium risk lists are compiled in two steps. Firstly, a 'human rights risk' score is calculated for each country on the basis of five different data points or indicators: respect for political rights and civil liberties, political instability, workers' rights, women's economic rights and physical integrity rights. The different data points are given a certain weighting: civil liberties and political rights, 55%; political instability, 10%; workers' rights, 10%; women's economic rights 10%; physical integrity rights data, 15%. The compiled scores are used to draft preliminary high and medium risk lists. These data points come from a number of different sources; *the Freedom House Annual Survey; World Bank Political Stability and Absence of Violence Governance Indicator; the Cingranelli & Richards (CIRI) Human Rights Database*. EIRIS cross-references some of this data with the annual reports from *Amnesty International* and *Human Rights Watch*. Secondly, on the basis of the existence of armed conflict, the gravity of this conflict and any pattern of systematic killing of trade unionists, amendments are then made to the draft lists. The sources used for this data are *Project Ploughshares Armed Conflicts Report* and *International Confederation of Free Trade Unions (ICFTU)*.

The size of a company's operations in a country identified as a country of concern is taken into consideration – with companies categorised as having a small or large presence in countries of concern. Presence in high and medium risk countries is based on ownership of at least a 20% equity or voting rights stake in a company incorporated in the country, except for oil & gas and mining companies where exploration and production ventures with at least a 5% stake in the consortium is the threshold. Companies are considered to have a large presence if their operations generate GBP 100m in annual turnover or assets, or if 1,000 employees are employed in that country.

64 Companies in this sector typically have direct links with central governments, often working in joint ventures with them, and investing large sums over a long period in the countries concerned. The nature of their industries means that the effect on local communities can be pronounced with displacement of local people, potential pollution threatening livelihoods, and in areas of conflict, the use of security forces to guard personnel, pipelines and installations from attack.
65 Based on the UN guidelines: *Basic Principles on the Use of Force and Firearms by Law Enforcement Officials and Code of Conduct for Law Enforcement Officials* (text at www.ohchr.org/english/la
66 The 2007 high and medium risk countries are provided in Appendix A

Figure 7: Percentage of companies with large or small operations in high risk countries

N=1996

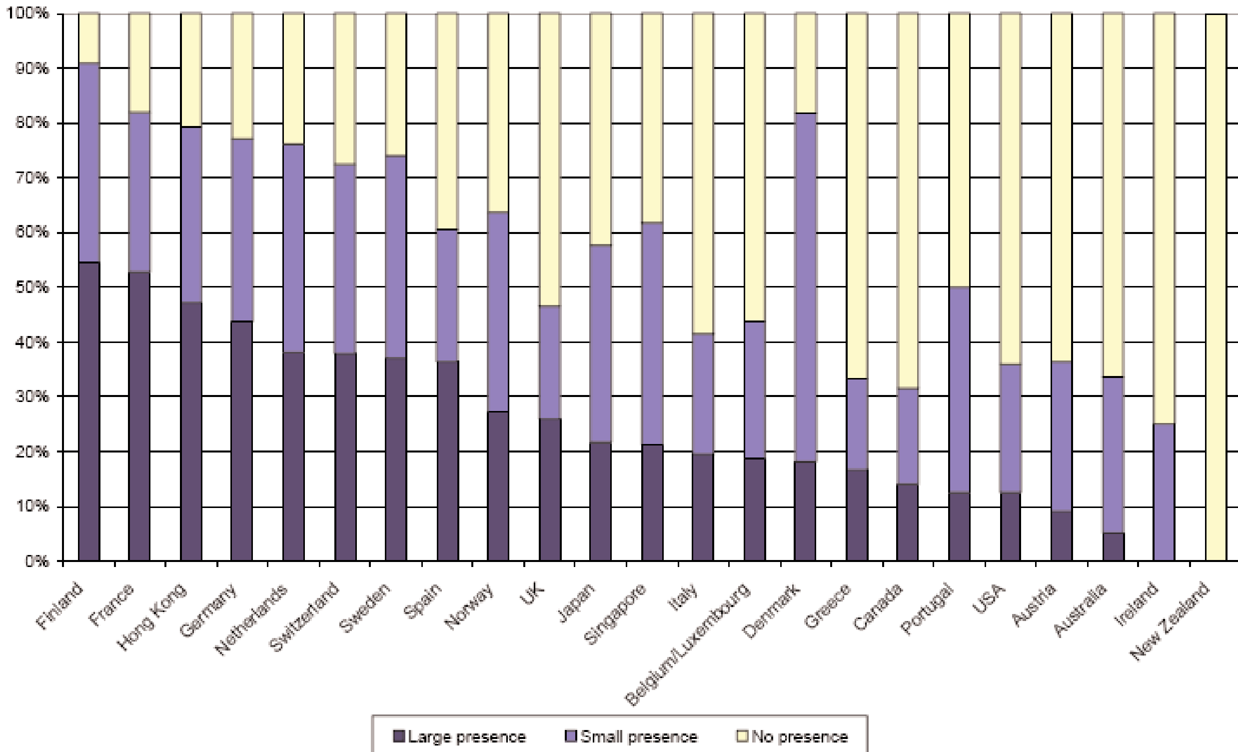

Figure 7 illustrates the percentage of companies in each country covered by EIRIS that have a large and small presence[67] in high risk states. Companies in certain sectors, such as the extractive industries, are more exposed to operating in high risk countries, so the data shown in figure 7 is partly determined by the proportion of companies in each country involved in these activities. Presence in China is also a major determining factor because China is a leading recipient of foreign direct investment and is currently classified as a high risk country. Almost 80% of companies in Hong Kong operate in high risk countries, primarily because of its investment and trading relationships in China, as almost 50% of companies incorporated in Hong Kong are operating in China.

90% of the companies with large operations in high risk countries have operations in China and 27% exclusively so. Following Hong Kong, the remainder of countries with over 25% of companies with large scale operations in high risk countries are European, notably France and Finland. This reflects the fact that a substantial number of European companies have manufacturing operations in developing countries, particularly China, to supply European and international markets. 22% of Japanese companies have large scale operations in high risk countries, again reflecting close manufacturing ties with China and other developing countries. However only 12.5% of US companies have large scale operations in high risk countries, which may be a reflection of the fact that certain US companies only operate domestically because of their larger home market.

67 US Equal Employment Opportunity Commission www.eeoc.gov

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EIRIS assesses a company's overall performance on human rights by looking at the quality of its human rights policy, management systems, and reporting mechanisms. Assessment of policy depends on the extent of a company's commitment to internationally recognised core ILO labour standards of forced labour, child labour, non-discrimination, freedom of association and collective bargaining, as well as a commitment to the Universal Declaration of Human Rights. Companies that do not have a policy relating to all the core ILO labour standards cannot achieve an advanced level grade, and policies must be made public.

3.4.2 Human rights policy

Figure 8: Percentage of companies adopting human rights policies

N=424 (companies with a large presence in high risk countries)

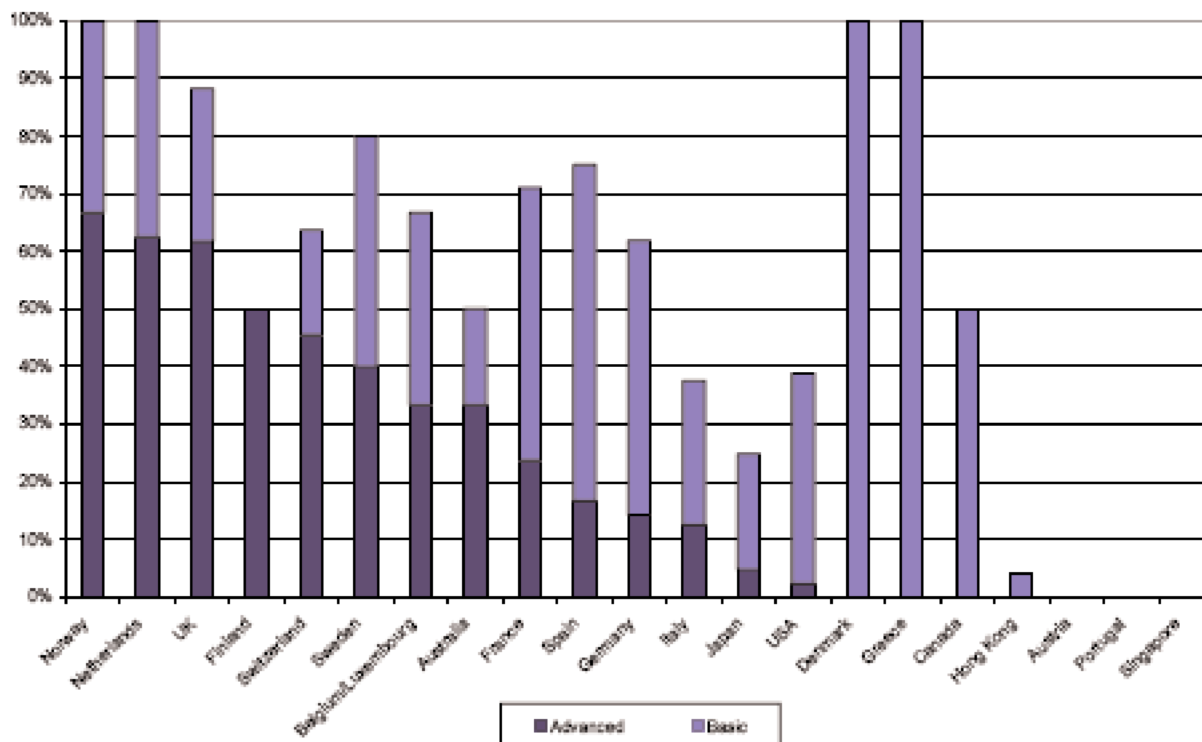


Figure 8 provides a country by country percentage breakdown of the scores received for human rights policy by companies with a large presence in high risk countries.

In view of its presence in China, it is notable that none of the Hong Kong companies have an advanced human rights policy in place and less than 5% of Hong Kong companies can demonstrate a basic policy. Whilst less than 5% of US and Japanese companies can demonstrate an advanced policy, around a quarter of Japanese companies and over a third of US companies can at least show a basic policy. European companies are more likely to have advanced and basic human rights policies. Norway, the

Netherlands and the UK are leaders, as over half of the companies in these countries have advanced human rights policies and over 85% have at least a basic policy. It is perhaps not surprising that human rights policies are most developed in European countries given the power of NGOs and the size of responsible investment in these countries. It is surprising that less than 40% of relevant US companies have developed human rights policies given the number of human rights NGOs and the size of responsible investment in the US. However, it is probably true to say that there is less focus on human rights in the approach to responsible investment in the US than in Europe as US investors are more likely to adopt a traditional screening approach.

The low proportion of companies achieving an advanced grade in the US may be explained by the lack of reference to freedom of association and collective bargaining in US companies' publicly available policies. Unionisation is lower amongst US companies in comparison to other regions, with the exception of Asia ex-Japan. 17% of US companies have met EIRIS' basic or advanced criteria for trade unions, compared with over 70% of companies in Japan and Europe, and over 30% of companies in Australia and New Zealand[68]. In addition, allegations have been made against some US companies of closing branches in the US that have attempted to form a union. A human rights policy that does not include all the core ILO labour standards cannot achieve a grade higher than basic.

The poor performance in Japanese, Hong Kong and Singaporean companies may be explained by the differences in perception of how to manage human rights abuses amongst companies, and the difference in company approach in terms of establishing policies to address human rights issues. The culture is to adopt systems to manage challenges, but not necessarily to adopt formal policies. Indeed, Asian companies can feel disillusioned by the fact they are asked these kinds of questions about their employees, and questions relating to human rights can be misconstrued as accusations, as a Japanese academic acknowledges, "*it is true that Japanese companies are perplexed by this situation*"[69].

In Japan, the Keidanren Charter offers guidance for adopting good corporate behaviour. The charter only contains reference to non-discrimination and not the other core ILO labour standards of child labour, forced labour, freedom of association and collective bargaining. However the implementation guidelines were recently updated and now contain reference to all the core ILO labour standards. EIRIS does not award an advanced grade to companies in national business associations, such as the Keidanren, and others such as those present in Norway and Germany, without a public statement by the company relating to the human rights labour standards adopted. However, EIRIS does consider multilateral initiatives and principles, such as the UN Global Compact (UNGC) and OECD Guidelines.

Pressure from campaigning groups and both mainstream and responsible investors has put increasing pressure on companies to develop and adopt human rights policies, particularly so in Europe. Conversely, there is a lower level of policy development in Asia because there are fewer NGOs driving the change and these NGOs have not been operating for such a long period of time. One might expect this to change over the coming years as the number of NGOs is increasing in Asia and the developing world, and European and North American investors step up pressure on Asian companies. However, the concept of human

68 Data used from EIRIS' database not covered elsewhere in this report. Companies with over 25% of the workforce covered by collective bargaining agreements achieve basic and companies with over 50% coverage achieve advanced.Contact EIRIS for further information.
69 Eiichiro Adachi 2001 *Country Report: Japan* in Reisch, L. (Ed) 2001 *Ethical-ecological Investment: Towards Global Sustainable Development* Verlag fur Interkulturelle Kommunikation

rights is understood differently in Asia. In particular, increased onus is placed on collective rights rather than rights of the individual. Therefore change may be slow amongst Asian companies in adopting policies that meet criteria that reflect Western values.

3.4.3 Human rights systems

Assessment of systems and reporting depends on disclosure of appropriate procedures and practices used by the company for monitoring and verifying implementation of its policy commitments. Several data points combine to make the systems criteria, including training, monitoring, procedures to remedy non-compliance, consulting with independent local stakeholders, undertaking regular reviews, target setting, supporting human rights capacity-building projects in countries of concern and integrating human rights risks into formal risk assessment procedures.

Figure 9: Percentage of companies adopting human rights systems

N=424 (companies with a large presence in high risk countries)

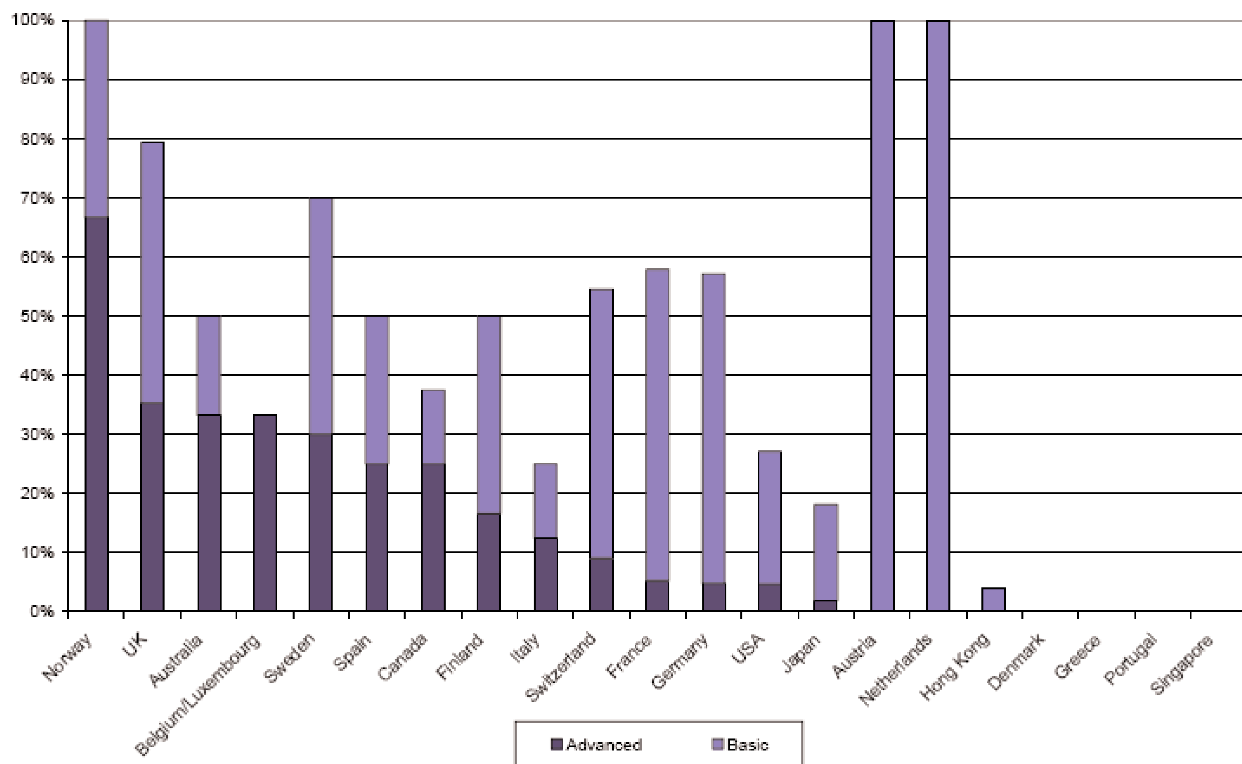


Figure 9 indicates how companies with large operations in high risk countries score for their human rights systems. It is notable that the majority of companies that scored well for policy do not necessarily translate their advanced human rights policy into advanced management systems. For example, over 50% of Dutch companies have an advanced human rights policy, however none of them have advanced systems. Similarly 50% of Finnish companies have an advanced policy whereas less than 20% have advanced systems.

Norway stands out as the exception, where two thirds of companies have developed an advanced human rights policy and two thirds have advanced systems. The UK also does well; over 85% have either an advanced or basic policy and just fewer than 80% either have basic or advanced management systems.

As with the policy criterion, Japanese and US companies are not likely to perform well against the systems criterion. Less than 20% of Japanese companies and less than 30% of US companies meet the EIRIS minimum. As before, the reasons for this include a combination of lower levels of pressure from NGOs and investors in comparison to European countries. In addition, approaches to managing human rights abuses in the workplace are perceived differently amongst Japanese companies, and approaches do not centre on the requirements to meet the core ILO labour standards.

The low levels of advanced human rights systems worldwide reflects the previous historical reluctance of corporations to accept human rights as one of their responsibilities. Corporations have generally opposed adopting internationally binding agreements such as the draft norms with regards to human rights, as proposed by the United Nations[70]. More recently progressive companies have demonstrated a greater tendency to see human rights as a business responsibility, although this perspective has not been universally adopted in all countries and companies.

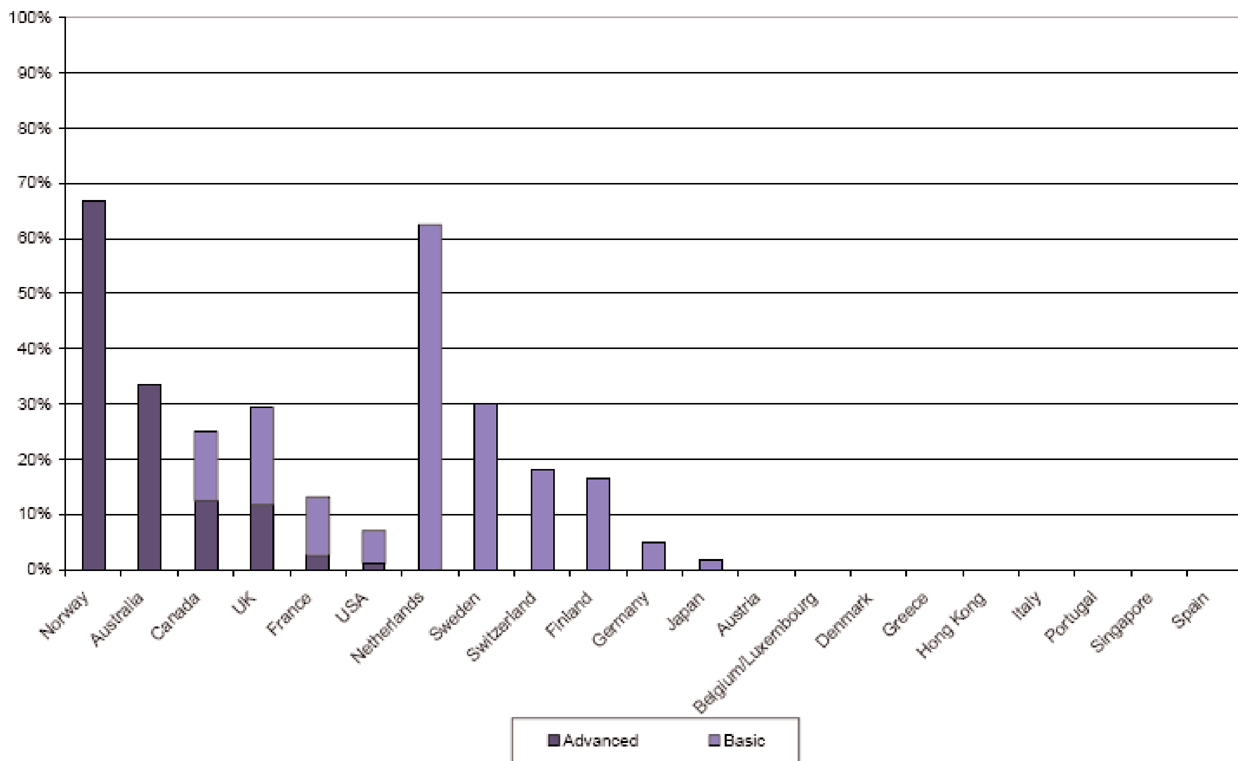
70 Ruggie, J. G. 2007 *Business and Human Rights: The Evolving International Agenda* Available at www.ksg.harvard.edu/m-rcbg/CSRI/publications/workingpaper_38_ruggie.pdf

3.4.4 Human rights reporting

The reporting criterion is based on the public reporting of the elements contained in the policy and systems criteria plus additional requirements including the adoption of external auditing, impact assessments, engagement with NGOs, and reporting on performance against the policy, such as an example of human rights performance or number of breaches of the human rights policy.

Figure 10: Percentage of companies reporting on human rights

N=424 (companies with a large presence in high risk countries)



In order to count as advanced, reporting has to include an element of independent monitoring and verification as well as details concerning performance on human rights issues (such as breaches of a statement of compliance). The auditing of companies for their policies and systems on human rights and related issues has developed significantly over the past decade with the growth of new accreditation standards developed by bodies such as Social Accountability International[71]. However, take up and reporting of auditing processes remains low. Few companies publish sufficient information to meet the EIRIS standards, and very few demonstrate sufficient evidence to meet the advanced level, as shown in figure 10. Only companies in six countries meet the advanced criteria: Norway, Australia, Canada, the UK, France and the US. Norway is a clear leader as two thirds of companies meet the advanced criteria for reporting.

71 See www.sa-intl.org/

However in a number of European countries and Asia ex-Japan, none of the companies are meeting the basic standard. In the case of Hong Kong companies, this may be largely influenced by companies not perceiving any need for special policies relating to investment in mainland China. However, this may also be influenced by the different attitude to human rights in Asia, as explained above. Finally, in the US, Germany and Japan less than 10% of companies meet at least the basic level. The low level of reporting amongst US companies may be due in part to a fear of litigation and NGO pressure if they start to disclose policies, systems and procedures to manage these issues.

3.4.5 The effect of market capitalisation

Figure 11: Human rights policies by proportion of companies and proportion of market capitalisation

N=424 (companies with a large presence in high risk countries)

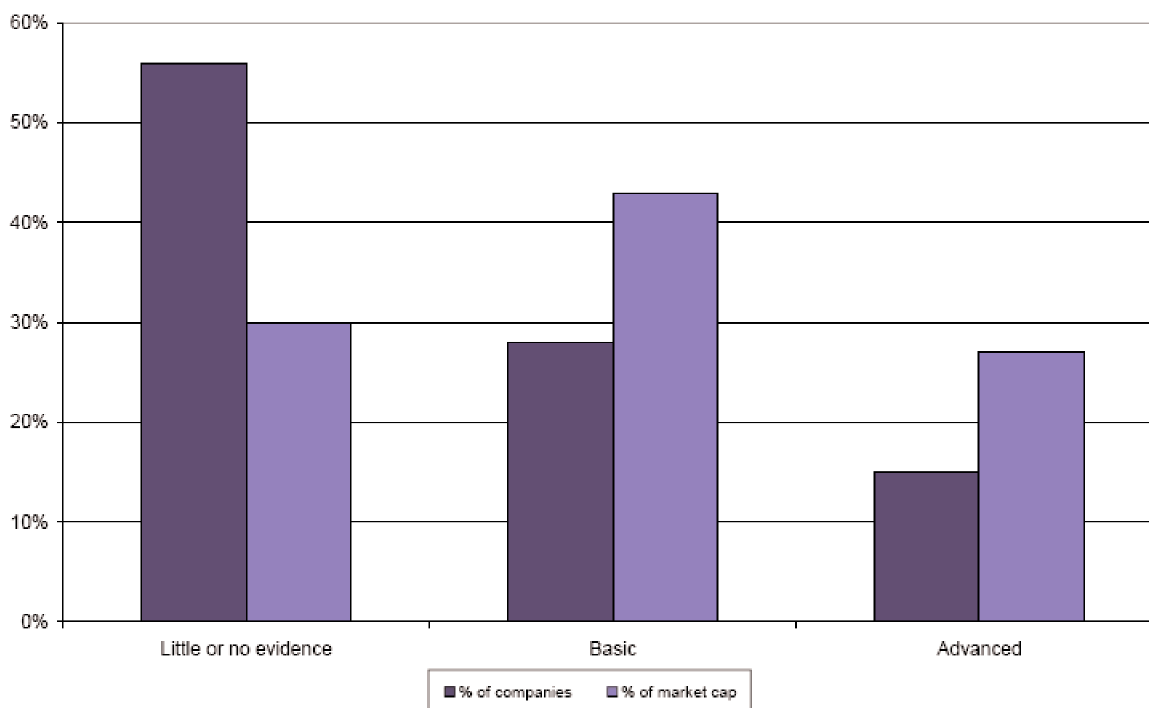


Figure 11 compares the proportion of companies that have a human rights policy with the proportion of market capitalisation these companies represent. It clearly shows that large companies by market capitalisation are more likely to adopt human rights policies than small companies. 15% of all companies in the FTSE All World Developed Index operating in high risk countries have adopted an advanced policy. These companies represent 27% of the value of those companies in the index. Similarly, 43% of all companies have developed either basic or advanced policies and these companies represent 70% of the value of those companies in the index. The trend is repeated for human rights systems as 8% of companies in high risk countries have developed advanced systems and these companies represent 18% of the value of the relevant companies in the index. The trend demonstrates that large companies by

market capitalisation are more likely to address their human rights risks. This is largely due to their greater exposure to investor, NGO and consumer pressure.

In summary, human rights policies and systems are most developed amongst European companies, particularly Norwegian companies. A small proportion of US and Japanese companies have developed policies and systems, and an even smaller proportion in Asia ex-Japan. The reasons for the comparatively low level of policies and systems amongst Asian companies is largely due to different perceptions of human rights and how to manage abuses, as well as lower levels of pressure from NGOs, investors and other stakeholders to act on the issue. US companies have faced less pressure from investors than European companies to address human rights in the workplace. In addition, US companies are less likely to include freedom of association and collective bargaining in their policies. Finally, large companies are more likely to have developed human rights policies and systems.

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3.5 Supply chain labour standards

Awareness of supply chain labour standards as an issue is continuing to grow amongst the general public and the responsible investment community. Due to the increasingly international nature of production and trade, an ever growing number of products are being assembled or processed in many different countries all over the world. Greater attention has begun to be paid to the working conditions in developing countries because these countries are, for various reasons, less able to ensure that basic minimum standards are maintained in all workplaces. Companies which source many of their products from developing countries are coming under increasing pressure to demonstrate that these products are manufactured under minimum working standards. Starting in the 1990s, a number of high profile campaigns have been run against large multinational companies, and in response these companies have developed and disclosed policies and systems in relation to labour standards in their supply chain. The potential for damage to corporate brand and reputation and therefore to financial performance has made this a key ESG issue for many responsible investors.

3.5.1 Supply chain risk exposure

EIRIS has identified a number of sectors as being high risk for supply chain labour standards. These sectors are food producers, food and drug retailers, general retailers & textiles, household goods, personal goods, leisure goods, electronic & electrical equipment, mobile telecommunications, technology hardware & equipment and tobacco. These sectors have been identified because they have the greatest concentration of activities involving global supply chains. EIRIS assesses all companies identified in these sectors that are sourcing products from non-high income OECD countries. Companies are assessed as high or medium impact based on the size of their operations. Those companies determined as high or medium risk are then assessed on their supply chain policy, management systems and public reporting. In total 280 companies have been classified as being high or medium risk for supply chain labour standards.

Figure 12: Exposure to potential labour rights violations in the supply chain

N=1996

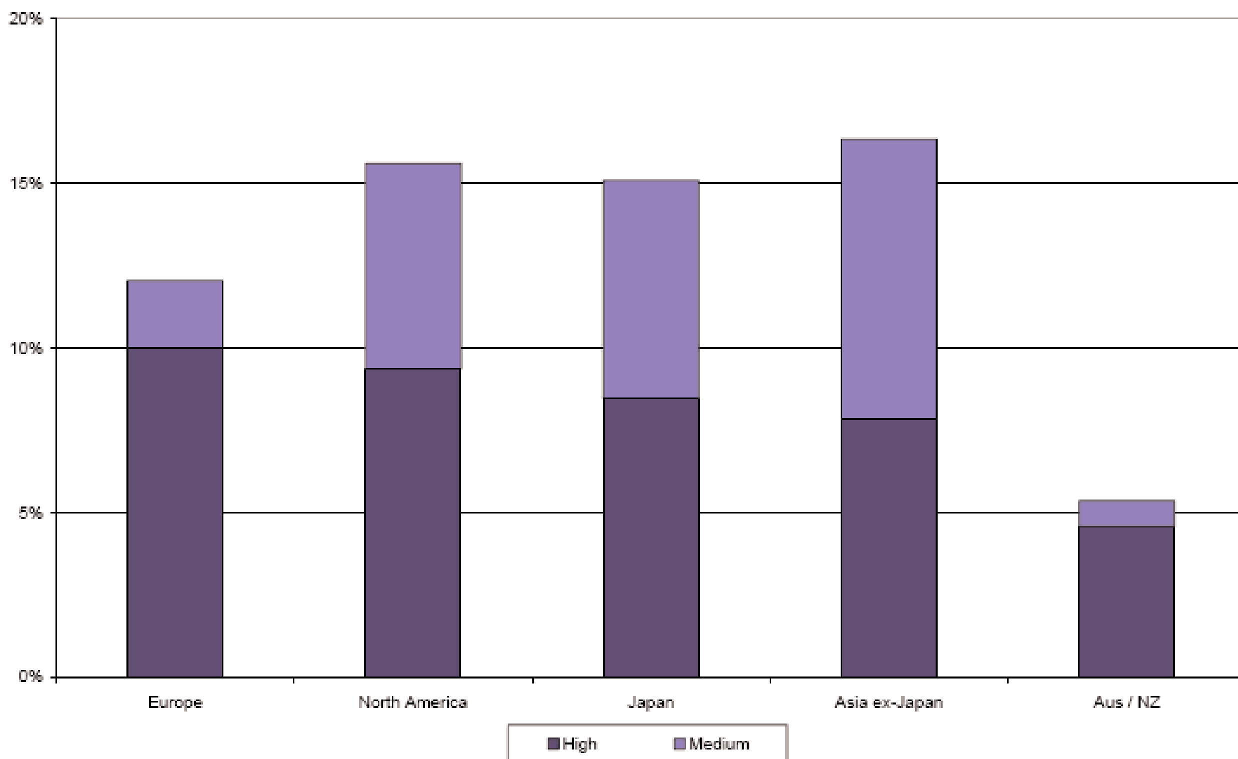


Figure 12 shows the proportion of companies in each region identified as having medium or high exposure to potential labour rights violations in the supply chain. Because of the low number of companies identified as high or medium risk in each country the results have been displayed by region (the numbers of companies in each country are available in table 1). Around 10-15% of companies in Europe, North America and Asia have been identified as high or medium risk, compared against 5% in Australia/New Zealand.

3.5.2 Supply chain policy

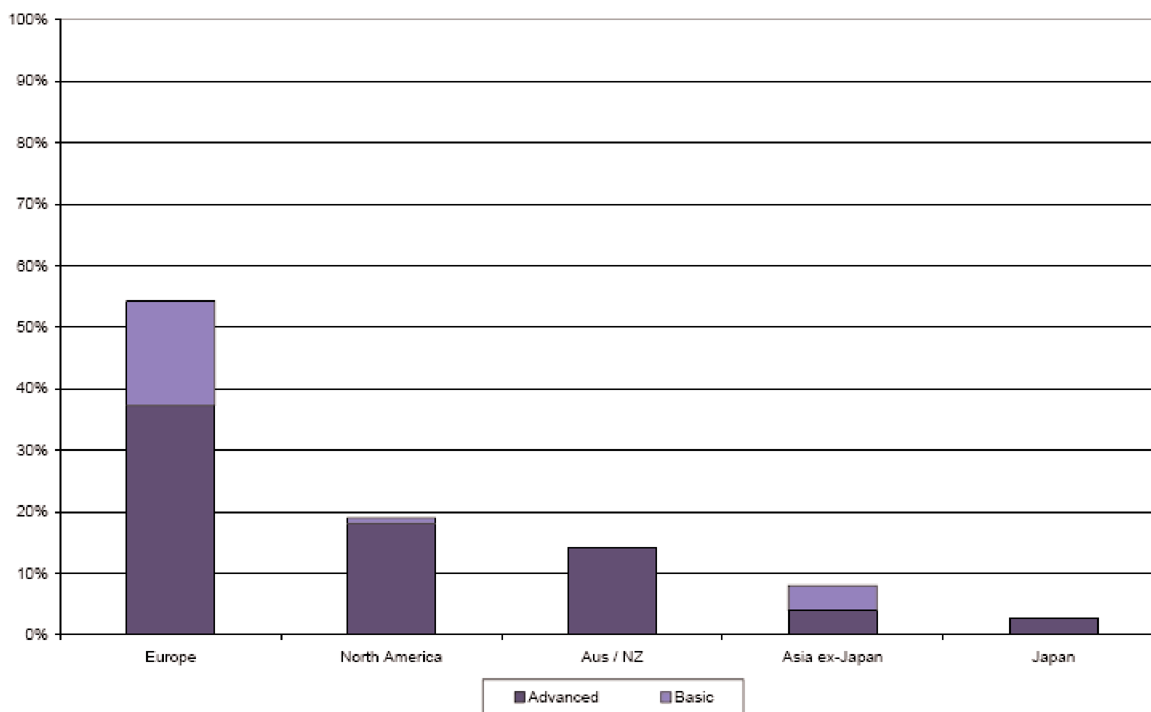
The policy criterion measures whether a company has a supply chain labour standards policy and how comprehensive it is. It assesses whether a company's policy covers the core ILO convention areas of freedom of association, collective bargaining, equal opportunities, forced labour and child labour as well as related key conventions on working hours, health and safety, wages and disciplinary practices. Membership of relevant initiatives for supply chain labour standards, such as the Ethical Trading Initiative, is also taken into account.

To achieve a basic score against this indicator, a company must at least be able to demonstrate commitment to one of the core ILO conventions areas, and make the policy publicly available. To achieve

advanced, a company must demonstrate commitment to all the core ILO convention areas and all the other key labour standards identified by EIRIS. It must also demonstrate integration of its policy with the company's procurement process and membership of a relevant initiative dealing with labour standards, such as the Ethical Trading Initiative, Fair Labour Association or Social Accountability International.

Figure 13: Percentage of companies adopting a supply chain policy

N=280 (companies at high or medium risk of exposure to potential labour rights violations in the supply chain)



It is clear that proportionally more European companies are responding to this issue and to a greater degree than comparable North American, Australian & New Zealand, and Asian companies. As figure 13 shows, across all regions with the exception of Europe, the majority of companies show no evidence of having a supply chain labour standards policy. Over 80% of relevant companies in all regions outside Europe do not have even a basic supply chain policy. However in Europe, over half of the companies have adopted a supply chain policy that meets at least basic, and over a third have adopted a policy that meets the advanced level.

In Asia over 90% of relevant companies do not even have a basic supply chain policy. For many companies the reason for this is because supply chain labour standards have historically not been a high profile issue in Asia and so there has been less incentive for companies to develop policies and systems. Being further away from investor and consumer lobbying on corporate responsibility issues, they may also see themselves as less likely to be exposed to pressure on supply chain labour standard issues. This may be especially so for companies which serve primarily their domestic market or which have a domestic

shareholder base. However the increase in responsible investment and NGO activity will put increasing pressure on companies to improve their response to this issue.

In the UK and Europe, and to a somewhat lesser extent in North America, supply chain labour standards are a high profile issue with a number of large NGOs such as Oxfam campaigning on this issue. This exposes better known companies, especially those dealing directly with consumers, to public pressure to improve any poor labour standards found and exposed in their supply chains. The relatively high number of such companies in Europe coupled with the prevalence of trades unions and NGO campaigns means that European companies are under greater pressure to demonstrate a policy on this issue.

3.5.3 Supply chain systems

The systems criterion assesses how comprehensive a company's management systems are for implementing its supply chain labour standards policy. To score a basic grade, a company must at least prove it communicates its policy to its suppliers; indicate some form of relevant monitoring or auditing system; and have developed procedures for addressing non-compliance. The advanced level is only attained if a company can go further than this by demonstrating training of relevant employees (either its own or those of its suppliers) and demonstrating responsibility for supply chain labour standards at a senior level.

Figure 14: Supply chain systems levels by region

N=280 (companies at high or medium risk of exposure to potential labour rights violations in the supply chain)

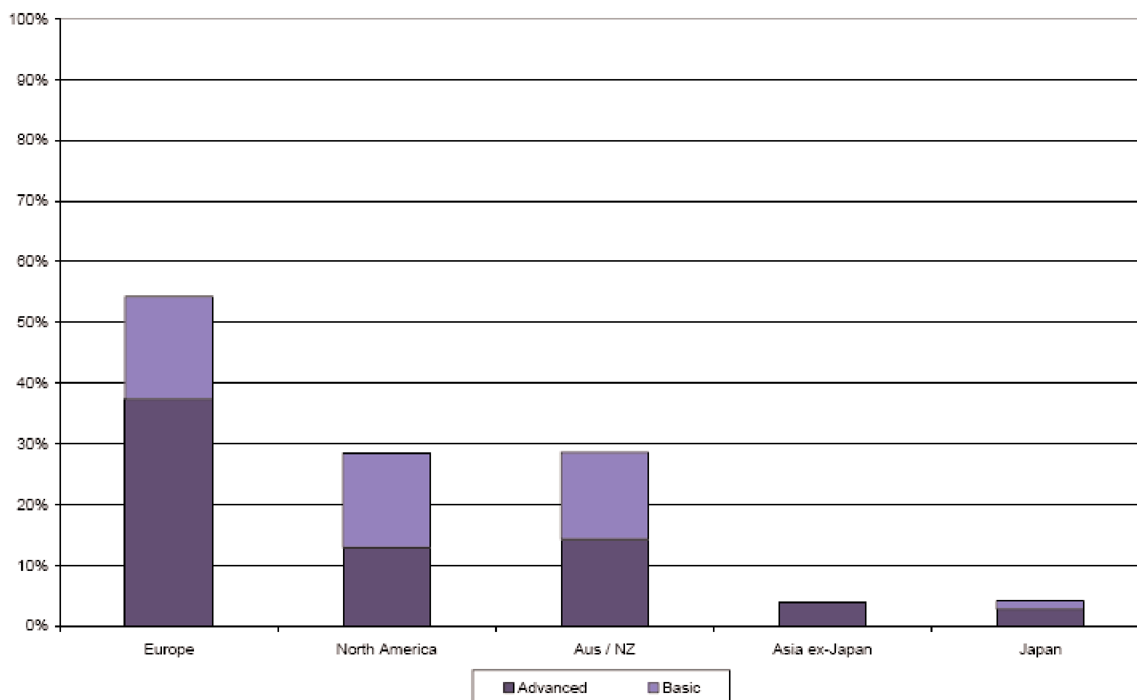


Figure 14 shows that for all regions with the exception of Europe, most companies show no evidence of having management systems in place to support a policy on supply chain labour standards. In Europe over 50% of companies have developed sufficient systems to meet EIRIS' basic criteria, whereas in North American and Australia/New Zealand, under 30% have achieved this standard and in Asia less than 5% of companies show sufficient evidence of management systems.

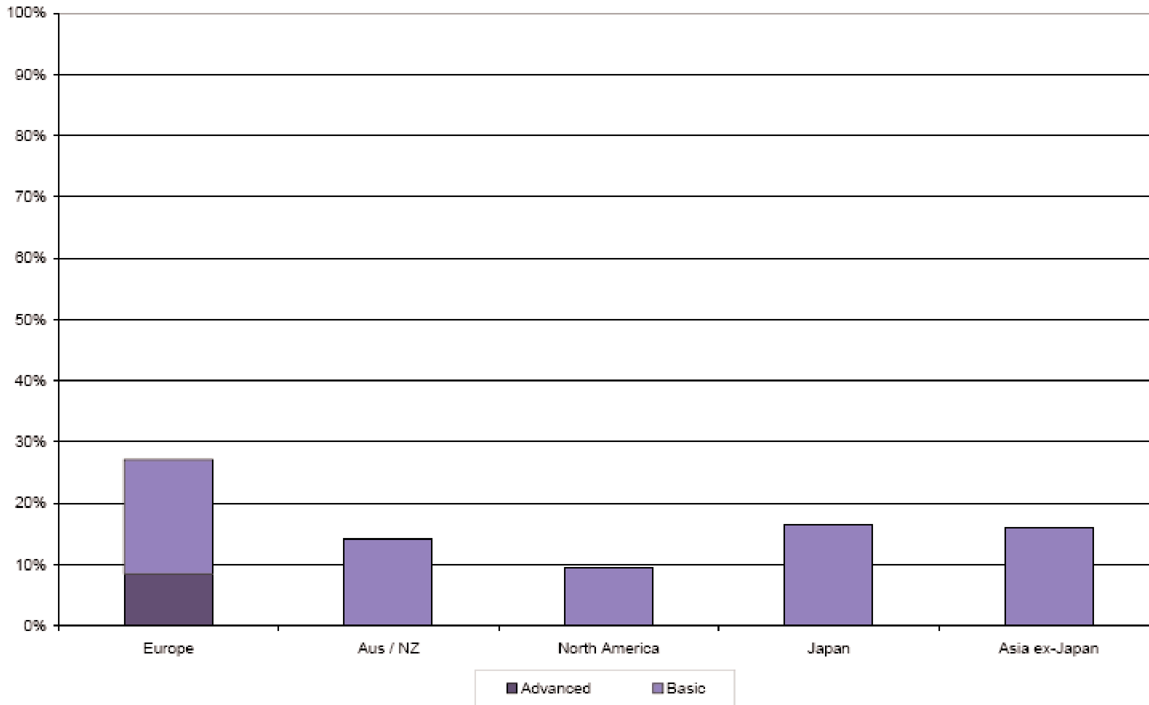
A larger percentage of companies in North America and Australia/New Zealand overall show evidence of having management systems in place compared to the proportion having a policy. One might expect the results to show that proportionally more companies have a supply chain policy in place than have supply chain management systems. The first stage of developing management systems is to set up a policy which is then communicated to suppliers and monitored. However the lower proportion of companies having established supply chain policies that meet EIRIS' minimum standards may be a reflection of the low number of companies prepared to develop a policy in relation to all five of the core ILO labour standards, particularly freedom of association and collective bargaining.

3.5.4 Supply chain reporting

The reporting criterion assesses how comprehensively a company reports on its supply chain labour standards policy and systems. To meet the basic level, companies must meet four of the following five indicators: make the policy publicly available; communicate the policy to suppliers; publish details of procedures to remedy non-compliance; publish details of visiting/auditing suppliers; and disclose details of training provided to relevant employees and suppliers' employees. In addition, companies must provide an indication of the extent of the supply chain monitored. In order to meet the advanced level, companies must meet all five indicators listed above, and provide an indication of the extent of the supply chain monitored as well as publishing information on performance against the policy, have responded to non-compliances found, and demonstrate some evidence of independent verification of their report.

Figure 15: Supply chain reporting levels by region

N=280 (companies at high or medium risk of exposure to potential labour rights violations in the supply chain)



The results show that in all regions the majority of companies showed no evidence of reporting publicly on their supply chain labour standards policy and systems. Over 80% of all companies show insufficient evidence of reporting to meet EIRIS' minimum standards, and only in Europe do more than a quarter of companies meet at least the basic requirements. In addition, the only companies to meet the advanced level are European.

As with policy and systems, the companies which achieved an advanced level of reporting include some which have come under scrutiny in the past over their supply chain labour standards and whose reputations are vulnerable to allegations of poor labour standards and to NGO campaigns on this issue.

Supply chain labour standards are a relatively new issue of public concern. Awareness of supply chain labour standards issues has risen in Europe, North America and Australia/New Zealand; however awareness remains low in Asia. The highest level of response can be seen in European countries, although it is reasonable to expect progress from countries in the other regions of the world as the profile of the issue rises, and NGO and investor pressure develops. Public awareness of the issues is increasing and it is

72 See www.iccr.org/

likely that over time more companies will put policies and management systems in place in response to this.

Although policies and systems are being developed by companies in various regions, reporting is the final link in this process and so is only likely to increase over time as companies' policies and systems become more established. NGO reports and campaigns by groups such as the Interfaith Council on Corporate Responsibility to file more shareholder resolutions[72] in the United States on supply chain issues are arguably prompting more companies to disclose greater levels of information on these issues. In the future, the focus on supply chain labour standards is likely to become greater as more investors integrate questions about supply chain standards within their investment decisions.

3.6 Environmental responsibility

Public concern about environmental degradation, climate change and water availability has grown in recent years. Protests, shareholder actions, investor pressure, regulation and the introduction of initiatives such as the European carbon emissions trading scheme have focused the attention of business onto these concerns. In recent years, there has been a steady expansion in the number of companies seeking to actively manage their environmental impacts as well as ongoing improvements in the standards of these efforts. Initiatives such as the Global Reporting Initiative (GRI) and the Carbon Disclosure Project (CDP) have helped to provide guidance to companies and facilitate greater levels of reporting on, and management of, environmental issues.

EIRIS researches company responses to environmental issues under the following categories: policy, management systems, reporting, and performance. Based on their performance in each of these categories, companies are assigned one of five assessment grades – inadequate, weak, moderate, good or exceptional. For the purposes of this report, weak and moderate have been grouped into 'basic', and good and exceptional have been grouped into 'advanced'.

Companies are classified as high, medium or low impact based on the direct impacts of their business sectors relative to the following key issues: climate change, air pollution, water pollution, waste, and water consumption. Sectors with a high impact in at least one key issue or a medium impact in all five key issues are rated high, and sectors with a medium impact in at least two issues are rated medium overall. The remaining sectors are classified as low impact (see table 2 below). Companies that operate in high environmental impact business sectors (e.g. the extractive industries, agriculture, manufacturing, chemicals and pharmaceuticals) face a greater risk of damaging the environment, often stringent regulatory requirements, and significant pressure from stakeholder groups to both manage and report on their environmental impacts and strategy. As a result they also tend to be more advanced in their overall approach to the environment than do their counterparts in low or medium impact sectors. The number of high impact companies in each country is shown in table 1.

Table 2: High, medium and low environmental impact sector classifications

High impact	Medium impact	Low impact
Agriculture	DIY & building supplies	Information technology
Air transport	Electronic and electrical equipment	Media
Airports	Energy and fuel distribution	Leisure not elsewhere classified (gyms and gaming)
Building materials (includes	quarrying)	Engineering and machinery
Consumer / mortgage finance	Chemicals and pharmaceuticals	Financials not elsewhere classified
Property investors	Construction	Hotels, catering and facilities
management	Research & development	Fast food chains
Manufacturers not elsewhere	classified	Support services
Food, beverages and tobacco	Ports	Telecoms
Forestry and paper	Printing & newspaper publishing	Wholesale distribution
Major systems engineering	Property developers	
Mining & metals	Public transport	
Oil and gas	Retailers not elsewhere classified	
Pest control	Vehicle hire	
Power generation		
Road distribution and shipping		
Supermarkets		
Vehicle Manufacture		
Waste		
Water		

73 Eco-Management & Audit Scheme, www.emas.org.uk/

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A common first step for a company is to produce a policy statement or make a formal commitment to a set of principles established by organisations such as the International Chamber of Commerce (ICC). The EIRIS policy criterion comprises 13 data points, including a policy that relates to the company's key impacts (energy use, water use, water emissions, air emissions and waste), senior responsibility, and the setting of objectives and targets.

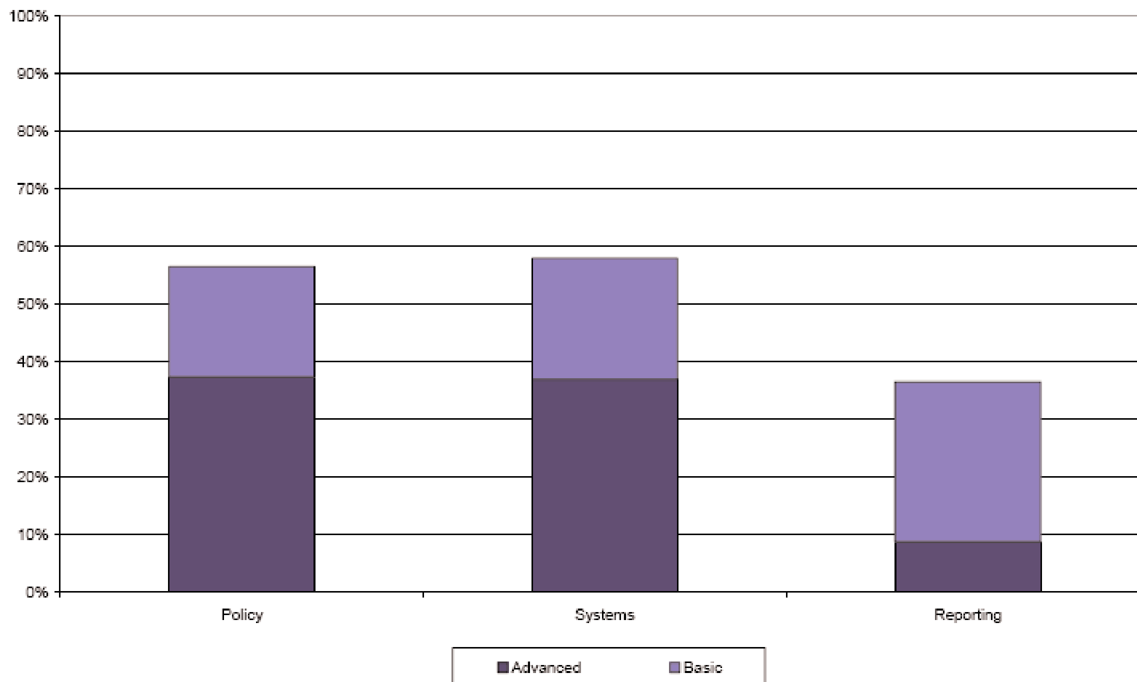
Companies may then implement an environmental management system (EMS) in order to drive continual improvement in performance and compliance with the corporate environmental policy. Factors considered here include the setting of quantitative objectives and targets for all key issues, systems to monitor compliance, feedback to management, and the presence of a 'plan-do-check-act cycle'. Management systems certified as meeting the requirements of ISO 14001 and EMAS[73] are sufficient to meet EIRIS requirements, meeting the basic or advanced level dependent on the proportion of operations covered.

Calls for increased transparency in company activities have led to an increase in reporting on environmental performance, although the proportion of companies in various countries producing reports and the quality of information continues to vary widely.

3.6.1 Overview of global environmental practices

Figure 16: Percentage of companies adopting environmental policies, systems and reports

N=1996



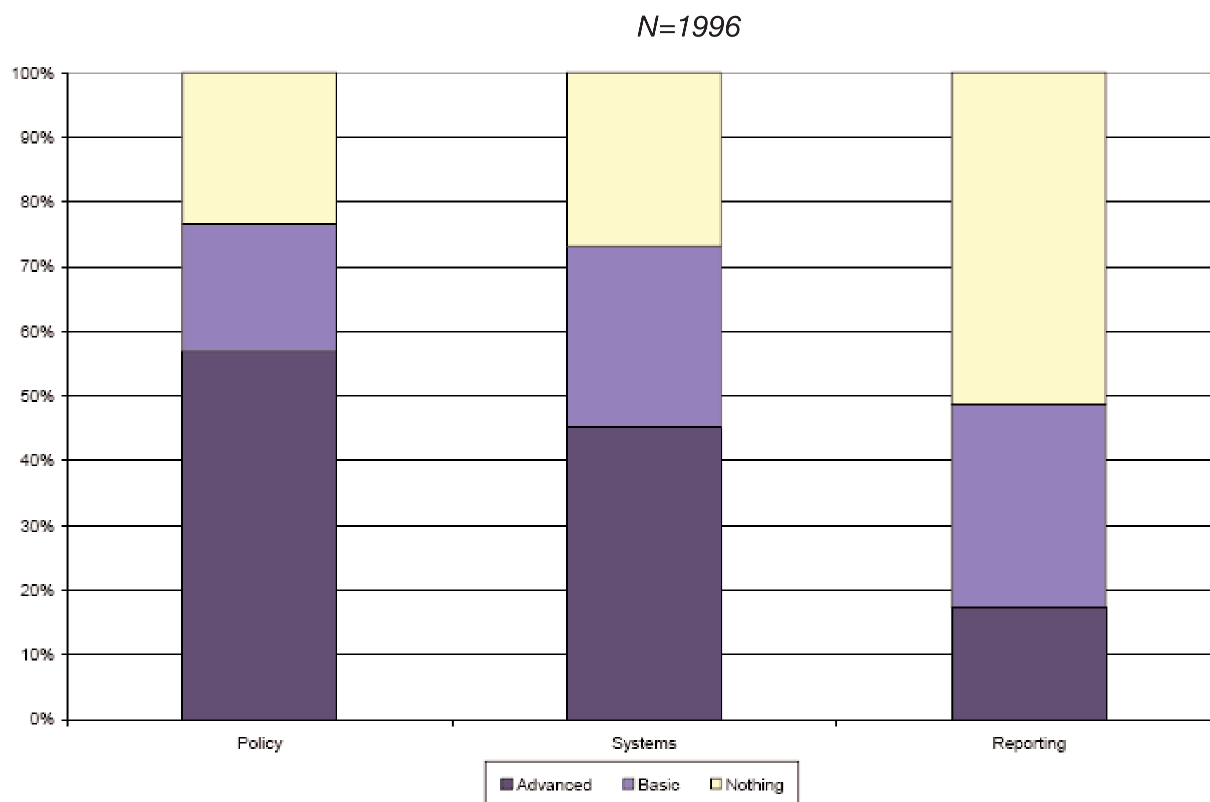
As demonstrated in figure 16, over 50% of all companies researched by EIRIS, across all countries and business sectors, have in place some form of publicly available environmental policy statement. A similar percentage of companies have implemented environmental management systems to support their

environmental policy commitments. A much smaller proportion (36%) actively report on their environmental performance, with less than 10% of companies achieving advanced for this indicator.

Figure 17, below, shows the proportion of companies categorised by market capitalisation with environmental policies, systems and reporting.

Figure 17: Proportion of market capitalisation adopting environmental policies, systems and reports

N=1996



The graph shows the collective market capitalisation of companies achieving basic and advanced for each indicator. Larger companies are more likely to adopt environmental polices, systems and reporting. 56% of all companies in the FTSE All World Developed Index have adopted an environmental policy meeting at least basic. These companies represent 77% of the value of the index. Similarly, 58% of all companies achieve at least basic for environmental management systems. These companies represent 73% of the value of the index. Finally, 36% of all companies achieve at least basic for reporting. These companies represent 49% of the value of the index. The data confirms assertions made elsewhere that large companies are more likely to adopt responsible business practices.

Large companies by market capitalisation are more exposed to responsible investment as they are more likely to be present in investors' portfolios. Therefore they are subject to greater pressure to respond to environmental challenges such as providing data to the Carbon Disclosure Project. Engagement undertaken by FTSE4Good and other responsible index providers also encourages large companies to

improve their response to environmental (and indeed other) ESG issues. Large companies are keen to be constituents of FTSE4Good and so improve the quality of their policies, systems and reports in order to meet its requirements for inclusion. Finally, given the high profile of climate change, pollution and biodiversity issues large companies, particularly those with prominent brands, are also subject to greater pressure from actors such as NGOs and consumers.

Owing to the higher standards expected by regulators on companies in high impact sectors, it may be expected that a larger proportion of high impact companies will publicly disclose environmental policy statements of some description. Figure 18, below shows the percentage of high impact companies adopting policies, systems and reports.

Figure 18: Percentage of high impact companies adopting environmental policies, systems and reports

N=720 (high impact companies)

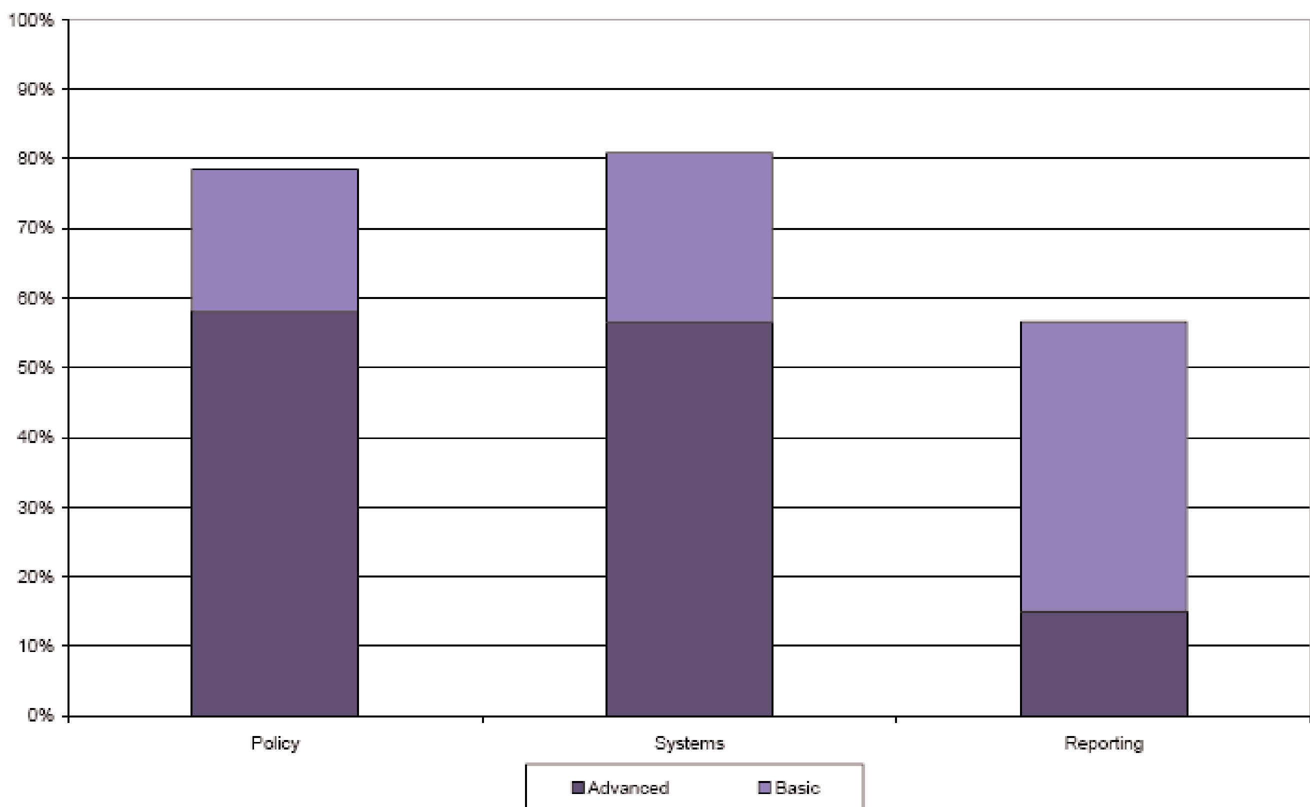


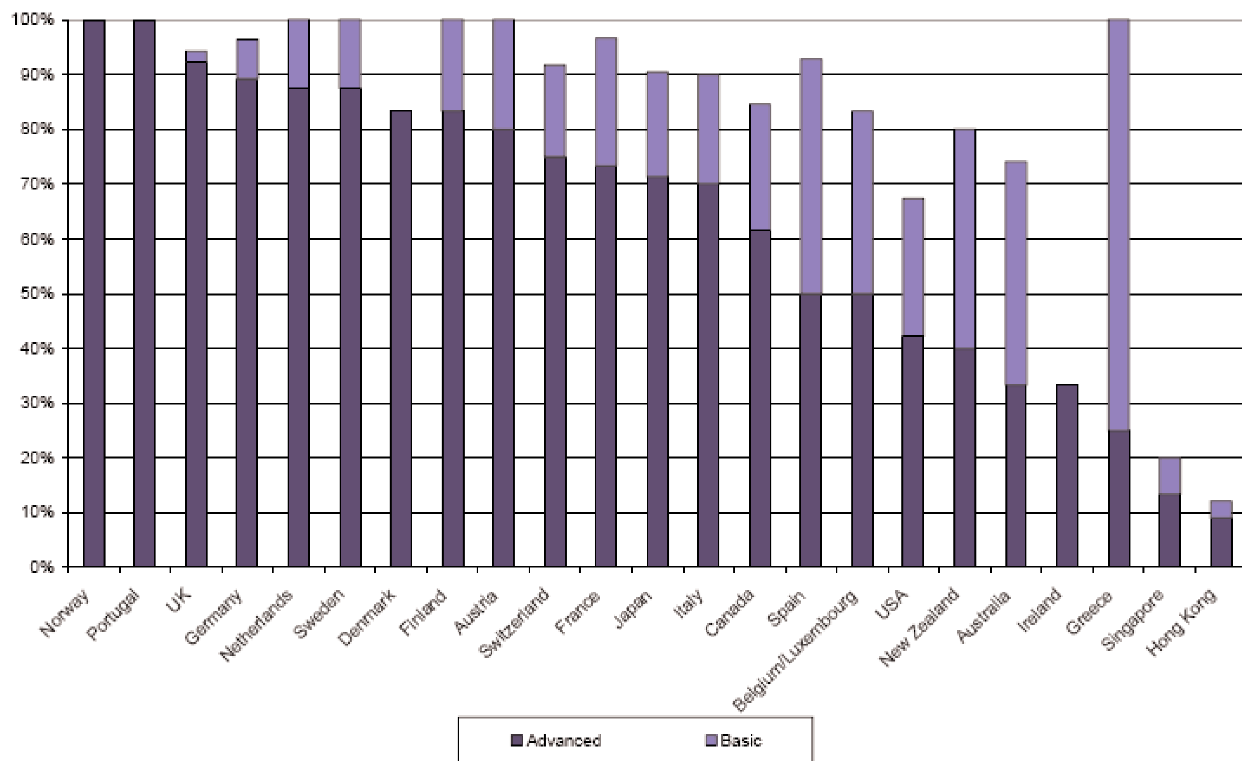
Figure 18 confirms that a higher proportion of high impact companies have indeed adopted policies, systems and reports; almost 80% of high impact companies have an environmental policy statement meeting at least basic compared with less than 60% for all companies. Environmental management systems across high impact sector companies are similarly prevalent; over 80% of all high impact companies have environmental management systems in place. Encouragingly, over 50% of high impact companies actively report on their environmental performance, although there is still a low proportion of companies (15%) reporting at an advanced level.

Figures 19, 20 and 21 below, show the percentage of high impact companies in each country meeting basic and advanced levels for their environmental policies, systems and reporting respectively. These graphs only show high impact companies as the importance of developing environmental policies is more acute for these companies.

3.6.2 Environmental policy

Figure 19: Percentage of high impact companies with environmental policies

N=720 (high impact companies)



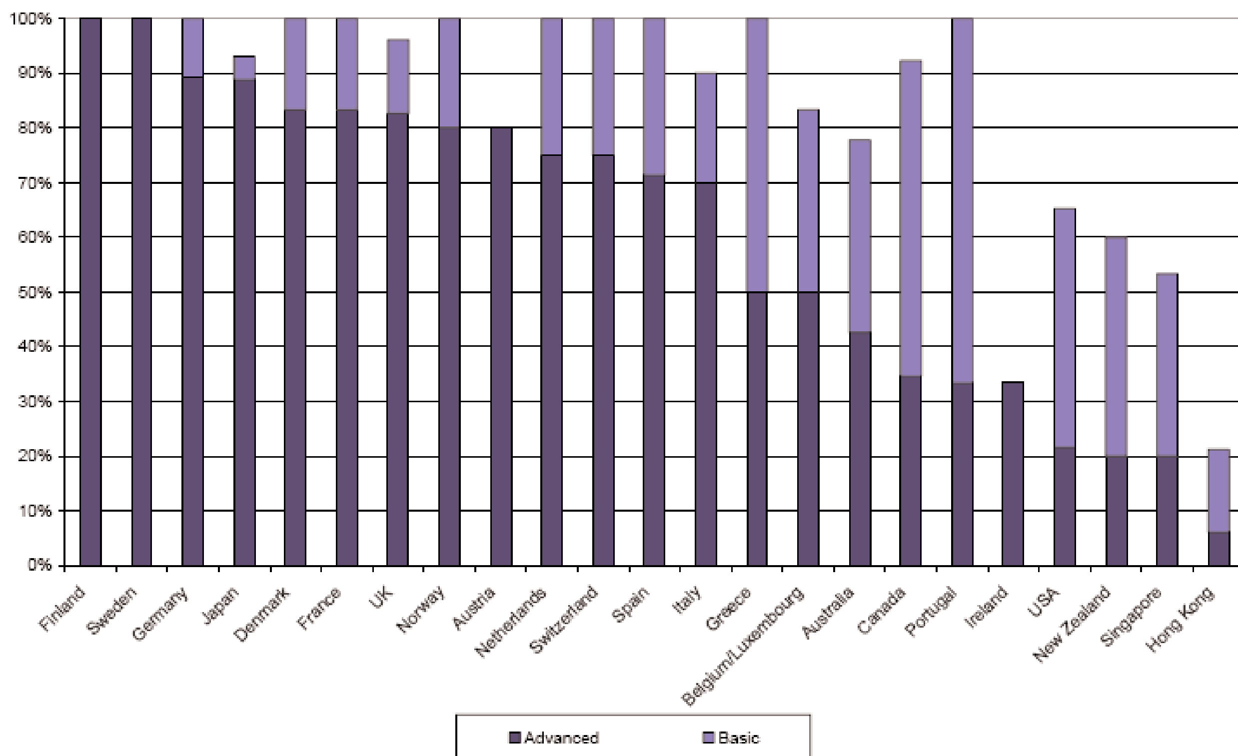
As demonstrated in figure 19, a large proportion of high impact companies have developed advanced environmental policies. Over 75% of companies in the majority of European countries have advanced policies, and over 70% of Japanese companies have advanced policies. 100% of the Norwegian and Portuguese high impact companies have developed environmental policies that achieve the advanced grade. Over 90% of high impact companies in UK, Germany, Netherlands, Sweden, Finland, Austria, Switzerland, France, Japan, Spain and Greece have adopted an environmental policy that rates at either basic or advanced. A number of factors drive the strong performance by European companies including strict EU regulation, a high level of NGO and civil society pressure, awareness of sustainability issues and investor willingness to put pressure on companies to adopt better environmental practices.

Conversely, 10-20% of companies in Hong Kong and Singapore achieve either basic or advanced. The higher performance in Japan compared to the other Asia-Pacific countries can be attributed to government involvement in the adoption of environmental policies. Japanese companies have been encouraged by government to adopt environmental systems standards, as explained in greater detail in the following section.

3.6.3 Environmental systems

Figure 20: Percentage of high impact companies adopting environmental management systems

N=720 (high impact companies)



As demonstrated in figure 20, all countries where 50% or more of companies achieve advanced are European, with the exception of Japan. This might be attributed to the high level of ISO 14001[74] and EMAS (see below) adoption amongst companies in European countries, particularly in the Nordic countries, where strong public and governmental awareness of environmental issues historically has translated into companies demonstrating strong commitment to manage their environmental impacts[75]. 89% of all high impact German companies have an advanced environmental policy in place, and 89% have advanced environmental management systems. Similarly in Japan a large proportion of companies have adopted ISO14001 standards due to support from government: 89% of high impact companies have adopted advanced management systems, compared to 71% that have adopted advanced policies. Widespread

74 ISO classifications are co-ordinated by the International Standards Organisation based in Geneva www.iso.org
75 Paul Scott, *Management systems and sustainable development: the moving goal posts from environment to corporate responsibility*, ISO Management Systems, September-October 2003

adoption of ISO14001 amongst Japanese companies is party due to the decision by government to promote ISO14001, encouraging a take-up of the standard by the bulk of companies. ISO 14001 has been widely adopted by Japanese companies, principally as a way of providing customer assurance, and to avoid losing export business to certified firms elsewhere. This has been linked to the country's prior experience with the quality standard ISO 9000, which was eventually widely adopted in order to meet the requirements of European and US customers who were demanding that their suppliers adopt the standard.

The Eco-Management and Audit Scheme (EMAS) was developed by the European Union (EU) in 1995 for sites based in the EU. Sites, rather than whole companies, become registered to EMAS following verification by the competent body of each EU country. By the end of June 2007, 5,587 sites in 3,725 organisations were EMAS registered[76]. EMAS is very similar to ISO 14001 in terms of EMS requirements, but differs in that it requires the registered site to publish a verified environmental report.

North American high impact companies, particularly US high impact companies, have a relatively lower implementation rate of environmental management systems compared to other parts of the world. This may be due to historically tight regulation of environmental impacts in the US, which has led to the perception that compliance with regulations is enough to meet the objectives of an EMS. Certification schemes such as ISO 14001 are also perceived as being European and not relevant to US companies unless their key customers and suppliers outside North America demand certified standards[77]. In addition, under the Bush administration reporting requirements have been rolled back[78]. As companies have to meet less stringent reporting requirements there is less incentive for them to improve their reports. However, the US Government appears to be beginning to change its stance and the next administration may enact more effective environmental policies and laws (as some state and city governments already have already done). There are high levels of awareness amongst the public and lobbying groups, and whereas corporations have historically resisted proposals to introduce more stringent regulations, a recent public consultation regarding relaxing reporting requirements under the Toxic Release Inventory (TRI)[79] resulted in an overwhelming response, predominantly from companies and industry associations, in support of maintaining current reporting requirements[80].

76 EMAS Statistics *Evolution of Organisations and Sites* quarterly data 20/06/2007 Available at www.emas.org.uk/aboutemas/mainframe.htm

77 Charles J Corbett and Michael V Russo, 2001 *The impact of ISO 14001: ISO 14001-irrelevant or invaluable?* ISO Management Systems, December 2001

78 For instance, in 2006 the EPA exempted pesticides from the Clean Water Act, and proposed cutbacks to reporting requirements under the Toxic Release Inventory (TRI). See www.nrdc.org/bushrecord/

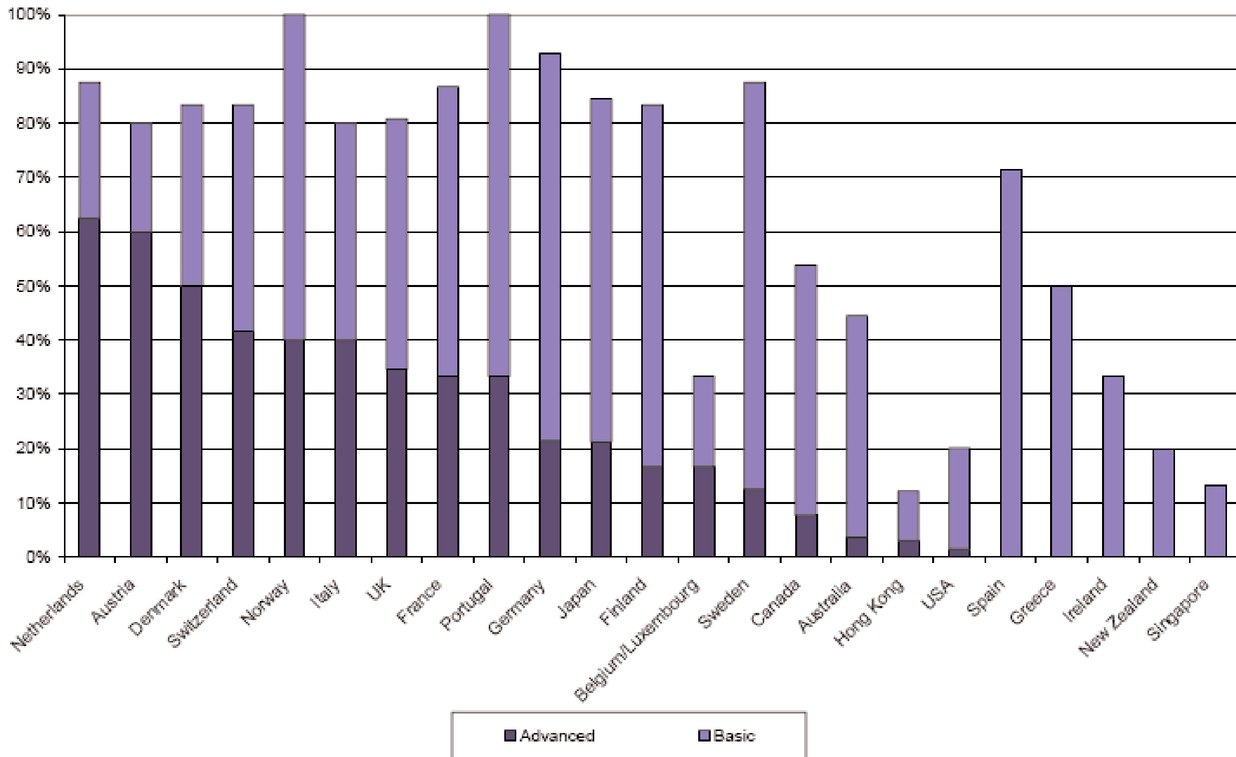
79 The Toxics Release Inventory (TRI) is a publicly available EPA database that contains information on toxic chemical releases and other waste management activities reported annually by certain covered industry groups as well as federal facilities. This inventory was established under the Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) and expanded by the Pollution Prevention Act of 1990 www.epa.gov/tri/

80 Gumm, B. 2006 *Americans Overwhelmingly Opposed to EPA's Plans to Cut Back Toxic Reporting* available at www.ombwatch.org/article/articleview/3662/1/192

3.6.4 Environmental reporting

Figure 21: Percentage of high impact companies demonstrating environmental reporting

N=720 (high impact companies)



For all companies, evidence of reporting on environmental performance is significantly lower than environmental policies and systems, as shown in figure 21. Approximately 56% of high impact companies have published sufficient environmental information to meet at least basic for reporting. Reporting is strongest amongst European and Japanese companies. Over 50% of companies in the Netherlands, Austria and Denmark report sufficient environmental information to meet the advanced level. However reporting levels are below a third for companies in Ireland, Belgium/Luxembourg, the US, New Zealand, Singapore and Hong Kong. Reporting is an essential component of improving and communicating improvements in environmental performance, so these figures are disappointing.

North American high impact companies trail Europe in the level of their environmental reporting. 20% of US companies publish sufficient environmental information to meet basic reporting standards, compared against an average of 81.5% in Europe. Again, one key explanation for lower levels of public reporting, particularly in the US, is linked to the existing regulatory environment. US companies have a mandatory requirement to report environmental data to the US Environmental Protection Agency (EPA)[81]. However US companies may be reluctant to report environmental data beyond these requirements due to the potential threat of litigation and, having disclosed information to the EPA, companies may see reporting additional information as unnecessary.

81 See http://europa.eu.int/comm/environment/emas

Reporting in Asia ex-Japan is very low. Less than 10% of companies in Hong Kong and Singapore report sufficient environmental information to meet basic standards, and none of the Singaporean companies meet advanced. These countries do not have strict mandatory disclosure regulations and companies are less incentivised to respond on the issue as the drivers, such as level of responsible investment, are not as compelling. However, this is set to change as the number of local and national NGOs is rising in Asia and both national and international investors are increasingly interested in responsible investment in the region. Also, states throughout the world are increasingly identifying environmental protection as a priority and are implementing regulations that companies will need to adhere to.

In the European Union, companies in high impact sectors are required to report through the IPPC and although reporting is required in many states it is not always made public[82]. In countries such as Denmark and Norway, companies in certain high impact sectors are subject to mandatory public reporting, which explains their relatively high levels of reporting, (over 80% in each case). However, regulatory pressure is clearly not the sole determinant of greater levels of corporate disclosure. For example, Japanese companies have one of the highest rates of environmental reporting in the world, driven by governmental encouragement to voluntarily adopt ISO14001 standards and produce environmental reports. 83% of all high impact Japanese companies report on their environmental performance, which reflects their relatively high adoption rate of certified environmental management systems.

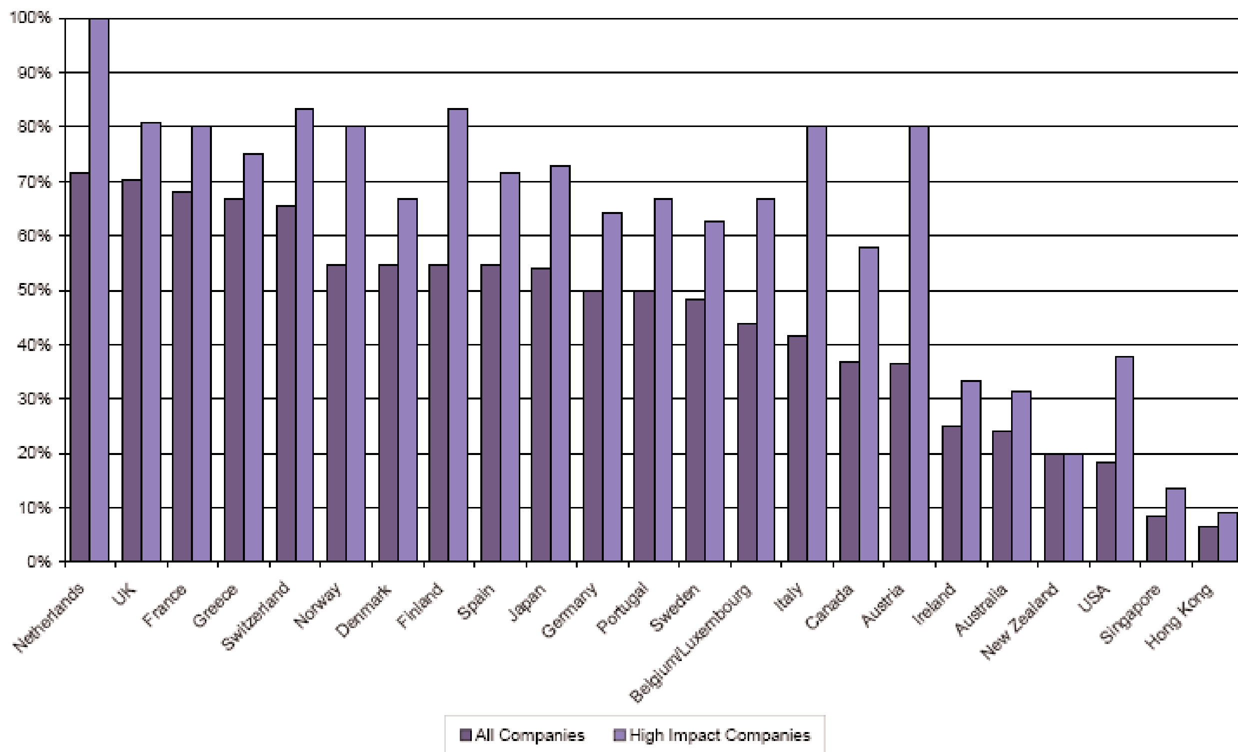
82 IPPC (Integrated Pollution Prevention and Control) requires all installations belonging to the categories of industrial activities referred to in the EU directive to supply the competent authority with data required for checking compliance with the emissions permit

3.6.5 Environmental performance

Environmental performance is the most telling indicator in terms of assessing whether companies are reducing their negative impact upon the environment. EIRIS assesses the extent to which companies are improving their environmental performance on a five point scale (no data, no improvement, minor improvement, significant improvement, major improvement), however the data here only shows whether companies achieve an improvement in performance or not.

Figure 22: Percentage of companies demonstrating an improvement in environmental performance

N=1996 (all companies) N=720 (high impact companies)

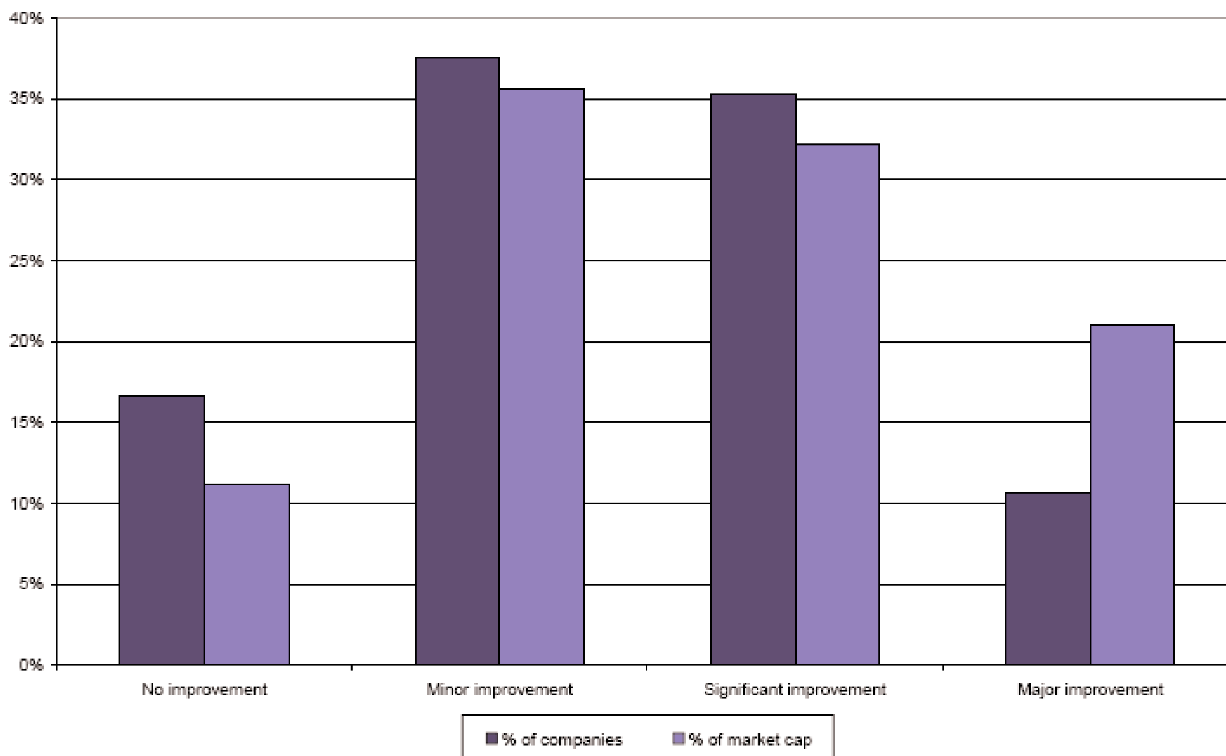


As can been seen in figure 22 European companies are most likely to achieve an improvement in their environmental performance. Over 60% of companies in the Netherlands, UK, France, Greece and Switzerland achieved an improvement in performance. When looking at high impact companies, over 80% of companies in the Netherlands, Finland and Switzerland have improved. As with other environmental indicators, Japan also performs well: over 50% of all companies and over 70% of high impact companies demonstrate an improvement. It is likely that these companies can demonstrate an improvement in performance as they have developed environmental policies and systems to manage their environmental impacts. However, US companies are either not achieving the same levels of improvement or not reporting on their improvements. Less than 20% of all companies and less than 40% of high impact companies demonstrate an improvement. Similarly, reported levels of improvements in Asia ex-Japan are worryingly low. Less than 15% of high impact companies in Hong Kong and Singapore demonstrate an improvement, and the figures are only marginally better for high impact companies.

Of the 720 high impact companies, 33% do not publish environmental performance data. These companies account for 16% of the market capitalisation of high impact companies. Of the total sample of 1,996 companies, 52% do not publish environmental performance data. These companies represent 33% of the market capitalisation. In short, large companies by market capitalisation are more likely to report on their environmental performance. Figure 23 below only contains data for high impact companies that have published environmental performance data. Companies that have not published data have been excluded from this analysis.

Figure 23: Environmental performance by proportion of companies and proportion of market capitalisation, for high impact companies only

N=482 (high impact companies reporting environmental performance data)



As shown in figure 23, large companies by market capitalisation are more likely to demonstrate environmental performance improvements than small companies. 83% of high impact companies in the FTSE All World Developed Index reporting their performance data demonstrate an improvement. These companies represent 89% of the value of the index. The trend is repeated amongst all companies, as 78% of all companies show an improvement in environmental performance; and these companies represent 83% of the value of the index. When looking at major improvement only, 11% of high impact companies report a major improvement, representing 21% of the value of the index. This trend demonstrates that large companies by market capitalisation are more likely to improve their management of environmental risk. This is probably in part due to their exposure to investor, NGO and consumer pressure.

In summary, European and Japanese companies are most likely to have developed a response to their environmental impacts (over 70% of these companies have developed advanced policies). Companies in North America, Australia, New Zealand and Asia ex-Japan have less well developed responses (less than 50% of these companies have developed advanced policies). EIRIS expects to see improvements from all companies in their management of environmental impacts because of the urgency off climate change and the high profile of the issue. In particular, improvements are expected in North America and Asia ex-Japan.

European companies are more likely to respond to their environmental impacts because of a number of factors, including strict EU regulation, a high level of NGO and civil society pressure and awareness of sustainability, and investor willingness to put pressure on companies to adopt better environmental practices.

Similarly, high performance in Japan can be attributed to strong encouragement from the Japanese government to address their environmental impacts, in particular stressing the importance of achieving ISO14001 certification.

Large companies by market capitalisation are more likely to have well developed policies, systems and reports. Similar patterns are witnessed when examining environmental performance, both for all companies and high impact companies. Large companies by market capitalisation are more exposed to investor, NGO and consumer pressure to improve their response to ESG issues.

3.7 Community involvement – corporate giving

Community involvement is a major corporate responsibility issue. When a company gives to charity, it often produces a tangible business reward in terms of improved reputation and profile, as well as benefiting a good cause. However the simple signing of cheques in themselves does not always impress responsible investors, especially if they do not share the same priorities as companies in choosing which causes to support. The donation of expertise, time and resources may often be considered more valuable in terms of the benefit it provides to the wider community and society. Conversely, there are instances, particularly where companies make gifts in kind in lieu of cash donations where the gifts given may not be considered as an appropriate or helpful response to the cause in question.

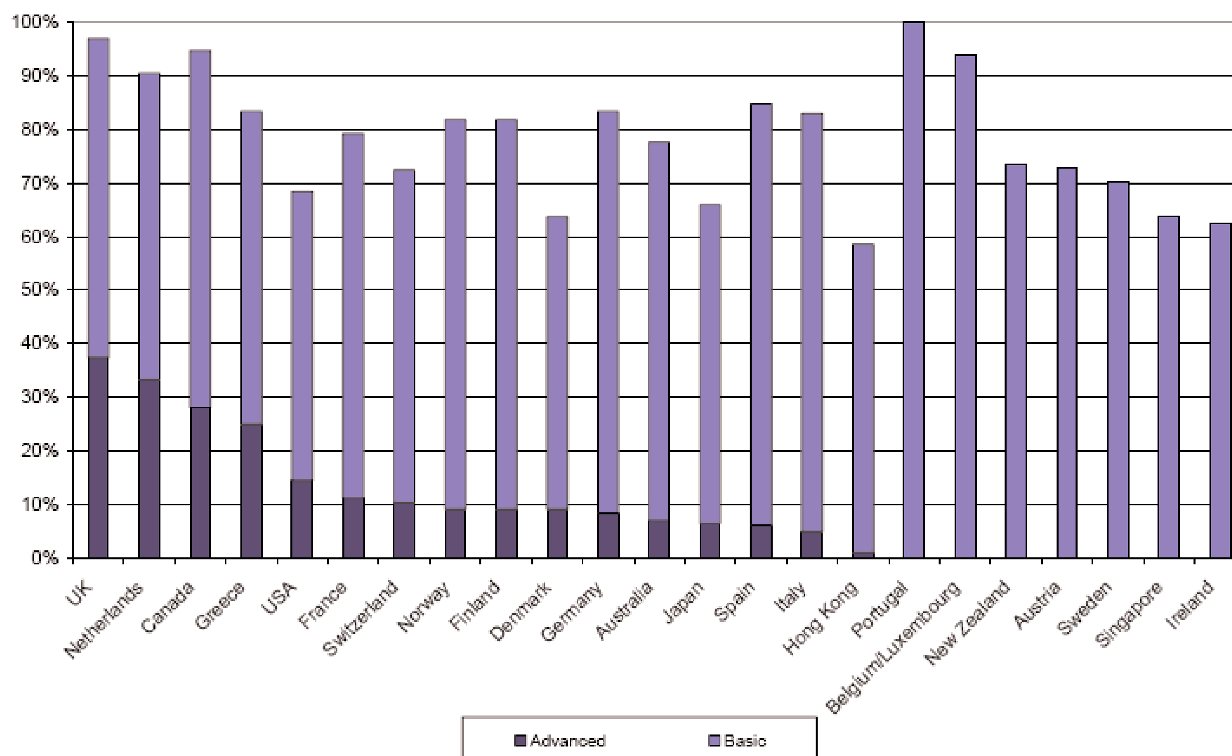
Tax policies can significantly influence attitudes to corporate giving. In Sweden and Germany for example, companies pay significantly more in taxes towards national welfare systems than equivalent companies in North America. Companies could therefore argue that they benefit society by paying more in taxes and that looking at charitable donations alone may favour US rivals, who have greater tax incentives to donate to foundations. The overall approach and methods adopted by a company to corporate giving are also highly relevant and attitudes towards what counts as an appropriate level of corporate giving vary widely from investor to investor and company to company.

EIRIS considers three main issues when examining a company giving policy. Firstly, when considering the amount of money spent by a company on community involvement, the figure is graded in relation both to absolute size and as a percentage of the company's overall profits. Secondly, the company should report fully on the causes it supports and set out a clear rationale explaining the choice of beneficiaries. Thirdly, as best practice suggests, company involvement should extend beyond donations of money by, for example, allowing and encouraging secondment of staff time and expertise to charities and community organisations, providing non-commercial sponsorship and supporting payroll giving.

Those companies graded as having little or no evidence usually do not provide any details of any projects they are involved in, either in their annual report or on their website. Basic level represents companies that are on the road to being able to demonstrate good practice and advanced represents best practice. The data excludes sponsorship of cultural and sporting events as well as cause-related marketing deals where a business has a partnership with a good cause in order to attract customers.

Figure 24: Percentage of companies adopting community involvement strategies

N=1996



A wide range of countries have companies with a good set of scores for community involvement. This suggests that despite the wide variation in attitudes towards company giving, a large proportion of the companies do actively perceive benefits in developing their community involvement policies. All the countries covered have at least 50% of companies scoring at basic or above. Even Hong Kong, with the lowest total of companies scoring at basic or above, achieves 58% including 1% at the advanced level.

Varying tax rates and/or incentives for charitable giving between different countries undoubtedly also play a part in affecting the average amount donated from country to country. Canada, which at nearly 30%, has amongst the highest level of companies attaining an advanced score for company giving, has a number of high profile government initiatives seeking to improve company giving rates.

Companies often adopt community involvement for the purposes of raising brand value and motivating staff. Less developed views of responsible business centre on philanthropic activities rather than responsible business practices, so companies throughout the world adopt at least some level of philanthropic giving or approach. This may explain the low proportion of companies meeting the advanced level as companies may be able to sufficiently raise brand value whilst only meeting the basic level.

In summary, although 61% of companies have adopted basic community involvement practices, only 12% have adopted advanced practices. Companies score well against this criterion in all countries, including Asia ex-Japan, as at least 50% of companies in all countries have met the basic standards. However companies commonly adopt philanthropic activities as a tool to raise staff morale and increase brand value, so this is not an adequate indicator of whether a company has adopted responsible business practices.

3.8 Nuclear power

Since the Three Mile Island accident in the US in 1979, and the Chernobyl accident in the Ukraine in 1986, nuclear power has been surrounded by controversy. In addition to public concerns about safety and security, cost has come to be seen as a major limiting factor in nuclear power expansion. In the UK for instance, market liberalisation and competition with gas generation led to the near bankruptcy of the main nuclear generator. However, recent oil price increases, together with concerns about energy supply security and global warming have reignited the debate as to the desirability of nuclear power. Debates about nuclear power expansion are likely to become newly topical across the world as current plants are ageing and nearing the end of their lives.

In the US, a significant number of nuclear power plants are having their life extended from typically 40 years to 60 years. In addition many plants are having their power capability increased by up to 20%. This is a less costly and much quicker way of increasing nuclear power capacity than building new plants. Significantly the first new western world nuclear power plant for decades has been ordered in Finland to a new European design. Other countries currently considering plans for significant numbers of new plants include the UK, China and Iran.

No solutions have yet been found to the key problem of long term disposal of nuclear waste. In the US, public debate over a proposed waste depositary at Yucca Mountain, Utah, which is already over used, continues with significant opposition leading to the imposition of stricter disposal conditions. Other countries have similar problems in acquiring acceptable long-term storage. Re-processors such as British Nuclear Fuels Ltd are having significant difficulties with the technology of reprocessing and economic feasibility.

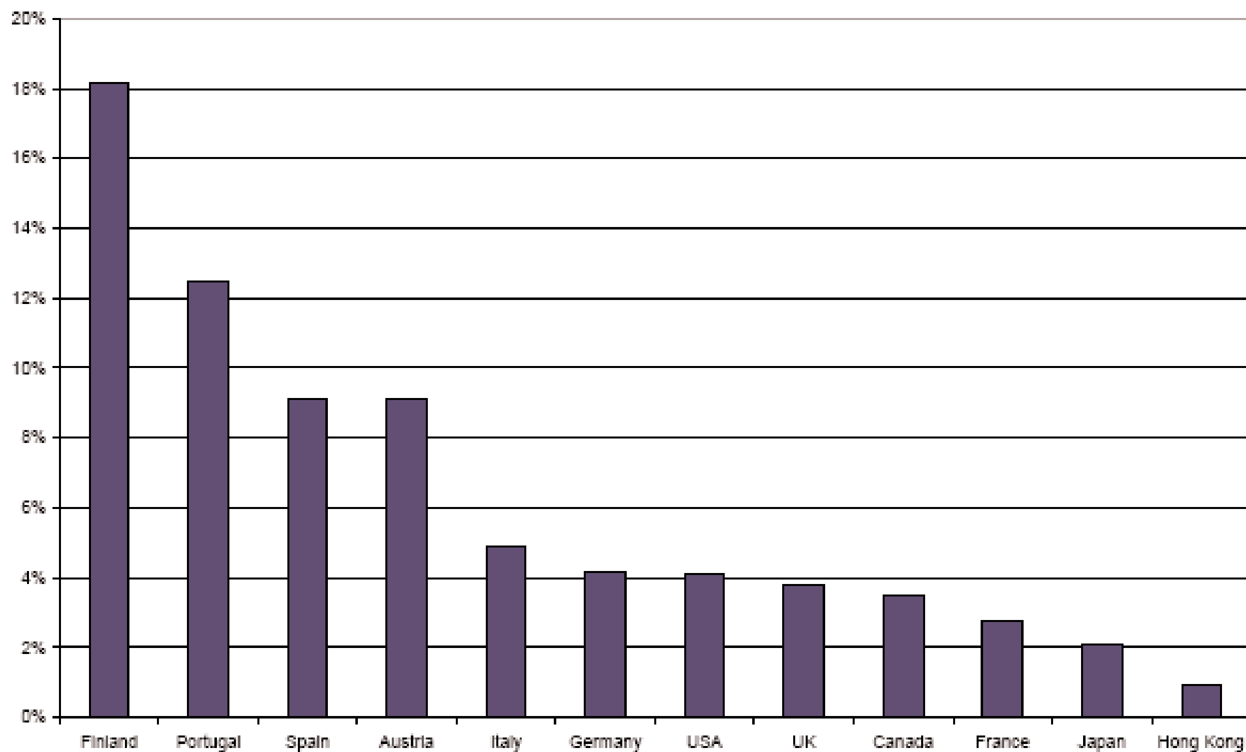
Since September 11, 2001, security issues have taken on considerably greater significance, further increasing costs and leading to greatly increased concerns over the control of nuclear materials. Environmental and security concerns have led to significant opposition to new power plants and criticism of companies significantly involved in this field. Additionally, as there has been a dearth of orders for new plants, many companies in this field are struggling economically, and are unwilling to attract negative comment or protest. Some responsible investors actively exclude companies owning or operating nuclear power plants or which are significantly involved in the nuclear fuel cycle from their portfolios.

Figure 25 below identifies the proportion of companies producing nuclear power, on a country-by-country basis. Nuclear power production includes the following categories:

- owning or operating nuclear power stations
- selling nuclear generated electricity
- generating over 3% of turnover from nuclear power generation

Figure 25: Percentage of companies producing nuclear power

N=1996



The percentage of companies with involvement in nuclear power is shown in figure 25. Over 10% of companies in Finland and Portugal are involved with nuclear power generation. The proportion of companies in other countries in Europe, North America, Japan and Hong Kong are involved with nuclear power generation, although to a lesser extent. 12 countries have no companies identified for nuclear power generation at all in the FTSE All World Developed Index, including the Netherlands, Greece, Switzerland, Denmark, Belgium/Luxembourg, New Zealand, Singapore, Australia, Norway, Sweden and Ireland.

These percentages do not account for company size, so in some instances the figures include a large proportion of relatively small companies. EIRIS excludes state and privately owned companies that are not traded on stock markets from its research, so this is an added factor to be taken into consideration when making comparisons.

3.9 Provision of weapons

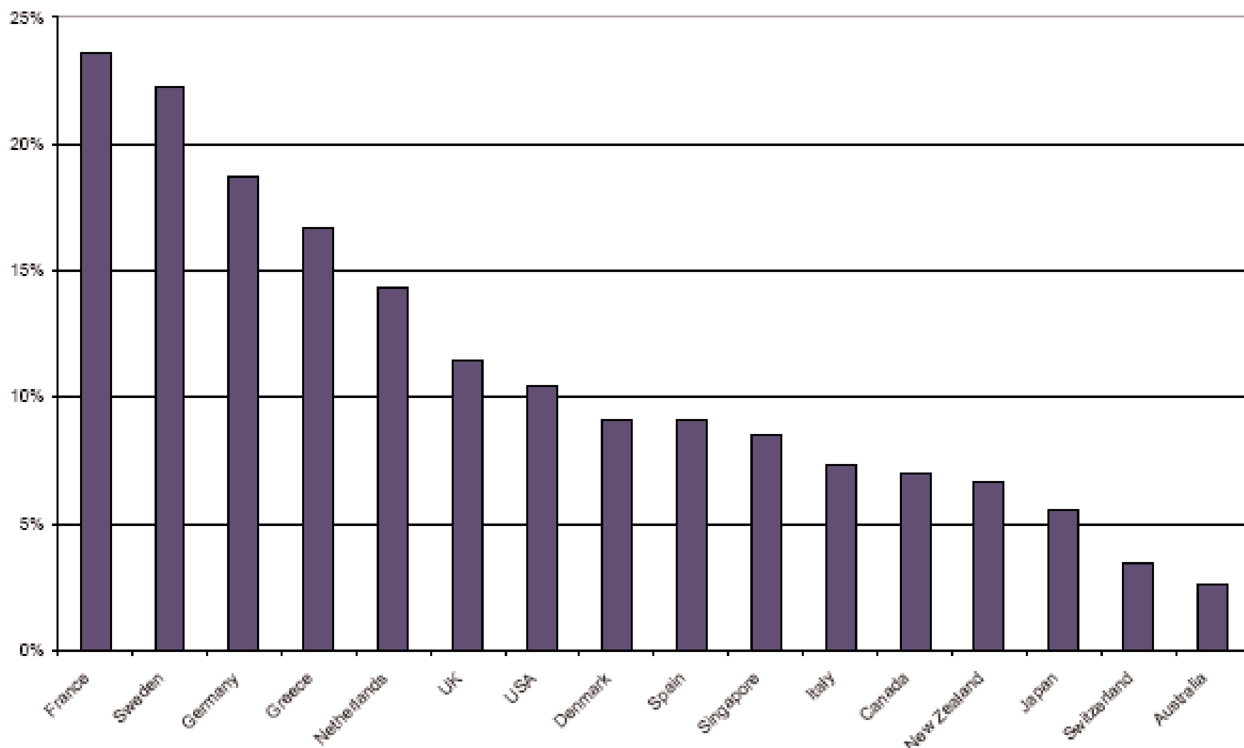
The arms trade is a key issue of concern for many investors. Some investors disapprove of what they regard as the harmful diversion of government funds from social spending to unproductive and destructive military programmes, both in the developed and the developing worlds. Even investors who generally approve of domestic manufacture of military equipment for defensive purposes, may still for example, have major concerns about export of arms overseas, especially to oppressive regimes.

The proliferation of weapons in poor countries and areas of political instability or conflict is another high profile area of concern. Campaign groups on issues such as landmines and arms exports to countries of high risk for human rights abuses have done much to raise public awareness of these issues. In countries such as the UK and France, that are major exporters of arms to the Middle East, investors often focus calls for greater responsibility by arms companies on cases where the company exports strategic goods or services to particular regimes of concern.

EIRIS bases its research on military involvement on a wide range of sources including company reports, specialist journals, government registers of exports, and product catalogues and directories. Figure 26, below, highlights companies involved in supplying weapons or parts of weapons to military organisations. EIRIS records whether the weapons systems provided are strategic, nuclear, whole weapons systems or platforms, or parts of weapons. These are all included in the data shown in figure 26.

Figure 26: Percentage of companies supplying weapons or parts of weapons to military organisations

N=1996



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Overall less than 10% of companies in the FTSE All World Index have been identified as supplying weapons or parts of weapons to military organisations. Only Austria, Belgium/Luxembourg, Finland, Hong Kong, Ireland, Norway and Portugal have no companies in the FTSE All Wold Index identified in this way. France and Sweden top the list with over 20% of companies in these countries identified. Germany, Greece, the Netherlands, the UK and the US follow with over 10% reflecting their position as major producers of high technology military equipment, as well as the size of these countries' military forces. In some countries national governments still own domestic arms companies which is another reason they may not be identified here. Although the nature of this sector means that companies are always subject to national government decisions and policies, internationally, the drive towards consolidation of military companies suggests that the largest number of companies supplying military weapons and parts of weapons will continue to come from these countries.

4 Current hot topics

4.1 Climate Change

Climate change is now widely recognised as one of the most significant challenges facing the global economy. According to the International Panel on Climate Change (IPCC), temperature increases of 1.8°C to 4°C are predicted by 2100 with associated sea level rises of 28-43cm. The economic impacts are also significant. The Stern Review recently concluded that under a business-as-usual scenario a 2-3°C rise in temperature could reduce global economic output (as measured by GDP) by 3% annually[83]. This presents a number of risks and opportunities for companies and their investors.

The international community implemented the Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) in 1999. The ultimate aim of the Protocol is to achieve stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent the worst effects of climate change. It established emission reduction targets covering six greenhouse gases (GHGs) that countries which have ratified the Protocol are obliged to achieve within the period 2008-12. These reductions can be achieved through flexible mechanisms including emission trading schemes, of which the European Union's Emissions Trading Scheme (EU ETS) is the most well known, and arrangements whereby industrialised countries can invest in emission-reducing projects in other industrialised countries (known as Joint Implementation) or developing countries (known as Clean Development Mechanisms) as an alternative to reducing emissions in their home country. The aim of these mechanisms is to encourage cost effective CO_2 emissions reductions. Under the EU ETS, companies are allocated a number of carbon emissions credits. Companies must either cut their emissions or purchase emissions allowances from other companies to meet their targets. If companies reduce their emissions below their allocated level they may sell these credits to companies needing to meet their targets.

Institutional investors are beginning to collaborate closely on the issue of climate change to encourage companies to disclose their emissions and carbon reduction strategies. For example, the Carbon Disclosure Project (CDP), launched in December 2000, provides a coordinating secretariat for institutional investors with a combined USD 41 trillion of assets under management. In 2007 2,400 companies reported their emissions through the CDP's website and the fifth report from the Carbon Disclosure Project launched in New York in September 2007[84]. In addition, the Institutional Investors Group on Climate Change (IIGCC) is a forum for collaboration between pension funds and other institutional investors on issues related to climate change. It seeks to promote better understanding of the implications of climate change amongst investors as well as encouraging companies to address the associated risks and opportunities and shift to a lower carbon economy[85]. And finally, in the US, CERES directs the Investor Network on Climate Risk (INCR), a group of more than 50 leading institutional investors with collective assets of over USD 3 trillion[86].

EIRIS currently records policies relating to energy use as well as carbon dioxide emissions as part of its existing environment criteria. In addition, EIRIS has identified the key issues facing business in relation to climate change, has devised a methodology for assessing companies' responses to these issues and is in the process of researching companies against the criteria. Companies have been classified into over 50 climate change sectors and sub-sectors based on their business activities. Each sector is defined as very high, high, medium or low climate change impact based on the direct, indirect and product emissions.

83 *Stern Review on the economics of climate change* 2006 Available at www.hmtreasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm
84 The Carbon Disclosure Project www.cdproject.net
85 The Institutional Investors Group on Climat
86 CERES www.ceres.org

Companies' management response to the challenges of climate change is also assessed. The indicators include a policy commitment relating to climate change, addressing the management of operational emissions, disclosure of targets, publication of performance against targets, disclosure of emissions and trends, improvements in performance over time, development of new products and verification of the report. Full data on this issue will be available early in 2008. EIRIS supplies the data to FTSE4Good, who will implement indicators on climate change as part of their criteria in February 2008.

HIV/AIDS and corporate responsibility

There are currently over 40 million people living with HIV/AIDS, a large proportion of whom are of working age. The global labour force has lost more than 28 million people as a result of AIDS, without further intervention this number has been estimated to grow to 74 million by 2015[87]. The greatest number of new infections are amongst young adults between the ages of 15 to 24 years of age, so HIV/AIDS will continue to impact the workforce in future. In addition the disease is escalating in some of the world's fastest growing markets, including China, India and Russia. Looking at the direct costs to individual companies, increasing evidence has shown that HIV/AIDS is threatening productivity and profitability in the worst-affected regions. As a result companies increasingly understand the need to address the issue of HIV/AIDS not only for reasons of good corporate citizenship, but also because of the business imperative.

Until recently, most in the business sector left responsibility for mitigating the effects of the pandemic to governments, activists, or the public health community. However this has not always been successful and there is a growing perspective amongst companies that becoming involved in the fight against HIV/AIDS is crucial[88]. Indeed, businesses are well placed to implement change as they have the capacity to do so. In countries like South Africa where 20% of the working age population is infected, more and more companies consider it an essential responsibility to help alleviate and tackle the disease as, without improvement, they will have to absorb the business costs in other ways. There are higher costs in relation to health insurance, funeral costs, increased absenteeism, higher staff turnover and resulting recruitment and training costs, loss of staff knowledge and decreased morale[89].

Business action on HIV/AIDS incorporates basic human rights principles related to non-discrimination, health and equitable access to care. By addressing HIV/AIDS as well as the economic and social context of the disease, companies contribute to the sustainability of their business operations.

According to a survey recently conducted by the Global Business Coalition on HIV/AIDS, companies are working to address the issue with 82% of surveyed companies providing workplace information on HIV/AIDS. 60% of companies have trained peer educators in workplaces and 55% have expanded prevention programmes to the community. In parts of Africa with a high prevalence of HIV, more than 70% of companies surveyed are fully subsidising staff access to HIV treatment. In emerging markets such as China, India and Russia, companies are looking to extend HIV/AIDS programmes, specifically focusing on awareness and prevention, although this is not yet a widespread approach. Companies are making progress in partnering with governments, multilateral organizations and communities to support the fight

87 UNAIDS and WHO, AIDS Epidemic Update: December 2005 IntensifyingPrevention, 2005

88 Columbia University, the Global Business Coalition on HIV/AIDS and the University of Cape Town 2004 *Opportunities for Business in the fight against HIV/AIDS: A framework for analysis of the impact of HIV/AIDS on business and the benefits of direct company action in the global response* Available at www.kintera.org/atf/cf/%7B4AF0E874-E9A0-4D86-BA28-96C3BC31180A%7D/Executive%20Summary.pdf

89 The Global Business Coalition. An organisation established to harness the power of the global business community to fight the HIV/AIDS, tuberculosis and malaria epidemics worldwide www.businessfightsaids.org/site/pp.asp?c=gwKXJfNVJtF&b=1008805

against HIV/AIDS. Workplace prevention and education programmes are also more common, but further collaboration with suppliers and programmes need to be expanded in emerging markets[90].

EIRIS is developing an impact classification for companies based on a combination of the proportion of operations in particular business sectors and activities and the presence in countries with high levels of HIV/AIDS prevalence. In terms of the management response, EIRIS will be considering companies' global policies, prevention and education programmes, treatment programmes, including in-house testing, provision of drugs, care and support, and the extent to which companies communicate their policies and engage with charities, agencies, and local and national government.

4.3 International Conventions

In an address to the World Economic Forum on 31 January 1999, then United Nations Secretary-General Kofi Annan challenged business leaders to join the UN Global Compact (UNGC), an international initiative supporting basic global principles. These principles cover the areas of human rights, labour standards, the environment, and corruption.

The UNGC's direct appeal to business to work with UN agencies, trade unions and civil society groups in tackling these types of issues adds weight to calls by some investors that companies should be required to expressly ensure compliance with fundamental international principles such as those enshrined in the Universal Declaration of Human Rights. International conventions are primarily ratified by and binding in the first instance, on governments. Non-ratification or poor enforcement by some governments can of course severely limit the extent to which conventions are applied in practice. This may be especially acute in developing countries as, even where relevant legislation exists, lack of capacity may result in weak enforcement of relevant laws, to the particular detriment of the poor and vulnerable.

The latter is a key reason why a growing number of investors have supported calls for corporate codes of conduct to make direct reference to upholding relevant international conventions. The ILO itself has encouraged this process by publicly highlighting, out of its many hundreds of conventions, what it sees as the most fundamental or "core" conventions. Bodies such as the UNGC and OECD have backed this approach and extended it so that companies are increasingly being asked to demonstrate support for major international conventions.

Compliance with international conventions is considered particularly important by a growing number of managers of public assets, such as national or local government pension funds, because as the signatories to international conventions, governments have a direct stake in ensuring compliance. Hence more public sector pension funds are asking fund managers to require companies contained within their portfolio to demonstrate compliance with conventions.

EIRIS' Convention Watch service provides an assessment of company responses to allegations of breaches of key conventions, including the UN Declaration of Human Rights principles, the UN Convention

90 Global Business Coalition on HIV/AIDS 2006 *The State of Business and HIV/AIDS: A Baseline Report* www.businessfightsaids.org/atf/cf/%7B4AF0E874-E9A0-4D86-BA28- 96C3BC31180A%7D/The%20State%20of%20Business%20and%20HIVAIDSFINAL.pdf

against Corruption, the ILO Core Conventions, the Ottawa Anti-landmines Convention, the Kyoto Protocol and Montreal Protocol. In order to achieve an 'addressed' status, companies must demonstrate that each specific alleged breach has been remedied and that the Company has made improvements to its management systems in order to prevent a recurrence of the breach. In addition companies must demonstrate process improvements or actions to ensure that the breaches will not reoccur[91]. Table 3 below summarises how many companies out of the approximately 3,000 normally covered by EIRIS are identified by the Convention Watch service[92].

The percentage of companies with involvement in nuclear power is shown in figure 25. Over 10% of companies in Finland and Portugal are involved with nuclear power generation. The proportion of companies in other countries in Europe, North America, Japan and Hong Kong are involved with nuclear power generation, although to a lesser extent. 12 countries have no companies identified for nuclear power generation at all in the FTSE All World Developed Index, including the Netherlands, Greece, Switzerland, Denmark, Belgium/Luxembourg, New Zealand, Singapore, Australia, Norway, Sweden and Ireland.

These percentages do not account for company size, so in some instances the figures include a large proportion of relatively small companies. EIRIS excludes state and privately owned companies that are not traded on stock markets from its research, so this is an added factor to be taken into consideration when making comparisons.

Table 3: Allegations of breaches of key international conventions

See next page.

91 The methodology differs for each area. For more information about the Convention Watch Service please contact EIRIS.
92 These figures represent coverage between November 2004 and July 2007

Table 3: Allegations of breaches of key international conventions

Allegations of breaches of:	No. of Companies with 'addressed' reports	No. of Companies with 'not addressed' reports
Core ILO labour standards by the company	13	18
ILO labour standards on working hours by the company	0	4
ILO labour standards on child labour by the company	0	1
ILO labour standards on ondiscrimination by the company	11	4
ILO labour standards on forced labour by the company	3	2
ILO labour standards on freedom of association and collective bargaining by the company	1	13
ILO labour standards on health and safety by the company	8	4
Core ILO labour standards in the supply chain	14	17
ILO labour standards on working hours in the supply chain	6	26
ILO labour standards on child labour in the supply chain	9	4
ILO labour standards on nondiscrimination in the Supply Chain	5	6
ILO labour standards on forced labour in the supply chain	6	6
ILO labour standards on freedom of association and collective bargaining in he supply chain	5	10
Human Rights – UN Human Rights principles	5	17
Allegations of breach of anti-bribery principles made against the company or its agents	20	24
Allegations of:	**No. of Companies with 'addressed' reports**	**No. of Companies with 'not addressed' reports**
Use or retail of threatened species	4	5
Severe damage to ecosystems, natural habitats or populations of species	2	23
Severe damage to biodiversity through direct involvement in clearance of high conservation value ecosystems	1	8
Or indications of involvement with antipersonnel landmines (3 year time limit)	3	4
Or indications of capability for involvement with anti-personnel landmines (10 year time limit)	1	7
Does the Company:		**Yes**
Oppose the Kyoto protocol?		1
Fail to publicly commit to reduce production of ozone depleting substances scheduled for phase out in the Montreal protocol?		2

4.4 Taxation and Transparency

The Enron, Tyco and WorldCom scandals significantly heightened investor concerns about corporate governance issues. It is likely that pressure for increased transparency particularly in relation to the historically sensitive issue of how much tax companies do and should pay, will move further up the corporate responsibility agenda in the future. The US Senate Finance Committee for example is currently investigating legal tax minimisation schemes that are estimated to be costing the US taxpayer more than USD 170 billion a year. NGOs such as Transparency International and the Tax Justice Network are seeking to encourage more investors to approach taxation and transparency in a more structured manner.

Transparency in relation to taxes is likely to develop slowly in the absence of common standards and regulations and a consensus is building that it would be helpful to encourage full and open disclosure of the tax and royalty payments made by oil and mining companies in the developing world. Internationally, this has been championed by the Publish What You Pay (PWYP) coalition of NGOs[93] and by the Extractive Industries Transparency Initiative (EITI)[94]. The EITI supports improved governance in resource-rich countries through the verification and full publication of company payments to government and government revenues from oil, gas, and mining. Around 30 companies in the extractive sector are involved with the EITI process and it is being implemented in 22 countries in Africa, Asia, Latin America and the Caribbean. To date however, consultations among governments and oil and mining companies have resulted in the rejection of a compulsory international framework, such as the one demanded by PWYP, which would require companies to disclose all their payments.

4.5 Responsible business practices in emerging markets

Hong Kong and Singapore perform comparatively poorly against the majority of criteria presented here. The pattern is largely replicated in other emerging market economies in Asia ex-Japan, where responsible business practices are yet to be widely adopted and companies are not yet reporting extensively with respect to their ESG activities. However, patterns are changing as responsible investment is growing in a number of emerging markets, notably South Africa, Korea and Brazil. There is also growing international interest in the growth of Islamic investment, which addresses a number of corporate responsibility issues. The growth of responsible investment both within emerging market countries and from investors in developed world markets seeking to invest in emerging markets is driving the adoption of responsible business approaches in these countries.

It is hoped that there will be significant movement from China and other Asian countries on corporate responsibility as a result of the impact of climate change in these countries, and as these countries' economies continue to grow rapidly. Companies will be influenced both by pressures at a regional, national and international level. There is a growing number of NGOs in developing nations working to improve companies' approaches to responsible business. In addition responsible investors in the developed world are increasingly interested in making investments in emerging markets. These factors will aid in pushing the growth of responsible business in emerging markets.

In 2006 EIRIS produced a report analysing the performance of 50 companies in emerging markets. The report found that the majority of companies in the study have shown evidence of addressing at least some environmental, social and governance issues in their public disclosures, with some significantly so. However, the level of adoption is generally below that demonstrated by companies in Europe, North

93 www.publishwhatyoupay.org
94 www.eitransparency.org

America, Australia/New Zealand and Japan, as confirmed by the poor performance of Hong Kong and Singapore in this study. South Africa appears notably ahead of other emerging markets in disclosing responsible business practices. Some countries such as China have yet to produce strong evidence in this area. And other countries may show positive signs in some spheres but lag behind in others. For instance, Taiwanese companies showed poor governance performance, yet a number of them showed evidence of addressing the environment. Overall the study found that there is significant diversity amongst companies in emerging markets in addressing their ESG risks, and that there are opportunities for investors to make responsible investment decisions based on these differences. The report is available at HYPERLINK "http://www.eiris.org" www.eiris.org

4.6 Other emerging issues

Three other emerging responsible investment issues that are likely to have an impact in the near future are outlined below, namely access to water and poverty eradication, nanotechnology and private equity.

4.6.1 Access to water

Nearly 20% of the world's population does not have access to drinking water and 40% lack access to sanitation facilities[95]. Water shortages are being felt particularly in the developing world as the effects of climate change bring an increase in the number of droughts. Three issues threaten access to water amongst communities in the developing world. The first is that as the water supply is privatised prices can often rise beyond the reach of the poorest. The second is the usage patterns of water in developing regions of the world. The third is that increased population puts pressure on demand for a finite resource. As a result, conflict over access to water is expected to increase significantly in future. With reference to responsible business practices, there is a concern amongst NGOs and investors about water usage by large corporations operating in the developing world. Companies must consider and reduce their water use in such areas of the world, as well as adopting business strategies that are both responsible and sustainable. Recent allegations have been levelled at major drinks manufacturers pertaining to their water usage in developing nations such as India. They were accused of putting thousands of farmers out of work by draining the water that feeds their wells and poisoning the land with waste sludge that the company claims is fertiliser. Business conducted in this way is neither beneficial to the local communities nor to major brands' images and is therefore not sustainable in the longer term.

4.6.2 Nanotechnology

Nanotechnology is a field of applied science and technology involving matter on a scale smaller than one micrometre (one millionth of a metre). Much speculation exists as to what new science and technology might result from these lines of research. A number of concerns have been raised about what effects these will have on our society, and what action is appropriate to mitigate these risks. Short-term issues include the effects that widespread use of nanomaterials would have on human health and the environment. There is a growing body of scientific evidence which demonstrates the potential for some nanomaterials to be toxic to humans or the environment because of its greater surface area to volume ratio and the resulting higher chemical reactivity and biological activity[96]. Beyond the toxicity risks to human health and the environment which are associated with first-generation nanomaterials, nanotechnology has broader societal

95 World Health Organisation and Unicef 2006 *Meeting the MDG drinking water and sanitation target: The urban and rural challenge.* Available at www.childinfo.org/areas/water/pdfs/jmp06final.pdf
96 Hoet, P. et al 2004 *Nanoparticles – known and unknown health risks* Available at www.jnanobiotechnology.com/content/2/1/12

implications and poses broader social challenges. Longer-term concerns center on the implications that new technologies will have for society at large, and whether these might exacerbate the wealth gap between developed and developing nations. More radically, some observers suggest that nanotechnology will build incrementally, as did the 18-19th century industrial revolution, until it gathers pace to drive a nanotechnological revolution that will radically reshape our economies, our labour markets, international trade, international relations, social structures, civil liberties, our relationship with the natural world and even what we understand to be human[97]. A number of companies are involved in the research and marketing of nanotechnology products and, although some experts are warning of potential risks to health and the environment, confirmation of which could damage the reputation and value of such companies, it is clear that not all companies are reporting on how they manage such risks. Responsible investors are only beginning to look this issue.

4.6.3 Private Equity

The number and value of private equity takeovers has risen sharply over the past few years, from around 2-3% of the value of all merger and acquisition deals in 2001 to around 25% in 2007[98]. There is growing concern that private equity takeovers do not champion responsible business. Some commentators argue that socially responsible public companies are being taken over by private equity firms and stripped of assets for short term gain. Two accusations levelled at private equity firms include the allegedly excessive laying off of staff at some of the acquired companies in order to generate short term profit, and the potential for senior private equity firm managers to generate a disproportionate amount of wealth for themselves. In addition, partners in private equity firms benefit from tax breaks on their earnings, and therefore private equity companies are accused of not making adequate contributions to society through the taxation system. Conversely, it can be argued that private equity firms buy companies in order to turn them around and then sell them back into public ownership, therefore it is in their interests to maintain them in a good state rather than to destroy value[99].

Although the reality is debatable for each individual company, the trend is that private equity takeovers are on the rise, and that the factors encouraging the adopting of responsible business practices may no longer apply to private equity entities to the same extent as public entities. Private equity companies are not subject to the scrutiny that publicly traded companies face, and therefore have less need to be transparent: it is both the private equity firms themselves, as well as the companies they own that face less pressure to be transparent. In addition, as private equity owners are perceived to be keen to generate short to medium term gains from the companies they own, it may be that they are less likely to invest in responsible business practices, which are associated with a longer term approach. Responsible business programmes might be dropped as they may be seen as a business cost rather than an investment in brand[100].

For all of the reasons above, private equity firms do not face the same pressure from investors relating to their responsible business practices. Where pension funds and other institutional investors provide finance to private equity firms or invest directly in private equity themselves they are in a position to pressure those companies to report on their ESG business practices. Those private equity firms that are issuing shares through Initial Public Offerings (IPO) will access public investment and then be exposed to the same pressures to explain how they manage their own ESG risks and those of the companies they own.

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97 http://en.wikipedia.org/wiki/Nanotechnology#Implications

98 Briefing *Public v private equity: The business of making money* The Economist July 7th 2007

99 Baker, M. 2007 *Private equity - Agents or destroyers of responsible business?* Business Respect, Issue Number 110, 13 May 2007 www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1856

100 White, A. 2006 *Invest, Turnaround, Harvest: Private Equity Meets CSR* www.bsr.org/meta/Private_Equity.pdf; Arnold, M. 2007 *Firms urged on external directors* Available at www.ft.com/cms/s/be3f2bee-34a8-11dc-8c78-0000779fd2ac.html

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5 Conclusion

5.1 Current trends in responsible business

The past two decades have witnessed a period of rapid growth in responsible business practices. The movement has largely been driven by increased pressure from NGOs, governmental regulation, ethical consumerism, maintaining brand reputation and responsible investment. Responsible investment has grown to around USD 4 trillion worldwide, as calculated by the social investment forums, and now wields significant influence amongst businesses. The proportion of companies adopting responsible business practices has grown significantly, but to varying degrees in different regions, dependent on the pressure exerted by the various stakeholders such as investors and governments.

Broadly, European companies are leaders on the majority of issues. Around 90% of companies have adopted equal opportunities policies, and around 80% have adopted equal opportunities systems meeting at least basic standards. Less than 10% of European board members are women, although certain countries have adopted progressive policies, such as the implementation of quotas in Norway. 38% of companies with a large presence in high risk countries have developed at least basic human rights policies, and 35% have achieved the advanced level. European companies are clear leaders in addressing their supply chain challenges, as over 50% of European companies have developed at least a basic supply chain policy. Furthermore, European companies demonstrate strong performance on environmental matters, with around 80% having developed a policy, and high performance is also demonstrated on systems and reporting. Environmental performance is strongest amongst European companies, as 59% of all companies demonstrate an improvement in performance. Finally, 85% of European companies meet at least basic standards for community involvement. The factors that have driven the strong performance by European companies include extensive EU regulation, a high level of civil society awareness of sustainability issues and NGO pressure, and a mature responsible investment marketplace. Responsible investors are continuing to exert pressure on European companies to adopt responsible business practices in relation to all the issues covered in this report.

North American companies do not perform as well as European companies on a significant majority of measures. On the governance side, independence of directors is high with 91% of companies having more than a third of independent directors and the vast majority of companies disclosing their directors' remuneration (96%). However, rates of separation of Chair and CEO are significantly lower in the US (30%), where it is not stipulated in the corporate governance guidelines that companies should separate these positions. North American companies are leaders with respect to the proportion of women on the board, with the exception of Nordic countries. They are also leaders with respect to the development of equal opportunities policies, although they fall behind on equal opportunities systems as information relating to the number of women and ethnic minorities is rarely published, and companies in this region usually do not have sufficient flexible working policies that meet the required standards. North American companies do not perform well on issues of labour rights compared with European companies; only 40% have adopted at least basic human rights policies and less than 20% have adopted supply chain policies. In addition, North American companies fall significantly behind European and Japanese ones on developing and implementing environmental strategies; particularly US companies, as only 40% have developed at least basic environmental policies and as little as 20% demonstrate an improvement in performance. Finally, North American companies perform well on community involvement as 70% meet basic standards. Responsible investment in the US has historically focused on negative screening of companies involved in areas such as alcohol, tobacco, pornography, abortion and weapons. However US responsible investors are increasingly adopting sustainable investment approaches and are continuing to build upon their long

tradition of shareholder activism. These trends should see increased pressure put upon US companies, beyond those already engaged, to improve their corporate responsibility record.

Japanese companies are ahead of Asia ex-Japan in their development of policies and systems for all of the issues covered in this report however they are also further behind European companies with respect to the majority of measures. The exception is the addressing of environmental challenges, as Japanese companies lead on this issue alongside European companies. Japanese companies are more likely to be laggards with respect to director independence; only 6% of companies have more than a third of independent directors and 54% of companies separate the roles of Chair and CEO. In addition, less than 1% of directors in Japan are women. Furthermore, 25% of Japanese companies have adopted at least basic human rights policies, and less than 10% have adopted basic supply chain policies and systems. Finally, 65% of Japanese companies have met EIRIS' community involvement criteria at a basic level or above. Japanese responsible investment is less developed than European and North American responsible investment. USD 6 billion is managed under a responsible investment strategy, equating to 1% of all Japanese assets under management. However the sector has grown in recent years and whilst the approach may often be different from Europe this growth should encourage increasing levels of responsible business practice by Japanese companies.

Asia ex-Japan and the majority of emerging markets have yet to embrace responsible business to any significant degree. Hong Kong and Singapore based companies find themselves at the bottom end of the spectrum for a variety of issues, including environment, human rights and equal opportunities, where broadly, less than 20% of companies meet basic standards in each case. The exception to this pattern is community involvement, where around 60% of companies meet the basic standards or above. Philanthropy is therefore still seen as the most significant part of CSR and responsible business practices. However, given that Asia is undergoing a process of rapid development one has reason to be confident that within the next 5-10 years, there will be a highly significant level of progression in responsible business practices in this region. The first signs are apparent, as companies in certain countries are beginning to take up the responsible business mantle, NGO presence is growing in developing countries and responsible investment funds are emerging. Responsible investment is in its infancy in this region and so as it grows one should expect companies to respond by improving their responsible business practices.

In general, companies in Australia and New Zealand are performing at a similar level to Japanese and North American companies, outperforming Asia ex-Japan companies, but not reaching the same levels as European ones. Less than 10% of board members in Australia and New Zealand are women, which is a similar level to Europe. Performance is similar to North America with respect to labour relations, as 50% have developed human rights policies meeting at least basic standards and less than 15% have adopted supply chain policies. And performance is similar to North American on environment; around three quarters of companies have adopted environmental policies meeting at least basic standards although less than a quarter demonstrate an improvement in environmental performance. Finally, approximately 75% of companies meet at least basic standards on community involvement. Responsible investment in Australia and New Zealand is more developed than other countries in the Asia-Pacific region and it is growing at a phenomenal rate. Between 2000 and 2006 responsible investment portfolios in Australia grew by 3,587%[101].

101 Ethical Investment Association. *Sustainable Responsible Investment in Australia – 2006: A benchmarking survey conducted for the Ethical Investment Association by Corporate Monitor* Available at www.eia.org.au/files/PF5QGPZHO2/SRI%20Benchmarking%20Report%202006%20EIA.pdf

5.2 The future of responsible business

Companies are adopting responsible business practices as a means to manage their reputational risks, strengthen brand value, build consumer trust and improve internal processes and staff motivation. This is happening largely in response to government regulation and the growth of responsible investment and NGO activity.

Even amongst the largest global companies examined here, large companies are more likely to adopt responsible business practices. These companies face a more compelling business case due to both the greater importance of their brand value and their greater vulnerability to negative publicity.

EIRIS expects increasing numbers of companies to adopt responsible business practices. The imperative has been quantified in economic terms by Lord Stern, who recently predicted that climate change has the potential to cause economic depression "on a scale similar to those associated with the great wars and the economic depression of the first half of the 20th century"[102]. In the face of such a compelling economic argument it seems likely that companies will continue or enhance their responsible business practices. Furthermore, as responsible business practices are increasingly incorporated into mainstream business processes it seems likely that they will continue as the economic environment changes. Indeed, certain companies have identified new business opportunities as a result of the urgency to address ESG risks such as climate change, such as the development of the renewable energy sector.

In the event of a recession it is possible that companies will seek to expand their responsible business practices rather than reduce them. Naomi Klein reports that when there was a market crash in 1993, those companies that invested in advertising to boost brand image were the ones that emerged as leaders once the markets recovered[103]. As companies are adopting responsible business practices to protect their brand value and build customer trust, the trends should arguably be the same in the event of an economic slump. Customers and shareholders will become increasingly valuable so, by the logic expressed by Klein, companies maintaining or expanding their responsible image during this time may be likely to experience a proportionally lower decrease in share value and loss of market share. Conversely, companies that view responsible business as a fringe activity adopted to avoid negative publicity may discontinue their responsible business practices during periods of economic instability. Charitable giving may decline as this is an additional activity beyond core business. However responsible or sustainable business practice may be continued in cases where it has been incorporated into the core business strategy.

EIRIS also expects investors' appetite for increased company responsiveness to ESG issues to continue to grow. Responsible investment has grown rapidly over the past 10 years all over the world, and continues to do so. Recent evidence shows that incorporation of ESG issues into investment analyses can indicate which companies are likely to outperform the average in the long term[104]. If this proves true then analysis of ESG factors will increasingly be incorporated in mainstream investment analysis. In response, an increasing number of companies will adopt responsible business practices.

Customer demand and competitive pressures are likely to work alongside responsible investment to continually raise expectations of the standards expected of companies. Index providers will also remain

102 *Stern Review on the economics of climate change* 2006 Available at www.hmtreasury. gov.uk/independent_reviews/stern_r
103 Klein, N. 2000 *No Logo* Flamingo: London
104 *An Introduction to GS Sustain* Available at www.unglobalcompact.org/docs/summit2007/gs_esg_embargoed_until030707pdf.pdf

influential in both promoting awareness of ESG issues and in setting standards for investors. Indeed, in addition to established responsible investment indices such as FTSE4Good and the Dow Jones Sustainability Index (DJSI), a number of sustainability indices have been established in emerging markets, including countries such as Brazil, South Africa, Israel, Malaysia and Singapore.

5.3 Achieving sustainability

Looking forwards, it is probable that investors and pressure groups will continue to encourage companies to adopt *sustainable* business practices. Brundtland defines sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”[105]. Examples of sustainable business include activities such as striving to be carbon neutral, and practices that fully respect workers rights. At present some commentators contend that companies are managing their brand image and developing customer trust by adopting *responsible* practices rather than moving to *sustainable* ones[106]. However it is likely that in future investors and NGOs will raise their expectations of how companies address their ESG impacts, pushing companies to being more sustainable.

Considering that the corporate responsibility movement has only recently emerged, over the past 10-20 years[107], it is encouraging to see the progress made to date. It would be ambitious to expect a large proportion of companies to have adopted a sustainable approach at this time, and an increasing proportion of companies are already adopting sustainable business practices.

EIRIS measures sustainable business within the environmental policy criteria, having developed an indicator entitled ‘moves towards sustainability’. The indicator considers integration of the sustainability concept into the company’s main operations or business model. To be awarded the grade, companies must indicate a sustainability strategy guiding the whole company, or show evidence of taking sustainability seriously. For example a logistics company might change its fleet to a zero emissions one, or state an intention to work towards zero emissions. As of July 2007, a small proportion of companies (6%) are already meeting this indicator.

It may be that as investor and NGO expectations rise, an increasing number of companies strive to meet the challenge of sustainability. However, investors would need to adopt a longer term investment horizon in order to be more effective in encouraging sustainability advances amongst companies. A longer term investment approach would encourage a more sustainable approach since companies that address these issues are more likely to prosper in the long term. However, persuading investors to adopt a long term focus is a challenging one.

The changing approach to businesses taken by NGOs should also encourage an increase in responsible and sustainable business practices moving forwards. Pressure groups have historically focused on the negative actions of certain companies rather than the positive contributions of others, which encourages the avoidance of irresponsible business rather than encouraging responsible business. However, NGO

105 *The Brundtland Commission Our Common Future* Available at www.ace.mmu.ac.uk/eae/Sustainability/Older/Brundtland_Report.html
106 Baker, M. 2006 *Holding your company in trust* Business Respect, Issue Number 104, 8 Oct 2006
107 Elkington, J. 1997 *Cannibals with forks: the triple bottom line of 21st Century business* Capstone Publishing Limited, Oxford; Hopkins, M. 2006 *The planetary Bargain: Corporate Social Responsibility Matters* Earthscan, London

relations with businesses are evolving. NGOs are increasingly working with companies to encourage improvements amongst all companies, rather than solely exposing the laggards.

5.4 Delivering meaningful ESG data

One view is that responsible business has developed in terms of a 'business case', putting the interests of the business first and therefore not concentrating on the issues it attempts to address, such as poverty reduction and environmental sustainability. It is widely assumed that responsible business is a positive development. However some commentators doubt its effectiveness believing instead that the benefits may be greater for business in the form of risk management strategies than benefits to the global community[108]. Indeed, approaching social justice from the perspective of 'what's in it for the protagonist' has the potential to compromise the outcomes for the beneficiaries.

This may have been the case for early perceptions of CSR, such as philanthropy, however the focus is increasingly on company responses to ESG issues. The EIRIS criteria are based on specific quantifiable indicators that measure company actions in response to ESG issues. EIRIS considers company policies, systems, reports and performance, ensuring that the data reflects the extent to which companies are addressing their ESG impacts. Companies that do not adopt an approach that addresses their ESG impacts do not score highly against the criteria. Stakeholders and proponents of responsible business must continue to request information from companies using relevant and measurable indicators to ensure that companies continue to address their impacts in a meaningful way.

5.5 Concluding remarks

EIRIS is confident that responsible business will continue to grow around the world. It is expected that increasing numbers of companies will improve their responsible business practices and that European companies will continue to lead this process. However it is also expected that companies in other regions will make significant progress towards current best practice. Asia ex-Japan is expected to embrace responsible business as economic expansion continues in the region. In addition, one might expect US companies to embrace responsible business, particularly in response to the environmental challenges faced as a result of climate change.

The success of initiatives and schemes such as the Global Reporting Initiative (GRI) and Carbon Disclosure Project (CDP) are a strong indicator that companies are increasing their disclosure of ESG practices and strategies. EIRIS welcomes the continued success of these initiatives to increase the volume, quality and comparability of published information. The availability of high quality information enables the supply of quality research and analysis to the increasing numbers of investors who seek to integrate ESG factors into their investment decisions.

Ethical Investment Research Services (EIRIS)

September 2007

108 Jenkins, R. 2005 *Globalisation*, Corporate So

Appendix A: Human Rights Country lists

HIGH RISK LIST (2007):

Afghanistan, Algeria, Angola, Azerbaijan, Belarus, Burma, Burundi, Cameroon, Chad, China, Colombia, Congo (Democratic Republic of), Cote d'Ivoire, Cuba, Egypt, Eritrea, Ethiopia, Equatorial Guinea, Haiti, Iran, Iraq, Laos, Lebanon, Libya, Nepal, Nigeria, North Korea, Pakistan (with Kashmir), Russia, Rwanda, Saudi Arabia, Somalia, Sudan, Swaziland, Syria, Togo, Turkmenistan, Uganda, Uzbekistan, Vietnam, Zimbabwe

Note: China does not include Hong Kong, Taiwan or Macau.

MEDIUM RISK LIST (2007):

Armenia, Bahrain, Bangladesh, Bhutan, Brunei, Cambodia, Central African Republic, Congo (Brazzaville), Djibouti, Guinea, India, Indonesia, Israel (with Occupied Territories), Jordan, Kazakhstan, Kyrgyzstan, Liberia, Maldives, Mauritania, Morocco, Oman, Philippines, Qatar, Sri Lanka, Tajikistan, Tunisia, Turkey, United Arab Emirates, Yemen

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Appendix B: EIRIS research and research partners

EIRIS is a charity-owned, independent, business organisation that conducts research into corporate responsibility and sustainability issues. It does not offer financial advice. EIRIS researches approximately 3,000 companies from the UK, continental Europe, North America (the US and Canada) and the Asia-Pacific region (Australia, New Zealand, Japan, Singapore and Hong Kong). These include all companies on the FTSE All World Developed Index. Each company is analysed against 60 environmental and social benchmarks. A summary of the EIRIS research methodology is provided below.

Environment

EIRIS classifies companies as having a high, medium or low impact on the environment, based on their main business activity. If a company derives more than 15% of its annual revenue from a particular business activity, that business activity is ascribed to the company's overall environmental impact. The company's primary environmental sector classification is based on its highest environmental impact business activity, even if that business segment is not the company's largest business segment by turnover. Every company is then assessed for:

Environmental policy – whether it has an environmental policy and the extent to which this policy addresses the key issues relevant for that company, whether it is globally applicable, and a range of other elements – such as commitments to sustainability, monitoring and targets.

Management systems – the depth of its environmental management systems and the extent or percentage of the company which is covered by these. This includes looking at both externally-certified and internally-developed systems.

Reporting – the extent and quality of a company's environmental reports, including whether such reports are public and contain meaningful performance data.

Performance – based on the extent to which a company's own performance has improved or deteriorated over a given period, using key indicators in the five areas of climate change, air emissions, discharges to water, waste, and water consumption. In addition, wherever possible, the company's indirect impacts (either through its supply chain or its products) are assessed.

Specific environmental issues of concern – such as 'Chemicals of concern' or 'Sustainable forestry'.

Governance and ethics

EIRIS focuses on making comparable assessments of all companies in the following areas:

Board structure and practice – every company is assessed against four elements including separation of chair and chief executive, independent directors, independence of audit committee, and disclosure of directors' pay.

Women on the board – the percentage of women on each company's board.

Ethics – whether a company has a clear, public ethical code, what that code contains, and what systems it has in place to manage ethical breaches or issues. This includes looking at how the company deals with bribery and corruption issues.

SEE risk management – whether and how well the company's board and senior managers disclose and manage social, environmental and ethical (SEE) risk (also known as environmental, social and governance (ESG) risk).

Social/Stakeholder Issues

EIRIS focuses on a range of social issues including:

Stakeholders – how companies perform in relation to key stakeholders, including employees, customers, suppliers and the community. Employee stakeholders consider a range of issues, including training and development, occupational health and safety, employment equity, job creation, trade unions and employee participation. The extent of a company's philanthropic activities and how and where it engages with its key stakeholders is also considered.

Human rights – how companies deal with the challenges of operating in countries where human rights are most at risk. The policy and systems of companies operating in countries identified as high risk are assessed. In particular, how companies uphold the key rights outlined in the United Nations Declaration on Human Rights (UNDHR) and how they uphold core labour rights in difficult circumstances is examined. In addition the operations of companies in the oil & gas and mining sectors in non-OECD countries are reviewed.

Supply chain – how companies ensure that core labour rights apply within their supply chain. In particular, the policies and systems of companies with global supply chains are considered in those sectors where breaches of labour standards are most frequent. These are food producers, food and drug retailers, general retailers & textiles, household goods, personal goods, leisure goods, electronic & electrical equipment, mobile telecommunications, technology hardware & equipment and tobacco.

Sector Specific Issues

EIRIS has expanded its research into sector specific issues by developing a set of criteria based on recent ESG issues affecting particular sectors or subsets of companies, including the following:

- Access to medicines in the developing world (pharmaceuticals)
- Health risks of radiofrequency radiation (telecoms)
- Obesity (food and beverage producers)

- Hazardous chemicals (speciality chemical producers)
- Project finance & the Equator Principles (financial institutions)

EIRIS News service

EIRIS also monitors news reports and information published by regulatory bodies and NGOs for information on each company's performance in relation to ESG issues. Many clients find these additional news stories of particular interest. News stories related to ESG issues are kept on file for a maximum of three years unless they refer to an on-going issue (for example a court case) in which case they are kept on file until the issue is resolved. These news stories are available in the profile of each company as well as being summarized in our monthly newsletter, Corporate Ethics Overview (CEO).

Convention Watch

Convention Watch research is based on compliance with the norms enshrined in the UN Global Compact. It enables investors to gain a clear understanding of the many allegations made against companies in negative press articles and through NGO campaigns. At present ten EIRIS analysts work on Convention Watch, which means that it incorporates issue and sector expertise relevant to the allegations of specific "breaches".

Convention Watch incorporates allegations and assessments of breaches of international norms drawn from a range of principles, including: the UN Global Compact; OECD Guidelines for Multinational Enterprises; Universal Declaration on Human Rights; UN Human Rights Norms for Business; ILO Core Conventions; Kyoto & Montreal Protocols; Convention on Biological Diversity; Ottawa Convention on Anti-Personnel Landmines and the UN Convention against Corruption.

EIRIS contacts each company and sends the report to the company contact for their comments. This is an important engagement process incorporated in the research. In addition, company websites, CSR reports and news databases are checked for details of how the company has responded to the allegation.

EIRIS' research partners

EIRIS has several international research partners who together have a wealth of experience in the field of ethical investment research. EIRIS works with overseas partners to take advantage of their local knowledge and offer the best global research service to our clients.

EIRIS works with the following research partners:

Centre for Australian Ethical Research (CAER) (Australia)

The Centre for Australian Ethical Research (CAER) is an independent, not-for-profit research organization. CAER was established in 2000 to provide independent social and environmental data on companies operating in Australia and the Asia-Pacific region. CAER collects data on approximately 180 responsible

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investment issues for the S&P/ASX 300 and major New Zealand companies. The data is based on publicly available information gathered from company and government websites and company Annual Reports. CAER provides data on Australian and New Zealand companies to EIRIS. www.caer.org.au

EthiFinance (France)

Based in France, EthiFinance is an independent Research Agency dedicated to responsible investment management. Founded in 2004, EthiFinance provides asset managers with tailor made research and added-value information on CSR issues mainly on corporate governance, and social and environmental risks related to international listed companies. They research 250 listed companies in France. EthiFinance provides data on French companies to EIRIS. www.ethifinance.com

Fundacion Ecologia y Desarrollo (EcoDes) (Spain)

Established in 1992, Ecología y Desarrollo (EcoDes) is an independent, private not-for-profit organization specializing in sustainable development and corporate social responsibility. EcoDes branched out into responsible investment research in 1997 to supply data to an environmental fund set up by EcoDes. They have matched their strong environmental research skills with an expansion into social and economic research. EcoDes provides data on Spanish and Portuguese companies to EIRIS. www.ecodes.org

imug - Institut fuer Markt-Umwelt-Gesellschaft (Germany)

imug - in English 'Institute for Market, Environment and Society' – was set up in 1992 primarily as an environmental research body. It now produces ethical shopping guides for consumers, ethical investment research for green and ethical funds, and producing reports on corporate environmental and social performance for NGO's, government and others. Its staff of 22 provide both marketing consultancy and CSR research for SRI funds. The clients in the Investment Research area of imug come from churches and foundations, ethical and green banks and German asset managers. imug provides data German, Austrian and Swiss companies to EIRIS. www.imug.de

Appendix C: EIRIS clients

EIRIS has a rapidly expanding client base encompassing leading financial institutions, government bodies, pension funds and high profile charities. Many clients use our Ethical Portfolio Manager software as a tool for making the selection and analysis of suitable investments easier and quicker.

Our clients use EIRIS research in a variety of ways but mostly to help develop their engagement, preference and/or screening strategies, and implement their investment policy. As of September 2007 the list of public clients included:

ATP (Danish State Pension Fund)

ABN AMRO

Aegon Asset Management

AIB Investment Managers Ltd

AXA Investment Managers

BankInvest

Bank of Ireland Asset Management

Bernstein Investment Research and Management (a unit of Alliance Capital Ltd)

BlackRock

Boston Common Asset Management

Cazenove Fund Management

Co-operative Insurance Society (CIS)

Credit Suisse

F & C Asset Management

Fédéris Gestion d'Actifs

FIDH

Fonds de Réserve pour les Retraites

FTSE

Haringey Local Authority

Inhance Investment Management

Insight Investment

INVESCO Asset Management GmbH

Joseph Rowntree Charitable Trust

KBC Asset Management NV

L&P Financial Trustees Ltd

Legal & General Investment Management

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Martin Currie Investment Management

M&G Investment Management

Methodist Church Central Finance Board

Mondrian Investment Partners

Montgomery Oppenheim

Morgan Stanley

National Trust

New Star Asset Management

Newsweek Japan

Newton Investment Management

Norwegian Government Pension Fund

Nomura Asset Management

Old Mutual Asset Management

Oxfam

PenSam

Rathbone Investment Management

Robeco Institutional Asset Management

Royal London Asset Management

Santander Gestion de Activos

Sarasin Chiswell

Setanta Asset Management

Schroders Investment Management

Scottish Widows Investment Partnership

Standard Life Investments

Strathclyde Pension Fund

UNIFEM Singapore

WaterAid

World Wide Fund for Nature

In association with EIRIS, FTSE has developed a family of indices, named FTSE4Good, which identifies companies with the strongest records of corporate social and environmental performance. Indices are created for the UK, Europe, US, Japan and world-wide. EIRIS is providing information on companies, to identify those that meet FTSE's eligibility criteria for inclusion.

Appendix D: Other sources of information

There are a growing number of organisations and initiatives that relate to responsible investment interests. A selection of these organisations and initiatives are listed below:

Social Investment Forums

There are numerous social investment forums worldwide. Their role is to promote the concept and practice of socially and environmentally responsible investing.

Belgium: Belsif

Canada: The Social Investment Organization, www.socialinvestment.ca

France: Forum pour l'Investissement Responsable

Germany: Forum Nachhaltige Geldanlagen

Italy: Forum per la Finanza Sostenible

The Netherlands, VBDO (Vereniging van Beleggers voor Duurzame Ontwikkeling)

Sweden: Swesif

UK: UK Social Investment Forum, www.uksif.org

USA: Social Investment Forum, www.socialinvest.org

ASrIA (the Association for Sustainable & Responsible Investment in Asia), www.asria.org

The Carbon Disclosure Project (CDP)

The Carbon Disclosure Project (CDP) is an independent not-for-profit organisation aiming to create a lasting relationship between shareholders and corporations regarding the implications for shareholder value and commercial operations presented by climate change. Its goal is to facilitate a dialogue, supported by quality information, from which a rational response to climate change will emerge. CDP provides a coordinating secretariat for institutional investors with a combined USD 41 trillion of assets under management. On their behalf it seeks information on the business risks and opportunities presented by climate change and greenhouse gas emissions data from the world's largest companies: 2,400 in 2007.

Website: www.cdproject.net

Ethical Trading Initiative (ETI)

The Ethical Trading Initiative (ETI) is a UK alliance of companies, NGOs and trade union organisations. They exist to promote and improve the implementation of corporate codes of practice which cover supply chain working conditions. The ultimate goal is to ensure that the working conditions of workers producing for the UK market meet or exceed international labour standards.

Website: www.ethicaltrade.org

FTSE4Good

Launched in 2001, the FTSE4Good Index Series is a series of benchmark and tradable indices for socially responsible investors. The index series is derived from the globally recognised FTSE Global Equity Index

Series. The indices have been designed to measure the performance of companies that meet globally recognised corporate responsibility standards, and to facilitate investment in those companies.

Website: www.ftse.com/Indices/FTSE4Good_Index_Series

Global Reporting Initiative (GRI)

The Global Reporting Initiative's Guidelines provide a common framework for sustainability reporting globally. The GRI vision is that reporting on economic, environmental, and social performance by all organizations becomes as routine and comparable as financial reporting. An international network of thousands from business, civil society, labor, and professional institutions create the content of the Reporting Framework in a consensus-seeking process.

Website: www.globalreporting.org

International Organisation for Standardisation (ISO)

ISO is the world's leading developer of International Standards, including the ISO 9000 and ISO 14000 families of management system standards which include environmental, managerial and organizational practice. ISO standards specify the requirements for state-of-the-art products, services, processes, materials and systems, and for good conformity assessment, managerial and organizational practice and are designed to be implemented worldwide. ISO launched the global process for developing an international standard on Social Responsibility: ISO 26000. It will complement a number of initiatives supported by the European Commission to improve understanding, monitoring and development of Corporate Responsibility. ISO is independent as it does not carry out certification of its standards, nor does it control the certification business sector.

Website: www.iso.org

New Economics Foundation

The New Economics Foundation (NEF) is a UK charity that works to construct a new economy centred on people and the environment. Founded in 1986, it is an independent think tank, combining research, advocacy, training and practical action.

Website: www.neweconomics.org

The Principles for Responsible Investment (PRI)

The Principles for Responsible Investment, developed by leading institutional investors with the UN Environment Programme Finance Initiative and the UN Global Compact, the Principles include environmental, social and governance criteria, and provide a framework for achieving better long-term investment returns and more sustainable markets.

Website: www.unpri.org

The United Nations Equator Principles for Financial Institutions (UNEP FI)

UNEP FI is a global partnership between UNEP and the financial sector. Over 160 institutions, including banks, insurers and fund managers, work with UNEP to understand the impacts of environmental and social considerations on financial performance.

Website: www.unepfi.org

United Nations Global Compact (UNGC)

The Global Compact is an international voluntary initiative to bring companies together with UN agencies, labour and civil society to support universal environmental and social principles. These companies are working to advance ten universal principles in the areas of human rights, labour, the environment and anti-corruption. Through the power of collective action, the Global Compact seeks to promote responsible corporate citizenship so that business can be part of the solution to the challenges of globalisation. The Global Compact is not a regulatory instrument, rather the Global Compact relies on public accountability, transparency and the enlightened self-interest of companies, labour and civil society to initiate and share substantive action in pursuing the principles upon which the Global Compact is based.

Website: www.globalcompact.org

United Nations Universal Declaration of Human Rights (UDHR)

In 1948 the General Assembly of the United Nations adopted and proclaimed the Universal Declaration of Human Rights. It consists of 30 articles which outline the view of the United Nations General Assembly on the human rights guaranteed to all people.

Website: www.unhchr.ch/udhr

World Business Council for Sustainable Development (WBCSD)

The World Business Council for Sustainable Development (WBCSD) brings together some 180 international companies in a shared commitment to sustainable development through economic growth, ecological balance and social progress. Their members are drawn from more than 30 countries and 20 major industrial sectors. They also benefit from a global network of 50+ national and regional business councils and partner organizations.

Website: www.wbcsd.ch

Appendix E: Acronyms and Abbreviations

ASrIA	Association for Sustainable & Responsible Investment in Asia
BOVESPA	Bolsa de Valores de São Paulo (The São Paulo Stock Exchange)
CAER	Centre for Australian Ethical Research
CCSR	Centre for Corporate Social Responsibility
CDP	Carbon Disclosure Project
CORE	The Corporate Responsibility Coalition
CSR	Corporate Social Responsibility
EcoDes	Fundacion Ecologia y Desarrollo
EIRIS	Ethical Investment Research Services
EMAS	Eco-Management & Audit Scheme
EPA	Environmental Protection Agency
ESG	Environmental, Social and Governance
ETI	Ethical Trading Initiative
EU ETS	European Union's Emissions Trading Scheme
EUROSIF	European Social Investment Forum
FTSE	Financial Times and London Stock Exchange
GRI	Global Reporting Initiative
HKEx	Hong Kong Exchanges and Clearing
IIGCC	Institutional Investors Group on Climate Change
imug	Institut fur Markt-Umwelt-Gesellschaft
INCR	Investor Network on Climate Risk
IPCC	International Panel on Climate Change
IPO	Initial Public Offering
ISE	Índice de Sustentabilidade Empresarial (Bovespa Corporate Sustainability Index)
ISO	International Organisation for Standardisation
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
NGO	Non-governmental organisation
OECD	Organisation for Economic Cooperation and Development
SIF	Social Investment Forum
SRI	Socially responsible investment
TSE	Tokyo Stock Exchange
UDHR	United Nations Universal Declaration of Human Rights

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UKSIF	United Kingdom Social Investment Forum
UNEP FI	United Nations Equator Principles for Financial Institutions
UNFCCC	United Nations Framework Convention on Climate Change
UNGC	United Nations Global Compact
WBCSD	World Business Council for Sustainable Development

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Other publications and guides

Additional publications and guides for investors are available from EIRIS, including briefing papers addressing ESG risks facing specific sectors, for example

- 'Obesity concerns in the food and beverage industry'
- 'Beyond REACH – chemical safety and sustainability concerns'
- 'Project finance: a sustainable future?'

To obtain copies or for information on how EIRIS research can assist the investor to better integrate extra-financial environmental, social and governance issues please email clients@eiris.org or visit www.eiris.org

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