

The unvarnished money: is information reliable?

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On the 20th of November, our group attended the 12th workshop “The unvarnished money: is information reliable?” of the World Forum Lille 2009 - Meeting on Sustainable Finance. There were three speakers on this topic, namely Mike WALLACE, Director of Sustainability Reporting Framework - GRI (Global Reporting Initiative) from the Netherlands, Matthew KIERNAN, co-head of the Sustainability Solutions Department of the RiskMetrics Group from the USA, and Gerald BRAUNBERGER, journalist from the Frankfurter Allgemeine Zeitung from Germany.

The main subtopics include:

ESG (environmental, social, and governance) information developments:

- Stakeholders increased their demand for ESG information

besides financial information released by companies;

- Companies are taking this seriously as financial communication has currently turned into a strategic stage, as the corporate image can be at stake;
- Internet and governments are also actively participating in this trend.

Why GRI is important to us:

- We are facing 3 crises: credit, resources and climate change;
- We need to change our information set and financial information should be legally required to be accurate;
- Government should make sure that the financial information provided by companies is reliable, accurate, and useful.

The relationship between media and finance:

- Media should make their effort to decipher, control and pass on information;
- Media are endangered to become weaker as the media industry lacks competent journalists to report on financial information.

Mike Wallace

The first and most important question in the debate about environmental, social and corporate governance (ESG) information is who is *really* looking at ESG information? An increasing number of shareholders carry out due diligences that look at the sustainability of companies. These investors are grouped in projects

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like the principles for responsible investments (PRI), which has more than 600 signatories and currently represents over \$14 trillion. Another project is the carbon disclosure project (CDP) representing over \$55 trillion in invested capital. These investors investigate the sustainability of the business profoundly before buying shares of a company.

The assessment of ESG is rated by organizations as the Dow Jones Sustainability indexes, FTSE4Good, CRO or Fortune and by several research specialists who look at the financial statements and CSR reports of the companies involved. Even an investment bank as Goldman Sachs for example has an internal staff doing this analysis. In the ratings of technology companies HP and Intel are clearly outperforming their competitors at the level of ESG. A study of A.T. Kearny even shows that companies who focus on sustainability outperformed their peers during the recent financial crisis by 15% on an annual basis. This clearly shows that focusing on sustainability can be interesting from a financial point of view.

When we look at quantitative data and compare carbon disclosures, huge differences in the carbon footprint can be noticed between similar types of companies. This is mainly due to the operational efficiency and the kind of fuel they use. These differences play a major role in the cost of carbon and emissions to compensate for the carbon intensity and can affect the P&L of a company.

The FT500 companies use 34 different methodologies to calculate their

greenhouse gas (GHG) emissions, but a lot of initiatives are taken by various companies as Bloomberg and PWC to create more transparency with respect to these carbon ratios. Transparency, looking at the full ESG and showing information to the outside world in a standardized way are the most important challenges faced by the global reporting initiative (GRI). The number of companies who joined this program is growing very rapidly.

Mike Wallace stated that GRI is important for everyone, since we are facing 3 sorts of crises. The first is the credit crisis with a great deal of bad debts that need to be worked out of the system. The second crisis is about the limited oil resources, the increasing demand for oil and the rising price for extracting the oil. The third crisis is about climate change and affects everyone. It is expected that society will change dramatically in order to handle these 3 crises.

Gerald Braunberger

The well-known German journalist Gerald Braunberger highlighted topics as the reliability of information in the media. Having worked as an economic and business observer in several countries, he was able to provide a very interesting opinion on the issue.

Gerald Braunberger stresses the abundance of information sources these days and the relative easiness to assess most of them in a matter of minutes. However, when a reader tries to find information on specific issues on Google, he would most often face plenty of

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articles, which distort the information with all the “noise” created in the informational space. Moreover, he points out that purely commercial information will often pop up when you search for information on the net, which is one of the main sources of income for search engines as Google.

Problems of a similar nature can be seen in the activities of the rating agencies that are not always consistent with their valuations and ratings. In fact, the market value of companies strongly depends on the ratings that those agencies provide. Conflicts of interest can be found in personal communication with the company’s executives. The CEO’s and CFO’s of today do not conduct spontaneous and objective interviews with business journalists or analysts. Instead, they seek professional advice of external communication agencies. Communication agents are there to request the preliminary questions beforehand, analyze them, research on the journalist/analyst (his previous works and potential questions that might be asked) and suggest adequate answers. Afterwards they would run the simulation interview with the company official to make it shiny and sound, before the real interview would finally take place. As one might guess, in the end it is a mere performance; there is not much left of a reflection of business reality or the personal portrait of the CEO. Gerald Braunberger also emphasizes the action of looking deeper into the human nature of the company officials, understanding their attitudes and driving forces. As he points

out: “If a banker talks to a journalist, it is not because he is a nice person. All his words about improvement and responsibility are usually carefully selected and prepared for the sake of personal and company benefit”.

Being a journalist himself, Gerald Braunberger was able to underline the pitfalls of journalists’ professionalism in the whole media industry. Unfortunately, the most competent and capable people, who have a better vision of the financial and business world, tend to work in better paid places than the media. Journalists are often lacking expertise and sufficient knowledge on the topics they try to cover. Therefore, it leads to misunderstandings of events and concepts, and hence to inconsistencies in the articles.

Marc Brammer

Despite the financial crisis and the bail out that governments have had to undertake there have not been any changes to the overall rules that exist in the financial system. Just by looking at individual trading we can clearly see that there is still no regulation and that traders still give more importance to the bottom line which is profit.

In the topic of information, what do we do with it? In order to manage the crisis as well as other problems that exist we need to change our information set. This means that companies have to provide accurate information in the widest possible level. This information has to be legally required to companies by governments.

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Currently much of the information that companies provide in terms of CSR are not legally required or do not have any repercussions to the law if they are not accurate. A very well known example that illustrates this problem is Nikes first CSR report that it made in the 90's. This report which detailed untruthful labor practices and led the company to a trial in the US was not sufficient to incriminate their actions.

It is also important to mention that the information provided has to be relevant from a financial point of view. For example if a fertilizing company provides a lot of information about CSR but does not provide any in regards to water pollution than there is a problem. The greatest affect that a fertilizing company may have on the environment is water pollution. Take for example areas in the ocean like the Gulf of Mexico and the Baltic Sea that cannot support some type of life due to the pollution. In some cases these areas are half the size of Europe.

Overall how can we make relevant changes in the way information is provided by companies? First of all governments have to step in and make it a requirement. This measure will also provide better research analysis on CSR that companies do. A second step is to review some of the impacts that companies have and their plans on how they are going to deal with it. Also, it is necessary to constantly question if information is reliable and accurate. One of the most important steps is to make CSR data more financially viable. This last

step involves that information needs to be accurate so investors can take it into consideration when they valuate companies. In other words, with this information investors can price externalities that companies generate. An example of this is how a company's carbon foot print is no longer considered an outside research but is becoming more something more mainstream.

ESG Information

ESG issues are getting more important for companies to consider. However, they are not used for financial reporting, but rather for integration to be able to improve the operations of the company. This will benefit their long-term strategy and is therefore also important for financial analysts to take into consideration. In contrast to the financial reporting, it is not yet required. However, this does not mean that financial information is more reliable today than ESG information. Another point to take into consideration is that financial information is becoming increasingly complicated. Even big banks are not able to understand their own balance sheets properly.

CSR data has to be interpreted with care as well. The difficulty lies in the fact that companies often do not understand how to report their ratings. Honda, for example, is the best rated company, but they did not evaluate the fact that Japan is one of the most carbon intensive societies in the world. Indeed, Japan is burning far more coal than other locations. Honda has put the wrong numbers because it did not

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have a clear understanding about the CSR reporting in terms of ratings.

Although the ESG reporting is not legally required yet, it does not mean that companies will not take this issue into consideration. ESG will bring more transparency to the capital markets. Even without regulation companies will apply these rules as it is pressured by other comparable companies that do care about making their reporting more transparent.

Media

People are absorbed by the financial crisis for already two years. They now try to look more into the future and ask themselves whether there are other issues than the financial crisis to be addressed. As a consequence, the media is making use of this opportunity to focus on the fashion of listing the greenest companies. CSR is therefore getting increasingly a marketing issue for the media.

The problem lies in the fact that companies are possibly inclined to use CSR reporting as a marketing trick as well. The focus will then be on the short term horizon, but this is not going to stop the financial crisis. The capital system will therefore have to find a solution to punish companies that fail to do the right thing. They have to focus on values that look behind the short term horizon.

Summary

The problem lies in the fact that companies are possibly inclined to use CSR reporting as a marketing trick as well. The focus will then be on the short term

horizon, but this is not going to stop the financial crisis. The capital system will therefore have to find a solution to punish companies that fail to do the right thing. They have to focus on values that look behind the short term horizon.