CSR and SRI: the growing business imperatives

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Corporate social responsibility (CSR) is an emerging, as yet poorly defined, process used by some as a fashion statement through glossy reports and websites, and by others as a potential framework for demonstrating a more responsible approach to doing business.

Over the past two decades, the pressure upon business to become accountable and perform a social and environmental role has increased dramatically. Incidents such as the Union carbide accident in Bhopal, India, in 1984 and the Chernobyl nuclear power station disaster in the Ukraine in 1986 helped put corporate responsibility for environmental hazards on the international agenda. Western industrialised governments responded to such incidents, and established legal and regulatory frameworks for corporate accountability.

Globalisation has had an extraordinary impact on its emergence. Throughout the late 1980s and 1990s, the new, knowledge-based economy generated millions of new jobs and a rash of innovative products and services for Western consumers. The offset of this has been to expose a wide range of labour, human rights and environmental abuses, and to create a dysfunction between meeting people's needs, protecting planetary resources and enhancing corporate profits -- the perfect trigger for the anti-globalisation demonstrations of 1999, 2000 and 2001. The result has been that even companies in sectors with high levels of environmental risk have introduced ways to reform their business by looking and listening.

Globalisation has gone hand-in-hand with business short-termism and a total focus on maximising shareholder value -- a strong emphasis on immediate results and a loss of faith in long-term strategic management.

CSR (or sustainable development, which is a closely allied concept) is generally regarded as the opposite of short-termism. It is argued that sustainable development looks at the needs of future generations rather than a focus on short-term delivery with scant regard for the consequences. It appears to run contrary to established market forces and modern business practices. However, there is a growing business imperative to embrace social responsibility, and it is emerging through consequences to the bottom line.

Whether or not organisations are enthusiastic about embracing greater social and environmental accountability, there seems to be a growing business imperative to do so. This can be defined in four categories of commercial penalties and incentives:

Socially responsible investment (SRI) and shareholder targeting are developments that are beginning to receive serious attention from financial analysts and institutional investors. Banks, term assures and asset managers are screening their shareholdings in favour of companies that demonstrate commitment to social and environmental programmes, and against those that engage in activities deemed detrimental to society and the environment. With institutional investors potentially deterred by the 'hassle factor' of picking non-SRI stocks, a company's ability to conform to sustainable development models will potentially have share price implications. The growth of ratings agencies is likely to mean that companies will find their financial position rated on CSR issues as well as conventional criteria, whether they like it or not. It is likely that in the future regulators will make companies hold capital against such risks.

SRI is an investment strategy that takes into account a company's ethical, social and environmental performance as well as its financial performance. SRI has supplanted 'ethical investment' as the criterion for judging responsible business, and has widened to include environmental and social issues. A range of vetted products, including unit trusts and pensions, are now on offer from most large banks and assurance companies.

Today, SRI is a dynamic and rapidly expanding sector of financial services in North America, parts of Europe, and Australia. It is estimated to be worth more than $2 trillion in the United States and around £25 billion in the UK, the largest market in Europe. The Dow Jones Sustainability Group Index has outperformed the Dow Jones Index by 36 percent over the past five years. In the UK, changes to the Pensions Act now require pension funds to declare how far they take social environmental and ethical considerations into account when choosing stocks for investment, and other European countries are considering introducing similar legislation.

The initial emphasis of SRI funds was on negative screening -- specifically excluding companies engaged in particular types of activity. However, negative screening has partly given way to screening on the basis of companies' positive activities and looking for best practice in what were once seen as controversial industries. Many fund managers now look to invest in companies that make a positive contribution to the economy and to society. A survey of the 23 top European ethical and green unit trusts' adoption criteria revealed that screening under positive measures in rapidly becoming as significant as negative screening:

Strict screening can exclude whole sectors, such as chemicals, from investment, but some new funds are adopting a 'best of sector' or 'light green' approach, and investing in (mostly larger) companies shunned by traditional ethical funds. This has enabled companies in the energy, automotive and agrochemicals sectors to warrant inclusion in some funds. For example, car manufacturer Volkswagen, chemicals company BASF and mining company Rio Tinto are included as sector leaders in the Dow Jones Sustainability Index.

Harnessing the importance of SRI through shareholder activism is now considered by some environmental groups to be a much more significant tool than consumer boycotts. In 1999 concerned investors in the United States introduced more than 200 resolutions on a wide range of issue relating to environmental health and corporate governance matters. In one case, Home Depot, a large lumber and hardware store, announced it would stop selling forest products from environmentally sensitive areas and would give preference to timber certified as sustainably produced, just three months after 12 percent of its shareholders asked the company to stop selling wood from old-growth forests.

Organisations like Friends of the Earth and Amnesty International are now consulted by fund managers, partly to clarify screening for ethical funds, but also to ensure that future pressures on companies' behaviour are adequately appreciated in financial-led investment decisions. This has developed particularly since the response in Europe to genetically modified products, which led to the near collapse of Monsanto and its subsequent acquisition by Pharmacia Upjohn. Monsanto had previously been strongly commended on Wall Street because of its rapid expansion in the United States. However, NGO pressure in Europe became so intense that it began to affect the US share price. Campaigners targeted all stakeholders, including shareholders. This led Deutsche Asset Management to recommend that institutional investors should sell Monsanto shares quickly. The resulting drop in share price made the company easy prey for takeover at the end of 1999. In spite of being one of the most innovative companies in the agrochemical and biotechnology sectors, the Monsanto brand never recovered from the legacy of this attack.

As demands for environmental and social responsibility in business have developed, they have also become more mature. Concerned consumers look at the corporate face behind the brand, and this influences purchasing decisions. At the same time, there is public acceptance that not every company can be the perfect eco-friendly business. Society needs products like oil and chemicals -- but there is demand for companies in these sectors to reduce their negative environmental and social 'footprint['. Consequently, there is an emerging emphasis on CSR best practice and leadership within sectors of industry, opening the way for individual companies to gain competitive advantages.

CSR is concerned with many aspects of a company's impact, from sourcing to service delivery or product disposal, and can affect a host of cost-based as well as reputational aspects of a business. The commercial and reputation risk management case for CSR is demonstrated in the risk to shareholder value from poor management of supply chain issues, inadequate environmental management, human rights abuses and poor treatment of employees, suppliers or customers. Human capital has become more important than physical capital, and so the threat to important relationships has become critical. Concerned investors will apply pressure to those that are not managing such risks and reward those that are.

The proliferation of financial and regulatory instruments in support of sustainable development is starting to engineer market forces in some countries to the extent that companies need to take a serious look at adoption. Failure to do so risks criticism for lagging behind and a detrimental impact on reputation. A perception of moving slowly in response to new societal and consumer trends and demands can not be damaging in the financial markets.

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India takes unique path to lower carbon emissions

REUTERS, *New Delhi*

REUTERS

A smoke rises from a chimney of a garbage processing plant on the outskirts of Chandigarh, India.

With four times the population of the United States, an economy growing 8-9 percent a year and surging energy demand, India's race to become an economic power has propelled it to No. 3 in the list of top carbon polluters.

India's greenhouse gas emissions will keep rising as it tries to lift millions out of poverty and connect nearly half a billion people to electricity grids. But it is also trying to curb emissions growth in a unique way, fearing the impacts of climate change and spiralling energy costs.

The government is betting big on two market-based trading schemes to encourage energy efficiency and green power across the country of 1.2 billion people, sidestepping emissions trading schemes that have poisoned political debate in the United States and Australia.

"The policy roadmap India is adopting to curb emissions is innovative -- something that will make industries look at making efficiency the centre-piece rather than some step that follows an ineffective carrot and stick policy," said Srinivas Krishnaswamy, CEO of green policy consultants Vasudha India.

In the world's first such national market-based mechanism, called Perform, Achieve and Trade (PAT), India is starting a mandatory scheme that sets benchmark efficiency levels for 563 big polluting from power plants to steel mills and cement plants, that account for 54 percent of the country's energy consumption.

The scheme allows businesses using more energy than stipulated to buy tradeable energy saving certificates, or Escerts, from those using less energy, creating a market estimated by the government to be worth about $16 billion in 2014 when trading starts.

The number of Escerts depends on the amount of energy saved in a target year.

A three-year rollout phase is set to start in September and will help India curb about 100 million tonnes of carbon emissions, the government estimates.

The rollout is aimed at working out hiccups in the process for companies to measure and report their energy use.

India has already rolled out a renewable energy certificate (REC) trading scheme for wind, solar and biomass power plants. Green power comprises about 8 percent of energy production in India, while coal generates more than 60 percent, leading to a hefty coal import bill.

Trading for the REC scheme, which currently occurs once a month, has picked up as more projects participate, underpinning a government plan to ramp up solar power from near zero to 20 gigawatts by 2022, about one eighth of power generation now.

On May 25, a total of 14,002 RECs were traded during the REC trading session on the Indian Energy Exchange valued at $4.6 million, compared with 260 units at the previous session in April.

But concerns remain about how both initiatives will evolve because of a lack of data and trained manpower as well as weak penalties for firms that refuse to comply.

"India has an issue of manpower and data. You look at incomes, industrial activities are growing, the share market might boom but hiring manpower, (building up) capacity and institutions is a long-term game," said Girish Sant, energy analyst at non-profit think tank Prayas.

Some analysts also point to technical gaps in the PAT scheme, including how various units of one company would be graded. There were also limitations that allow REC certificates to be traded only once, limiting the early entry of intermediaries or market makers.

"In order to have an effective cap-and-trade or market mechanism that aids desired reduction in energy use, it is necessary to have targets that are neither too easy nor too difficult to achieve," said leading Indian clean energy project developer and advisory Emergent Ventures in a report on PAT.

But industry observers said it still makes sense for India to opt for a national energy efficiency scheme rather than carbon emissions trading.

"Because the target is intensity, so you are basically asking people to reduce their intensity and that matches the overall target," said Sant of Prayas.

The government has pledged to cut carbon intensity -- the amount of carbon dioxide emitted per unit of economic output -- by between 20 and 25 percent by 2020, from 2005 levels.

Emissions trading would need an absolute emissions cap, something India does not want to do, saying it needs to keep its economy growing and competitive.

Adapting to the national policy and creating a unique market are a function of time and communication, said Vishwajit Dahanukar, managing director of Managing Emissions, a clean energy project developer, advisory and asset manager.

"That's basically it. It's just early days," he told Reuters from Mumbai.

Rival China is also looking at promoting energy efficiency but most of the government's planned efforts focus more on carbon emissions trading to achieve national climate and pollution goals.

India's greenhouse gas emissions will keep rising as it tries to lift millions out of poverty and connect nearly half a billion people to electricity grids. But it is also trying to curb emissions growth in a unique way, fearing the impacts of climate change and spiralling energy costs