BP crisis highlights value of sustainability research

By Sophia Grene

Published: June 13 2010 10:50 | Last updated: June 13 2010 10:50

“I told you so” is never pleasant to hear, particularly not if it is with respect to a company that has lost half its value after an accident has left it spewing oil all over the Gulf of Mexico.

But few are in a position to gloat, as analysts largely failed to predict the risk of such a catastrophic event and its potential impact on BP’s share price. The risk management of workplace safety and environmental damage is little represented in the figures reported by companies and rarely included in the spreadsheet models many investment analysts and managers rely on.

One exception is Philipp Aeby, managing partner of Ecofact, a Swiss consultancy that runs an equities data service called RepRisk. RepRisk monitors global press and other publications for criticism of companies relating to their environmental, social and governance (ESG) performance. This, Ecofact claims, is a useful indicator of the risks to a company.

BP, according to its RepRisk score, has been a high risk investment for the past four years. Its score has been consistently around 60, compared with an industry average in single figures.

Until now, however, RepRisk’s information has not been widely used and even where it has, it may not have been given very much weight in the overall investment process.

“The bad news is that sometimes it takes a crisis before people say ‘Hmm, maybe next time we’ll weight those criteria more heavily’,” says Gunnar Millar, co-head of global research at RCM, the equities specialist of Allianz Global Investors.

Sustainability analysis is moving rapidly towards the mainstream, with more and more European investment managers now claiming to see the advantages of considering extra-financial issues when weighing up the prospects of a company. However, there are obstacles in the way of making it completely standard – which means those companies already making the effort feel they may have a competitive advantage.

RCM feels it is ahead of the game in terms of integrating sustainability analysis into its mainstream investment process. “The original main driver was that we philosophically believe over the long haul good companies [in environmental, social and governance terms] should be better investment opportunities,” says Mr Millar.

While Mr Millar is happy to pick up an advantage by doing more research, focusing on non-financial issues, he also welcomes attempts by a variety of bodies to make it easier to do this kind of analysis.

The European Society of Financial Analysts Societies (Effas) recently commissioned the German financial analysts society DVFA to prepare a list of key performance indicators for ESG in each industry sector. This is an attempt to give analysts a framework for interrogating companies on their ESG performance and to standardise how companies report that performance.

Companies themselves, while “desirous of keeping things not too onerous to report”, are increasingly looking for ways to communicate their ESG performance, says Mr Millar.

“I think in the past it was: ‘Groan. There’s always the fringe that turns up at the AGMs. We have to be able to answer their questions.’ Then some more sophisticated companies started doing separate reports [on ESG issues] and now, increasingly, sophisticated investors are walking in and asking ‘why are you treating this as something special?’”

The DVFA/Effas report is an indication of how seriously the European investment management industry is taking these issues, but across the Atlantic the situation looks a little different. Senior figures at US asset managers look bemused when asked about sustainability issues, and in response to more detailed questions either refer to their niche ethical products or say they have always invested in companies with good governance.

Although US equity managers may still to a large extent be narrowly focused on traditional financial analysis, their clients are broadening their outlook. “We’re seeing some non-traditional demand coming through from the US for [environmentally focused products],” says Mr Millar. Some US institutional investors are starting to see such investment strategies as sources of diversification, he explains, without needing to be convinced of the impact of climate change, for example.
One segment of the investment management industry has quickly overtaken others in its application of ESG issues. Private equity, not known for its commitment to a better, more sustainable world, has caught up fast.

There are two factors behind this rapid change, according to Tom Rotherham, who has spearheaded an initiative by the UN Principles for Responsible Investment to bring these issues to the notice of private equity groups.

"It's both the fact that limited partners [external investors into private equity funds] had been applying ESG analysis to public companies and the market environment, which is much more about the fundamental drivers of returns for companies."

Until the financial crisis, much private equity investment had looked at optimising the efficient use of capital – ie loading up companies with cheap debt – but with the virtual disappearance of credit from the market, alongside investor suspicion of this as a business model, private equity has had to reconsider how it makes money.

"At first sight, ESG analysis doesn’t fit well with the original ‘rootless capitalism’ [of private equity], but if done properly, it’s a perfect fit," says Andrew Musters, head of private equity at Robeco and subsidiary SAM, a sustainability specialist. "If you do it well it’s about the long-term."

Robeco has been asking the fund managers in its private equity funds of funds to prioritise ESG issues for several years. Initially, it was a difficult job to persuade them it was worthwhile, but "we’ve seen a big change recently, with fund managers coming to us to ask how they can integrate these issues", says Mr Musters.