

## Innovation key to staying ahead in ESG game

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Published: July 5 2009 12:33 | Last updated: July 5 2009 12:33

Are environmental, social and governance issues becoming old hat as part of the investment management mainstream? As the Norwegian government pension fund adds an extra layer of ESG information to its arsenal, some ESG managers find they are having to innovate to stay ahead.

"We are an early warning view," says Charlotte Mansson of Ecofact, which will supply the Norwegian fund with data from its **RepRisk system**. By looking at a host of global media sources, RepRisk identifies companies facing controversy in areas such as environmental impact or labour relations.

"We find it's very important to look at the live picture – quite often you will find a discrepancy between a nice CSR [corporate social responsibility] report and what's going on on the ground," says Ms Mansson, who claims Ecofact's information is "unique". "Our clients want to know if there are any environmental, social or reputational risks attached to the companies they invest in," she adds.

She points out that ESG or sustainability has become a must-have element of investment management. "You need to offer something at least, even if you don't embrace it wholeheartedly." However, most Ecofact clients are well established as proponents of sustainable investment and are using RepRisk to help differentiate themselves.

Investors incorporating ESG factors have evolved over the years, according to Peter Ohnemus, chief executive of Asset4, which gathers data globally on companies' ESG practices from company reports.

"The first generation were the hippies, then the second generation was SRI. The third generation is value-based investing."

This is the stage he sees the industry having reached, after a "long road" as he and his competitors have struggled first to gain recognition for the concept, then to achieve consensus that it is a viable element of investment processes, and finally to work out standard indicators of ESG practice.

"Our whole model is to give a standard framework so you can compare apples with apples," says Mr Ohnemus.

While the trend has been clear for some years, last year's financial crisis gave it impetus, he says. "After the crisis, people are saying they need standardisation."

Corporate and social responsibility reporting is now the norm for public companies, making life easier for the likes of Asset4 and investment managers who wish to integrate ESG considerations into their investment strategies.

"The most important thing is the agreement of key performance indicators," says Mr Ohnemus. Investment managers have settled on between 30 and 70 KPIs, he adds. "Big corporates have taken this on board and are building this into their cockpits."

As the range of KPIs is accepted, investment banks are developing different frameworks to use the information, such as **Goldman Sachs's Sustain**, while stock exchanges are developing benchmarks for companies to use in benchmarking themselves. The New York Stock Exchange and **Nasdaq** offer such services.

These developments are largely being driven by asset owners, says Mr Ohnemus, citing the large numbers (more than 400) of owners signing up to the UN's **Principles for Responsible Investing**. Having signed up to this accord, they then require their investment managers to help them live up to its promises.

Having struggled to come to grips with it, fund managers are becoming more at ease with the concept, says Mr Ohnemus. "The next generation of asset managers has been taught about these factors in their academic preparation," he says.

So internalised is the process, in fact, that it no longer necessarily provides a competitive advantage and asset owners and managers have to innovate to add value.

This is confirmed by Sustainable Asset Management, which uses sustainability analysis as a key differentiator. Results of a study by parent company Robeco, released last week, show a performance advantage is gained by investing in companies that score well in SAM's sustainability rankings. But the outperformance effect is decreasing.

“We see some criteria that have performed well in the past [in helping select outperforming stocks] but have stabilised” as they became mainstream, says Stephanie Feigt, SAM’s chief investment officer. “We have to continue to innovate. It’s all about exploiting market inefficiencies.”

For those investors who live in an entirely relative universe, this is bad news – as more managers track extra-financial issues, it becomes harder to achieve outperformance – but there is a more positive way to view this. As more asset owners and managers take account of sustainability general standards rise.

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