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The Sustainability Imperative: Business and Investor Outlook

2018 Bloomberg Sustainable Business & Finance Survey

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Corporations and the financial institutions that invest in, lend to, and insure them, are at a critical juncture for engagement on sustainability issues. While the sustainability of a company and its financial stakeholders have always been interdependent, this bond has reached an inflection point.

From the first socially-responsible investment funds in the 1970s to 2000 when the Global Reporting Initiative launched its first sustainability reporting framework, the interest of financial firms in corporate environmental, social and Governance (ESG) factors continues to rise.

The growth of investor networks like the United Nations Principles for Responsible Investment (PRI), which brings together investors with shared beliefs to promote sustainable investment practices, has only deepened adoption of sustainable business and finance.

A combination of market drivers, such as the need for asset owners to combat short-termism and availability of more data to determine material ESG factors, is driving investors to integrate ESG issues into their investment processes. Clear, consistently reported ESG information gives investors the context they need to make decisions about which companies best align with their investment principles and long-term goals.

The corporate-financial bond on sustainability has reached an inflection point.

Companies understand this, and typically respond to investor demands for information through sustainability or corporate responsibility reports. In 2011, fewer than 20 percent of companies in the S&P 500 published sustainability reports, but by 2017 that number had increased to 85 percent.[1] This rise is a clear indication that sustainability reporting is largely the norm for investable companies, but is it enough?

Do investors have the information they need to adequately manage risk and identify sustainable investment opportunities? Are companies prioritizing sustainable strategies throughout their organizations? A new Bloomberg survey of U.S. and European investors and corporations, explored in this paper, seeks to uncover how these groups believe they are faring on their path towards a sustainable future.

The challenges and initiatives provide context behind corporate and financial sustainability practices between the two regions, and a deeper understanding of how the relationship between investors and corporations might look in the future.

Survey Criteria and Objectives

The survey, completed in July 2018, included 600 respondents, broken down by 400 respondents from the U.S. and 200 from France, Germany, Italy, Spain, and the U.K. Each group was split in half, with 200 U.S. corporations, 200 U.S. investors, 100 European corporations, and 100 European investors.[2]

The information gleaned from these survey groups provides a better understanding of how corporate leaders and investors define sustainability, and how it is implemented in business and financial strategies. While varying definitions of sustainability may influence which actions are taken, there is overall agreement that sustainability must be forward-looking.

Future strategies for sustainability may be impacting these groups today in different ways. And new frameworks and standards for disclosure, namely the Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB), can facilitate progress by providing practical structures to some of the more theoretical sustainability issues.

Finally, sentiment around the shared United Nations Sustainable Development Goals (SDGs) helps signal what progress has been made, and what gaps remain. Ultimately, a clearer picture of actions to take now can create not only a more sustainable future, but a more sustainable present.

A Shared Definition is Emerging

Sustainability has long meant different things for different organizations, and this is often cited by research groups and investors as a primary reason why the investment practice has not become more widespread in financial markets. Investors continue to report that they are confused by the term and what constitutes a sustainable investment.[3]

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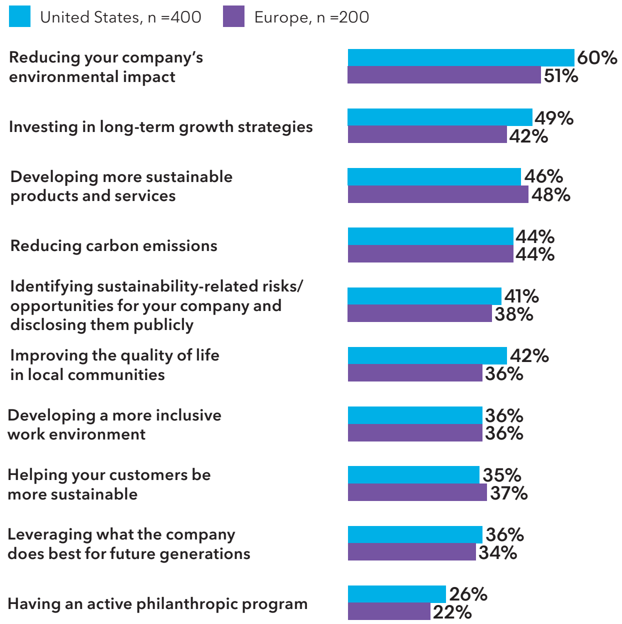
1 Governance & Accountability Institute, Inc., "Flash Report: 85% of S&P 500 Index Companies Publish Sustainability Reports in 2017," March 20, 2018, https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html

2 Investor respondents were director level or above with responsibilities including either analyzing performances of companies, advising on investment strategies, or managing investment portfolios. Corporate respondents all had responsibilities in either sustainability-related or environmental, social, or governance functions.

3 UBS Investment Bank, "Return on Values: Most Sustainable Investors Expect Better Performance, Bigger Impact," *UBS Investor Watch,* 2018, vol. 2, https://www.ubs.com/content/dam/ubs/microsites/ubs-investor-watch/IW-09-2018/return-on-value-global-report-final.pdf

The survey results, however, begin to tell a different story. When given 10 varying phrases to characterize what sustainability means at their companies, both European and U.S. respondents chose the phrase, "reducing your company's environmental impact" more often than other phrases. Respondents could choose as many phrases as they thought applied to their company's understanding of the word, and 60 percent of U.S. respondents and 51 percent of European respondents chose this phrase.

Which of these statements best describes what sustainability means to your company?



This definition reflects a number of different sustainability reporting frameworks that ask companies to disclose how their organization impacts the environment. Increasingly, investors are asking how environmental factors are impacting a company. In line with this definition, many companies work with their facilities and operational departments to improve the physical efficiency of their businesses through better energy and water use management.

These efforts are crucial to meeting global sustainability goals, but the next two top survey responses offer insight into how respondents may be moving together to take a more strategic approach to sustainability.

"Investing in long-term growth strategies" and "developing more sustainable products and services" were the second- and third-most selected definitions overall. These responses indicate that investors and corporations alike are placing emphasis on bringing a sustainable mindset to strategic development within their companies.

While this notion can work in tandem with operational efficiency, it is a signpost that companies are beginning to view sustainability as a more integral part of their overall strategy to unlock business opportunities. Further, investment in long-term growth strategies aligns with the core principles of the PRI,[4] and of a wider group of investors committed to using ESG factors in their investment processes.

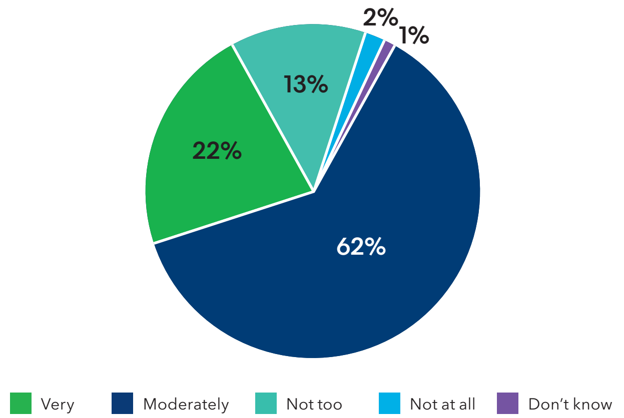
While respondents did not agree on one defining principle for sustainability, the fact that this definition varies from organization to organization is not a negative trend. Respondents on average selected four statements to describe what sustainability means to their company, indicating that companies are addressing sustainability on multiple fronts and participating in a variety of initiatives to build resilience across different aspects of their businesses.

For example, if the majority of respondents had just selected "reducing carbon emissions" as their answer, many crucial aspects of sustainable business practices would go unaddressed.

From Definition to Practice

Defining sustainability is challenging, and is only the first step to actually becoming a more sustainable enterprise. So how do these various definitions of sustainability play out in practice? To understand this, respondents were asked to rate how sustainable they believe their organizations are, and the results are largely promising.

How sustainable is your company?



In total, 84 percent of respondents believe their organization is either moderately sustainable or very sustainable. Broken down, this equates to 82 percent in the U.S. and an impressive 90 percent in Europe. For these practices to grow, it is helpful to understand how these organizations may be implementing sustainable practices.

[4] Principles for Responsible Investment, "What Are the Principles For Responsible Investment?" https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment

When asked to select who is placing the most emphasis on sustainability performance at the world's top companies, respondents were again divided between the U.S. and Europe. In both regions, chief executive officers and C-suite leaders were selected most often; however, while this was 44 percent for the U.S., it was only 36 percent for Europe. Europeans, on the other hand, were nearly twice as likely to select business managers as the driving force behind sustainability performance (29 percent) as U.S. respondents (16 percent).

84 percent of respondents believe their organization is either moderately sustainable or very sustainable.

It is promising that in both regions, respondents saw executives as leading the sustainability charge. This group sets the big-picture strategy for companies and seems to understand the high-level value of running a sustainable business.

When it comes to the practicalities of how a business will become sustainable, however, these executives are not likely to make those decisions. It is thus interesting to note the divide between the U.S. and Europe on the role of business managers in sustainable performance.

Perhaps Europeans were more likely to view their own companies as sustainable because more mid-level European business managers are the driving force behind sustainability initiatives. A chief executive with a vision for a sustainable company is certainly promoting positive sentiment. Yet without support throughout an organization, in particular in middle management where crucial strategy and development decisions are made, companies might struggle to achieve tangible sustainability results.

More Europeans view their companies as sustainable than their U.S. counterparts.

Further addressing contributions to sustainability, respondents were asked to consider how much different departments contribute to a company's bottom line by adopting sustainable business strategies and practices. The responses from U.S. corporations were more heavily concentrated among facilities, supply chain management, and procurement departments, with significantly fewer respondents choosing marketing, finance, investor relations, and human resource departments.

U.S. investors also chose facilities and supply chain management as their top two groups, but at a lower rate, and responses among all departments were much more evenly spread. The U.S. investor view aligned very closely with European corporations and investors. This latter view illustrates a more holistic approach to sustainability, where more departments within an organization are believed to be able to make significant contributions.

Regardless whether the emphasis on sustainability performance comes from the top or middle management, it is important to know which group is driving it. Among investors, nearly 10 percent of U.S. investors did not know who was driving the efforts, whereas only 1 percent of European investors responded that they did not know.

Measurement for Management

As sustainability strategies are developed and managed, it is essential to have processes in place to measure the initiatives. Like any other business plan, measurement is paramount to being able to determine progress and areas of improvement that will ultimately make the company more sustainable over time.

Metrics, such as return on investment from sustainable products and services, are used by nearly 60 percent of European corporations and investors, yet only 33 percent of their U.S. counterparts. Although this is not the only indication of a sustainable strategy, the results are at odds with the 82 percent of U.S. respondents and 90 percent of Europeans who believed their company was moderately or very sustainable.

For organizations that may still be in the process of determining which metrics they should use to help track sustainability efforts, they can turn to a number of standards and recommendations. Companies can use the SASB sector-specific accounting standards to help determine what material issues are pertinent to their industry and may therefore be beneficial to use as metrics.[5] As such, the standards can be useful internally to an organization as well as to investors when the companies begin to report them publicly.

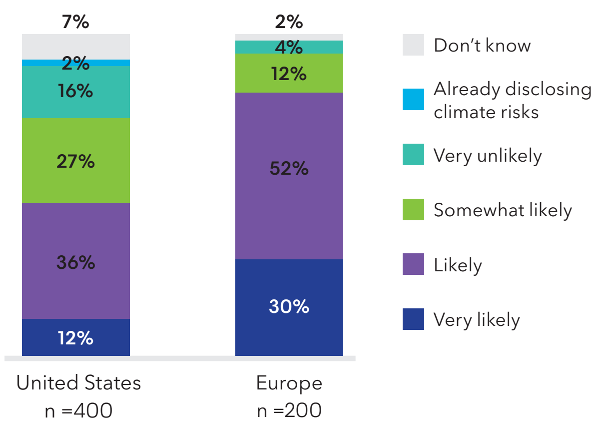
For organizations looking for specific guidance on managing climate change risks and opportunities, the TCFD provides a widely adoptable framework. Similarly to SASB standards, TCFD's reporting recommendations can be used as an internal management and strategy tool and communicate risks and opportunities to investors.

5 Sustainability Accounting Standards Board, "Why Is Financial Materiality Important?" https://www.sasb.org/standards-overview/materiality-map/

Both tools aim to help guide companies to report information that is specifically relevant to the financial community for long-term growth and risk management. This focus on information that could be financially material is a differentiator from many historical reporting tools, and a key building block in the interdependent relationship between financial institutions and sustainable corporations.

In Europe, 83 percent of respondents said they were either very likely or likely to adopt the SASB standards in their company reporting, while only 57 percent of U.S. respondents said they were. Regarding the TCFD, 82 percent of European respondents were very likely or likely to use frameworks for climate risk disclosure, such as the TCFD, while only 48 percent of U.S. respondents said they were.

How likely is your company to apply frameworks for climate risk disclosure using, for example, the recommendations made by the Task Force on Climate-related Financial Disclosures (TCFD)?



Despite the discrepancies between U.S. and European respondents, all figures should be encouraging for the 81 percent of European respondents who believe information disclosed in line with the TCFD and SASB is either useful or very useful for investors. In relative alignment with their responses on whether they would use the framework and standards, only 50 percent of U.S. respondents said they believed the disclosure would be useful or very useful to investors.

This divergence between U.S. and European respondents may in part be explained by some of the challenges that investors from both regions are experiencing in integrating ESG data into their financial analysis. In the U.S., 54 percent of investors said that the subjectivity or lack of consistency in ESG scores was one of their biggest challenges, while only 34 percent of European investors found this issue with scores to be a large challenge.

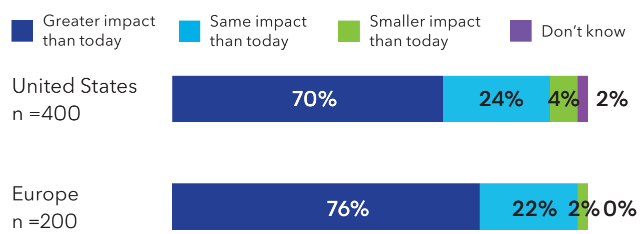
This response rate potentially indicates that U.S. investors rely more heavily on ESG scores than Europeans, who may favor direct analysis of company reports. On other issues such as obtaining consistent and comparable historical data, U.S. and European investors scored almost identically with 47 percent and 48 percent, respectively, saying this was a big challenge.

Encouragingly, of the respondents likely to apply the frameworks, an overwhelming majority plan to do so within five years. Specifically, 19 percent of U.S. organizations and 29 percent of European organizations plan to implement the TCFD in the next year, and 67 percent of U.S. and 64 percent of European organizations plan to implement in two to five years.

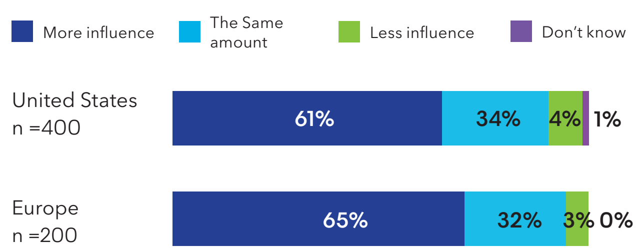
As far as taking action within the year, investors in Europe and the U.S. are more than 10 percent more likely to implement the recommendations than corporations. It is thus easy to see how as investors work on their own disclosures, they will pressure companies to follow suit to ensure that they have accurate and complete information for their portfolios.

Even if this pressure it is not being applied now by all investors, a majority of both European and U.S. respondents believe that investors will have more influence on a company's sustainability performance in 2030 as compared to today, so we can expect the pressure to increase. In support of this is the fact that over 70 percent of respondents believe a company's sustainability performance will have a greater impact on investment decisions in 2030 than it does today.

How much of an impact do you believe a company's sustainability performance will have on investors' decisions in 2030 as compared to today?



How much influence do you think investors will have on a company's sustainability performance in 2030 as compared to today?



Future Outlook

All this reporting is crucial for two aspects of sustainability for both corporations and investors: successfully investing in opportunities and managing risks. As the TCFD has shifted some of the focus of sustainability reporting from prior-year information to forward- looking scenarios, this survey looked ahead to 2030 to determine sentiment about climate change and sustainable strategies.

In the U.S., 77 percent of respondents believe climate change will be either a very serious or somewhat serious risk to corporations and investors in 2030, leaving 23 percent of U.S. respondents believing that the risk will either be not serious or not too serious. Although U.S. respondents are fairly divided on this sentiment of future risk, they are more aligned with each other in believing that opportunities from sustainable business strategies will be significant in 2030.

Eighty-four percent of U.S. respondents believe future opportunities will be significant. On the other hand, the notion that risks and opportunities represent different sides of the same coin is reflected in responses from Europe. Among European respondents, rates were 90 percent for believing in both very serious and somewhat serious risks from climate change in 2030, as well as 90 percent for believing that sustainable opportunities were very significant or somewhat significant.

Broken down further, investors in Europe seem more likely than corporations to believe the risks of climate change will be very serious. This is reinforced by the fact that European investors were also more likely than corporations to implement sustainable reporting frameworks as a risk management tool within the year.

This signal is reflected throughout the survey, indicating that growth in sustainable strategies and reporting will come from leading investors who are ready to take action now. The question remains, if most respondents believe the overall impact of climate change and sustainability will grow overtime, why not take a leadership position and start now?

Progress on a Global Agenda

Leading organizations are doing just that, and presumably many more will join in to manage risks and invest in opportunities through 2030 so progress can be made. Outlined in the United Nations' 2030 Agenda, the Sustainable Development Goals are a defined set of global goals that if achieved, will transform our world into a more socially, economically, and environmentally sustainable place.[6] It is an ambitious agenda, but one that the UN hopes nations can adopt, with the help of companies.

Sustainable Development Goals

1 No Poverty
2 Zero Hunger
3 Good Health and Well-Being
4 Quality Education
5 Gender Equality
6 Clean Water and Sanitation
7 Affordable and Clean Energy
8 Decent work and Economic Growth
9 Industry, Innovation and Infrastructure
10 Reduced Inequalities
11 Sustainable Cities and Communities
12 Responsible Consumption and Production
13 Climate Action
14 Life Below Water
15 Life on Land
16 Peace, Justice and Strong Institutions
17 Partnerships for the Goals

Source: United Nations

To project whether this may be attainable, respondents were asked to select the specific goals they believe will be achieved by 2030. Europeans surveyed were more optimistic about achieving some of the SDGs by 2030, on average listing six that they believed would be successful, while U.S. respondents on average only listed four.

For Europeans, clean water and sanitation, quality education, climate action, and affordable clean energy topped the list, in that order. While the U.S. had some overlap with affordable clean energy, reduced inequalities, employment and economic growth, and clean water and sanitation, these were selected with lower percentages than Europe's top four. Further, U.S. respondents were three times as likely to state that none of the goals would be achieved by 2030, with 18 percent choosing this response, compared to only 6 percent of Europeans.

[6] United Nations, "Transforming Our World: The 2030 Agenda For Sustainable Development," Sustainable Development Knowledge Platform, https://sustainabledevelopment.un.org/post2015/transformingourworld

Concrete Steps Forward

Throughout the survey, Europeans appeared to take a more progressive, holistic approach to sustainability initiatives and strategies within their own organizations and investment practices. Their outlook on the SDGs, where outcomes will be measured on a global scale, is no different. If the survey sentiment holds true that sustainability and ESG factors are integral to the success of organizations over time, leadership today in this direction will help propel European companies and investors to cultivate their own success.

European countries, however, cannot solve these global problems on their own. And U.S. respondents, while matching most sentiments, just to a lesser degree, will hopefully not be too far behind. It is clear in both regions that to ensure the health of the symbiotic relationship between financial institutions and sustainable corporations, both sides must work strategically to mitigate ESG risks and foster opportunities.

Market-based tools such as TCFD recommendations and SASB standards will help both groups transition their sustainability values to practice. As the market is looking for leaders on these initiatives, there is no reason to delay action.

Companies and financial firms must work strategically to mitigate ESG risks and foster opportunities.

A growing consensus on the strategic nature of what defines sustainability is an early step in this global agenda. What comes next will be an increase in demand for improved sustainability performance from companies and clear evidence of their practices through disclosure. With this step, companies on both sides of the Atlantic stand at a crossroads.

But the outlook seems quite encouraging. While progress may be somewhat uneven, and challenges certainly remain, corporate executives and investors in both the U.S. and Europe see significant opportunities for their companies in the years ahead. Overall, the consensus is that the movement toward a more sustainable future is under way.

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