

# Sustainability as an Investment Concept

TAUNI SANCHEZ, *Dow Jones Sustainability Group Index GmbH, Zurich, Switzerland.*

## ABSTRACT

The challenge facing the industrial, service and financial industries in the 21st century will be a global marketplace increasingly concerned with long-term sustainability. The growing economic, environmental and social accountability of all business brings with it a responsibility to educate customers and staff alike.

## KEY FACTS

- DJSG Index is part of the Dow Jones Family of Indexes.
- Based on the Dow Jones Global Index (DJGI) - 2000 largest companies/ 73 industries/ globally diversified.
- Top 10% sustainability leaders in all industries (226 components).
- Selection process is based on a robust SAM sustainability rating.
- As of 31 January 2000 - \$4.89 trillion market capitalisation.
- World's largest sustainability database.
- One global index, three regional indexes - North America, Asia, Europe and one country index - USA.
- Four specialised indexes for each geographical index: excluding alcohol, tobacco or gambling and excluding all three.
- Flexible enough for customised indexing.
- All indexes are market capitalisation weighted.
- PriceWaterhouseCoopers did the verification.
- All indexes are reviewed annually - and companies must re-qualify every year.

Shareholders are no longer satisfied by short-term performance. Instead, they are demanding sound financial returns, lasting economic growth, long-term productivity increases and sharpened global competitiveness. We are now witnessing the convergence of economic, environmental and social-growth concerns.

In response, Dow Jones Sustainability Group Indexes GmbH (DJSGI GmbH) launched the global Dow Jones Sustainability Indexes (DJSGI). The indexes reflect the combined expertise and resources of DJSGI GmbH's partners: the vast experience of the world's leading global index provider, Dow Jones & Company, and the world-renowned pioneer in corporate sustainability assessment, SAM Sustainability Group.

The DJSGI components are selected by a systematic corporate sustainability assessment and include only the leading sustainability companies world-wide. The DJSGI therefore provides a bridge between companies implementing sustainability principles and investors wishing to profit from their superior performance and favourable risk/return profiles.

For investors, the integrity of the corporate sustainability assessment and the index calculation ensures that the DJSGI are independent, reliable and investable sustainability indexes.

For companies, the DJSGI provides a financial quantification of their sustainability strategy and their management of sustainability opportunities, risks and costs. Because "What gets measured, gets done", they will be motivated to increase long-term shareholder value by integrating economic, environmental and social factors in their business strategies.

The DJSGI will provide investors and companies with insight into the trends and events driving global supply and demand of sustainable products and services. This will bring a greater appreciation of the benefits of integrating sustainability principles in both corporate and investment strategies.

## CASE STUDY

In 1999, Bristol-Meyers Squibb Co. USA - a diversified world-wide health and personal care company whose principal businesses are medicine, beauty care, nutritionals and medical devices - had the highest corporate sustainability performance of 58.77 out of a maximum score of 74. The corporate sustainability assessment criteria used and the associated weightings for Bristol-Meyers Squibb were specific to the Pharmaceuticals industry group.

## THE CONCEPT OF SUSTAINABILITY

Our definition of sustainability includes three components: Economy, Ecology and Society. Sustainability is built on the fact that well-run companies incorporate the economy, the environment and society into their long-term business strategy. The result is increasing long-term shareholder value.

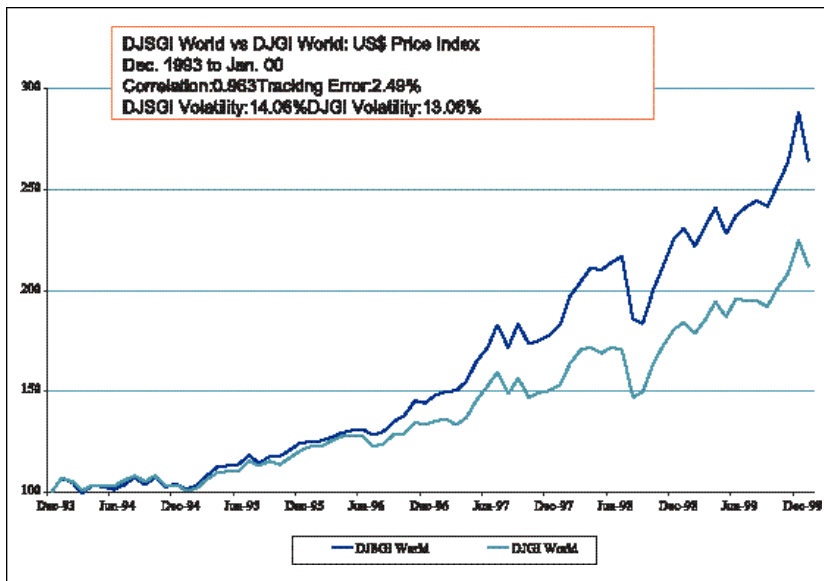


Figure 1  
DJSGI World vs DJGI World: US\$ Price Index

Success is not one-dimensional, focusing purely on the economics of business. Instead it relies on these three concepts to positively impact the financial bottom line. Success now has a name, Sustainability.

The evidence shows that success, most notably financial, is distinctly related to how companies directly and correctly manage the concepts of sustainability. Niall Fitzgerald, chairman of Unilever, states 'Unless we pay attention to the sustainability of the resource base from which we draw, we do not have a long-term business. We will not create long-term shareholder value. What we're seeking to do is draw the income from our stewardship of resources but not eat into the capital.' Essentially companies are more than just their traditional book value.

## DEVELOPMENT

Until recently the approach to measure sustainability has been academic in nature. Some have attempted to measure sustainability in a region (for example, the US and the UK), but they have yet to reach for that global index ring. We have set out to practise a pragmatic approach to sustainability, one that will be palatable to the financial community and in which risks are clearly defined.

The development of sustainability has a long tradition. In the early 1970s there was a strong movement toward what is known typically as 'Social Responsible Investing' (SRI). In the 1980s investment turned to environmental technology. In the early 1990s it then moved toward what we know as 'Eco-Efficiency'. Sustainability as a concept is built on the practice of environmental investing.

But Sustainability investing is fundamentally different from either SRI or Eco-efficiency. SRI takes an already existing universe and reduces it by applying negative filters to the companies or countries. The filters are negative in nature, because companies or countries are deleted from the universe simply because of the goods they produce or societal factors they disregard (e.g. armaments, tobacco and discrimination by gender or race). Eco-efficiency, on the other hand, leads to a reduction in risk by investing in companies that fulfill Eco-efficiency criteria, including reduction of emissions (in all media) and environmental management systems. Eco-efficiency is lacking in that new developments and market opportunities arising from the trend toward sustainability are ignored. Eco-efficiency has become synonymous with a static definition of environmental investing.

Sustainability, on the other hand, expands these concepts by focusing on those companies which fulfill sustainability criteria regardless of what is produced. Ergo the scope of what a sustainable company is can be

	Social-Responsible Investing	Eco-efficient Investment	Sustainability Investment
<b>Investment Focus</b>	Companies and industries are excluded which meet certain negative social criteria (e.g. armaments production, activities in South Africa and discrimination by gender or race)	Companies with high eco-efficient production in almost all industries.	Companies that profit most from the sustainability trends in almost all industries.
<b>Drivers</b>	Public awareness of Social Issues and rights.	Rising costs due to tighter environmental controls (Legal limits, fiscal measures, resource prices, waste disposal, etc.)	Business opportunities arising from political, social, environmental, technological and economic trends.
<b>Criteria</b>	Social criteria focused on the elimination of components from the investable universe.	Ecological criteria focused on the production site (corporate environmental management systems, audits and reporting).	Multifactor-criteria (Social, Ecological, Environmental, technological and economic trends).
<b>Risk/Opportunities to Traditional investment</b>	Lower risk due to the elimination of industries with high negative public awareness. Higher risk due to a reduction of the investable universe. Lower diversification effect in comparison to universe.	One additional analytical criterion, no significant reduction of the investable universe.	

broadened to include long-term strategic factors. In addition, the dynamics inherent in the concept of sustainability are seen as an opportunity for companies.

We believe that SRI and Eco-efficiency are antiquated terms which no longer hold true in a truly dynamic world. SRI (in the US) and Eco-efficiency (in Europe) are too short sighted and avoid taking that extra step to determine if a company has taken the risk to be sustainable in their prospective industries despite what is produced.

The trend toward sustainability from SRI and eco-efficiency is denoted by an increase in companies' transparency, i.e., the 'Goldfish' phenomenon. Indeed this has been seen recently in Shell's response to Brent Spar. Robert Ingram, chief executive of Glaxo Wellcome has noted, 'How a company acts or responds is communicated very quickly, directly affecting its reputation.' Distribution of wealth has brought investment might to those who see sustainability as a worthy investment strategy, indeed investors are looking for stocks in which they can invest without pricking their conscience. The growth of healthy living and ecological risk awareness has led investors to seek out those companies which use both human and natural resources in the most efficient manner. These are just a few of the trends toward global sustainability

### SUSTAINABILITY DRIVERS

Fundamentally, the newest criterion for investment is sustainability. The drivers rely heavily on:

- **Technology**

The long-term efficient, effective and economic use of social, financial and natural resources should be based on innovative technology.

- **Corporate Governance**

Sustainability is based on the highest form of management responsibility, stakeholder relations, organisational capability and corporate culture.

- **Shareholders**

Shareholders' demands on solid financial returns, an increase in long-term productivity, greater sense of global competitiveness and contributions to global competitiveness should be met.

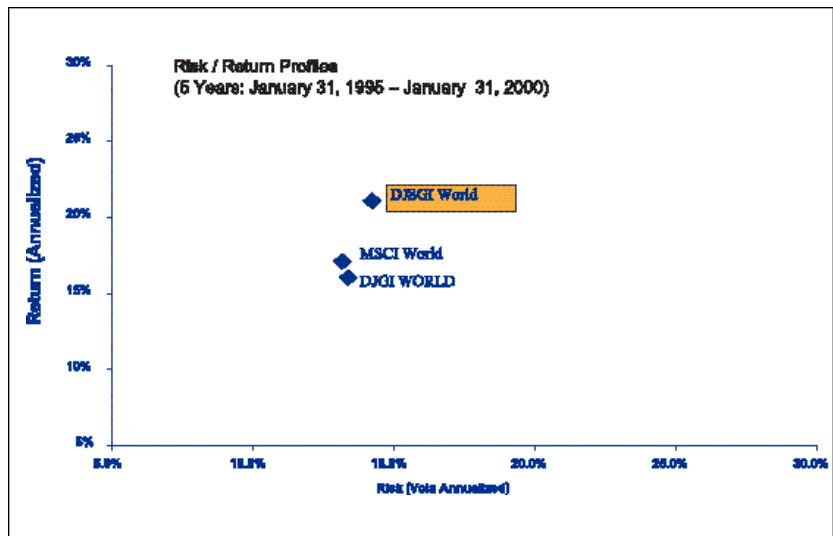


Figure 2  
Risk / Return Profiles  
Source: SAM

- **Industry**

Companies deemed sustainable, via our methodology, should be seen as sustainability leaders. This entails publicising their commitment to sustainability and the ensuing superior performance.

- **Society**

The community and the social environment of the company should play just as important a role in long-term strategy as sound finances. This includes the recognition, among others, of lifelong learning, evolving demographics and continuing education.

All of these drivers must be measured in concert to gain a clear picture of a company's sustainability stance. Being sustainable entails both risks (which are backward looking - eco-efficiency) and opportunities (which are forward-looking). The sustainability companies are the best positioned for integrating these sustainability drivers into their strategies and marketing new business opportunities.

Figure 3  
Industry-specific Factsheet

Industry Group	Pharmaceuticals	DRG					
Economic Sector	Consumer Non-cyclical	NCY					
Issues	Description	Improvement - Solution	Driving Forces	Relevant measures for companies of the industry group	Sust. Opp.	Sust. Risk	Quest. No.
Ecologic. Issues	a) Production: Air and water emissions, waste.	Increase in energy efficiency in production and transport; closed loop and cleaner technologies	Industrial standards; e.g. of the European Chemical Industry Federation (CEFIC); Green Tax system changes; Implementation of Kyoto-Treaty; Environmental regulation; Waste disposal costs.	Energy-efficient production; Closed loop production.		X	37, 44
	b) Production: hazardous or problematic products (danger for biodiversity, missing public acceptance)	Product stewardship, saving biodiversity	Risk management, biosafety and biodiversity protocols	Product life-cycles; decrease sludge containing heavy metals or low revenue in CMO's	X	X	38, 39, 43
	c) Transport: air pollutants, smog	Monitoring Systems	Ban of toxic substances	Existing monitoring systems		X	41
Social Issues	a) concerns of consumers	consumer information	Consumer organizations, NGO's	Product labelling; Development of environmental performance indicators	X		42
	b) Animal testing	Implemented policy; Substitution with alternatives	Consumers, NGO's, Guidelines	Exiting policy		X	40
Econom. Issues							
SAM Research							
Issues Industry-Factsheet by		L. Serck-Hanssen					
Date		January 99					
Evaluation Industry-Rating by		G. Furger / A. Flatz					
date		March 99					

## **BENEFIT OF SUSTAINABILITY FOR INVESTORS**

Sustainability has some concrete benefits for investors. On one hand, there is the diversification effect through the multi-factor analysis (e.g. economic, ecological and social). The stock selection has well-defined rules and is clearly transparent and comprehensive.

For the investment managers, we attempt to discern the best-run companies. One could argue that a better-run company has a lower risk of bankruptcy. Therefore, by investing in sustainability companies one could conceivably lower the risk of bankruptcy in a portfolio.

For determining performance and having an investable basis for sustainability, a benchmark is used. Prior to the DJSG, there was no inclusive benchmark in this area. The challenge for an index provider has been in translating the concepts of sustainability, as a proxy for very well-managed companies, into a credible, objective, liquid, transparent and quantifiable index to measure sustainability performance.

Unlike eco-funds in the 1980s which invested in eco-efficient technology (e.g. filters etc.) sustainability investing has superior performance and favourable risk/return profiles. Indeed compared to other indexes in its risk class, the DJSG index clearly has a better return given the amount of risk.

The DJSG Index shows increasing interest in companies which have taken the steps to pursue corporate sustainability. This commitment demonstrates that these companies follow the path of enlightened and disciplined management practices.

Investors can be sure that they are investing in the best of the 'best'. Can we guarantee that if markets dive that these companies won't dive? No – but can anyone? What we are trying to measure are those companies which have taken steps to soften external effects by implementing sound business strategies based on ecology, society and the economy.

## **FINAL COMMENTS**

It cannot be ignored that the Dow Jones Sustainability Group Index is unique in its class. This is the world's first global sustainability index which is liquid, transparent, objective and credible. The development of the DJSG Index goes hand in hand with the development of sustainability in the financial markets.

---

## **ABOUT THE AUTHOR**

TAUNI SANCHEZ is Managing Director of the Dow Jones Sustainability Group Index.

She has been actively involved in the area of environmental economics since 1993. Most recently she finished her Ph.D. thesis on the economic impact of international environmental policy at the university of St. Gallen in Switzerland. Her first working experience she gained in the Risk Management group of J.P. Morgan in Frankfurt. In 1997 she joined Dresdner Kleinwort Benson as a marketing representative for Fixed income. In 1998 she moved to Singapore to help support the marketing group in SE Asia. In 1999 she returned to Frankfurt to market structured products to Swiss Clients.

---

---

**IF YOU HAVE ANY ENQUIRIES REGARDING THE CONTENT OF THIS ARTICLE, PLEASE CONTACT:**

**Tauni Sanchez**

**Managing Director**

**Dow Jones Sustainability Group Index**

**Signaustasse 1**

**8008 Zurich**

**Switzerland**

**Tel: +41 1 395 2828**

**Fax: +41 1 395 2850**

**E-mail: [tauni@sustainability-index.com](mailto:tauni@sustainability-index.com)**

**Web site: [www.sustainability-index.com](http://www.sustainability-index.com)**