

**Materiality — What are the Big Risks for Asian Companies and How Should They be Analyzed?**

**Chair:** Patrick Vizzone, Rabobank  
**Panel:** Vince Chaney, Head of Commercial Development, Trucost PLC  
Julie McDowell, Head of SRI Research, Standard Life  
Sean Gilbert, Associate Director, Technical Development, GRI  
Patrick Choo, Director, Kingsway Fund Management

Materiality can be defined as issues of relevant importance. However, the questions arise: relevant to whom? How can and should materiality be measured? Is there an incongruity between shareholders and the financial community that tend to be short-term in their thinking and the concept of sustainability, which from its very nature is long term? The panel discussed these and other issues as they relate to evaluating and reporting on SRI.

**Vince Chaney:**

Trucost's **Vince Chaney** presented his firm's method for determining materiality of environmental impacts by assigning a common scale for measurement: a monetary value. The first task is to determine a quantity for the amount of resources used. Often this information is either not accurate or disclosed. There are methods employed by Trucost and others to estimate this usage through various historical and other reports. A price for the resource is then determined which can take on various elements: abatement cost,

damage cost, compliance cost or, as is now available for emission credits, market costs. These can all be used in combination to come up with a monetary cost of environmental impact. Issues that have environmental impact can then be compared by their monetary value to determine which are the most material or present the most risk. The current methods of measurement still face challenges, however. The cost of environmental damage may not necessarily be borne by the company directly—for instance the cost of polluting emissions may be increased medical costs in the community, not increased costs for the manufacturing concern producing the air pollution.

The trading of emissions credits has been a boon to the measurement of beneficial environmental practices. Although there is less history of measuring emission credits in Asia and therefore coming up with the numbers is a bit more difficult, there are industry studies that do allow for measurement of the quantity of emission credits. A market price for the credits greatly eases the methodology for measuring the value.

As more corporations focus on quantitative reporting of environmental and social risk management, the easier it will become to compare company actions and measure the success of management's actions. Japan has by far the highest level of quantitative reporting, although the focus is primarily on the domestic activities of Japanese companies. EU companies rank next in terms of quantitative reporting. American companies rank low in reporting CSR activities on a quantitative basis.

**Julie McDowell:**

Standard Life's **Julie McDowell** presented the case for using SRI as a research tool to evaluate companies. SRI issues provide a means to evaluate management and its ability to handle crises before they have a material financial impact. The better management is at handling these issues, the more likely the company is to be performing well overall. There is a link between best practices in CSR issues and market leaders in financial performance.

Ms. McDowell pointed to there being room to develop communication on CSR issues. There is the misconception by companies that analysts are not interested in these issues, or that they must only disclose the good in order for analysts to feel comfortable. More dialogue on the challenges as well as the successes in corporate management of environmental, social, and ethical issues will assist not only in bringing to the forefront the importance of these issues for management and analysts, but also in the evaluation of these issues from a risk management perspective. Mainstream investors still don't ask the questions about CSR issues as much as they could, but as investors ask more questions, analysts will have more incentive to look for the answers.

**Sean Gilbert:**

**Sean Gilbert** of the Global Reporting Initiative agreed that good consistent information allows for better decision making and better evaluation of risk. The GRI is establishing guidelines for sustainable reporting, linking conventional measurement with other measurement tools to present governance, economic, environmental, and social performance. The key to the success of this type of reporting is consistency in the approach, having more companies actually offering this type of reporting, and developing linkages between financial reporting and general business reporting. Sustainability reporting already connects to a company's productivity by providing an indication of how a company converts materials into products to be sold. It also gives a view into how a company manages its intangible assets through emissions standards, employee turnover and other indicators. Part of the key to assessing economic, governance, environmental and social risks is coming up with a common language that the social scientist, environmental specialist, financial manager, and investment community understand. Often, these groups are looking at similar measures for similar results but applying different labels that serve to confuse rather than aid in understanding. The goal is to have a generally accepted standard of reporting on all issues of corporate activities, financial and otherwise, underscoring the idea that sustainability equates to long term value for an organization. As GRI looks to establish the next set of Global Reporting Initiatives in 2006, the group will look to include views and support from companies, financial institutions, NGOs and others to assist in the comparability and cross-disciplinary acceptances of the standards. The group hopes to increase the

dissemination of the information through the common standard and incorporate technology to allow easier use of the more readily understood information by all industry sectors.

**Patrick Choo:**

**Patrick Choo** of Kingsway took the audience through his analysis of companies' sustainability for his SRI fund. He reviewed research work that he and his team have done on sustainability standards for Asian companies.

Mr. Choo's conclusions include the following:

- 1) Most companies surveyed were more interested in pollution control than issues related to social and ethical behavior or even other environmental concerns.
- 2) Governance issues have become mainstreamed, with companies easily seeing the need and benefit of good governance.
- 3) Companies see the advantage of sustainability programs to maintain their businesses, but may not act on this view as most companies are caught in the struggle between the fact that programs that address CSR issues often have a long term impact on earnings, which can conflict with short sighted investors who want an immediate impact on earnings.
- 4) Social responsibility programs are even lower profile than environmental/sustainability programs since there is not as much of an impact immediately on earnings, although companies do see some advantages through protection against litigation, better efficiency, fewer strikes and better reputation of products.

**Discussion:**

Panel Chair Patrick Vizzone, Rabobank presented and asked for comments on the following quote:

*“While the ‘holy grail’ of empirically linking CSR performance to financial or stock performance is something we believe is most likely never to be found (for a whole host of reasons discussed later), we believe good CSR minimises business risks” - Benjamin Yeoh, ABN AMRO Europe, February 2004 From The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing, UNEP Finance Initiative, June 2004*

The panel unanimously agreed that there can definitely be a linkage between shareholder value and issues of CSR. However, this can only be achieved if firstly, the activities are reported and secondly if there is a market understanding of the actions and their implications. The market cannot price in information they either do not have, do not have disclosure on, or do not understand. The more that the questions are asked, the investor relations professionals see the need and interest in answering these questions, and the results are reported, the more there can be a comparison, an analysis and a linkage between the actions taken, and the reaction in market price.