

Good governance wins through

Judges favour research that focuses on implementation at this year's Australian Sustainability Awards.

Story by NICHOLAS TAYLOR

Judges for this award

Professor Charles Sampford
(Griffith University)

Terence Jeyaretnam
(Net Balance)

Ulrike Schuermann
(Momentum Partnership)

Talieh Williams
(UniSuper)



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Goldman Sachs JBWere's Andrew Gray (left) receives award from UniSuper CEO Paul Murphy

As is often the case, a paradigm shift – such as the growing consideration of environmental, social and governance (ESG) issues as material to investment decisions – is followed by the far harder task of implementation. D deservedly then, this year's winner of the the *Special Award for Sustainability Research*, sponsored by UniSuper, was Andrew Gray of Goldman Sachs JBWere for his practical assessment of how good corporate governance may lead to better financial outcomes.

The report, *Good Governance = Good Returns (Still...and even through the recent period of market volatility)*, beat out the two other finalists, Elaine Prior's evolving analysis of the carbon footprint of the ASX 100 for Citi Investment Research, as well as Christal George's most ambitious report on the importance of Indigenous rights to the resources sector, for the Centre for Australian Ethical Research (CAER).

Winner: Good governance leads to better returns

Plotting the semi-annual governance rankings over more than seven years, Gray's report finds a positive correlation

between good governance and financial performance. The analysis notably includes periods of market volatility with data current to 31 March 2008, and so supports the conclusion that good governance may derive more optimal performance outcomes in a range of market climates.

Based on data supplied by governance specialists CGI Glass Lewis, specific indicators analysed in the winning study include: audit quality (independence, strength of process); overall board (skill mix and structure); board skills; remuneration (clarity of policy, reasonableness of policy, size); and accounting (clarity/reasonableness of policy around abnormal times), to form an overall governance score.

Measuring the excess returns from good governance against a passive index, accounting (12.5 per cent) and remuneration (8.2 per cent) proved the most rewarding factors over the short term, whereas remuneration (46.7 per cent) and audit quality (37.1 per cent) were the clear winners over the longer-term.

In presenting the award, the judges concluded: "This research has strong potential to influence, and provide direction to, professional investors as they look to avoiding the types of corporate disasters revealed by the financial crisis."

Importantly, the finding that good governance matters over different time horizons is relevant to both ESG and non-ESG investors. A common thought within the ESG community is that, over time, it will

increasingly be the corporate governance space – ‘where the rubber hits the road’ – where many ESG issues will be addressed.

For instance, my own research elsewhere has found that even supposed ‘ethical’ blacklisting and the \$1 billion sell-down of Rio Tinto by the Norwegian Government Pension Fund in September followed many months (perhaps years, if one considers the related blacklisting of Freeport-McMoRan in 2006) of failed engagement.

Too few investment professionals see the distinction between ‘sustainability’ and ‘ethics’ at all, most commonly because it takes place behind the closed doors of governance that Gray, the Norwegians and others, such as shareholder activist Stephen Mayne, have thankfully thrown open.

Finalist: Is carbon footprint data meaningful to investors?

Following a special mention at last year’s awards for her landmark report on the risks and opportunities of climate change to the ASX 100, Citigroup’s Elaine Prior has reinvigorated the report’s epistemological position to address a most pressing question: is carbon footprint data really useful for investors?

The answer, according to *ASX100 Carbon Footprints: data is data, but what does it mean?*, is that carbon footprint data is of little relevance to investors seeking meaningful insights into the financial impact of a carbon-constrained world on their investments.

More importantly to investors, Prior states, is a broader consideration of: the geographical location of carbon emissions; the allocation of free permits; outsourcing strategies; and a company’s particular

abatement options.

Building further on her previous research, Prior illustrates how a small number of materials, utilities and transport stocks – in particular **BHP Billiton (ASX: BHP)**, **Rio Tinto (ASX:RIO)**, **Bluescope Steel (ASX: BSL)** and **Qantas (ASX: QAN)** – contribute to 65 per cent of the carbon footprint of an indexed ASX 100 investment portfolio.

Andrew Gray’s research has strong potential to influence, and provide direction to, professional investors as they look to avoiding the types of corporate disasters revealed by the financial crisis

Although such carbon risk must be assessed against other investment factors, the report cautions that it is predictably greatest where low-emissions alternatives are not available or where companies are operating close to best practice.

Finalist: Indigenous rights and the resources sector

One of the year’s most ambitious ESG researchers must have been the Centre for Australian Ethical Research’s Christal George for her insightful report into Indigenous rights and the resources sector.

Bucking the trend of studies into either climate change risks or portfolio-level ESG performance, *Indigenous rights, Indigenous wrongs: the risks for the resources sector* finds that most companies have only basic commitments to Indigenous rights and report poorly on their implementation.

According to the report, continued poor business practices by resources companies in relation to Indigenous rights might reasonably lead to a number of risks, including: reputational damage, access to investment capital, license to operate, litigation, and increased regulation.

Recognising that the ‘S’ in ESG is often neglected as an investment-related research topic, by providing a framework for both corporate managers and investment analysts, the report makes a meaningful contribution to our understanding of the role of Indigenous rights in the resources sector.

2008: a fruitful year for ESG

As it draws to a close, 2008 must be seen as a fruitful year for advocates of ESG analysis; the paradigm shift has continued and our understanding of its implementation has markedly improved.

Thanks to the combined efforts of Australia’s vibrant ESG community, the last 12 months has increasingly seen ESG research being delivered in forms and by providers of more traditional investment analysis. In this light, Gray’s focused effort on good governance was a deserved winner, and has most certainly been at the vanguard of that advancement in a field of stiff competition. The ESG community must now engage and educate Australia’s public – whose best interests we (theoretically) all serve – if we are ever to play a major role in creating truly sustainable financial markets. Perhaps the paper that does that will win next year. 

Nicholas Taylor formed Outcrop to offer, bespoke research into environmental social and economic issues.

Nominees for the 2008 Special Award for ESG Research

| Principal Author | Position | Affiliation | Research Paper |
|------------------|---|---|--|
| Andrew Gray | Executive Director/Head of ESG Research | Goldman Sachs JBWere | Good Governance = Good Returns (Still...and even through the recent period of market volatility) |
| Ben Spruzen | Associate Director | SIRIS | Building Value— Responsible Property Investment Performance |
| Christal George | Corporate Ethics Researcher | Centre for Australian Ethical Research | Indigenous rights, Indigenous wrongs: the risks for the resources sectors |
| Darren Lee | Lecturer | School of Finance, University of Queensland | Socially responsible investment fund performance: The impact of screening intensity |
| Drew Fryer | Analyst | Innovest Strategic Advisors | The impact of industry assistance measures under the Carbon Pollution Reduction Scheme |
| Elaine Prior | Director/Senior Analyst | Citigroup | ASX100 Carbon Footprints: data is data, but what does it mean? |
| Graeme Newell | Professor | School of Economics and Finance, University of Western Sydney | Sustainability and property trusts series |
| Joanne Saleeba | Executive Director | Investor Group on Climate Change | 2008 Carbon Disclosure Project Report Australia and New Zealand |
| Mark Barraclough | Analyst | Innovest Strategic Advisors | Impacts of carbon pricing in Australia |
| Mark Goddard | Australian Climate Change Services Leader | PricewaterhouseCoopers | Carbon value |
| Stewart Jones | Professor | University of Sydney | The Investment Performance of Socially Responsible Investment Funds in Australia |