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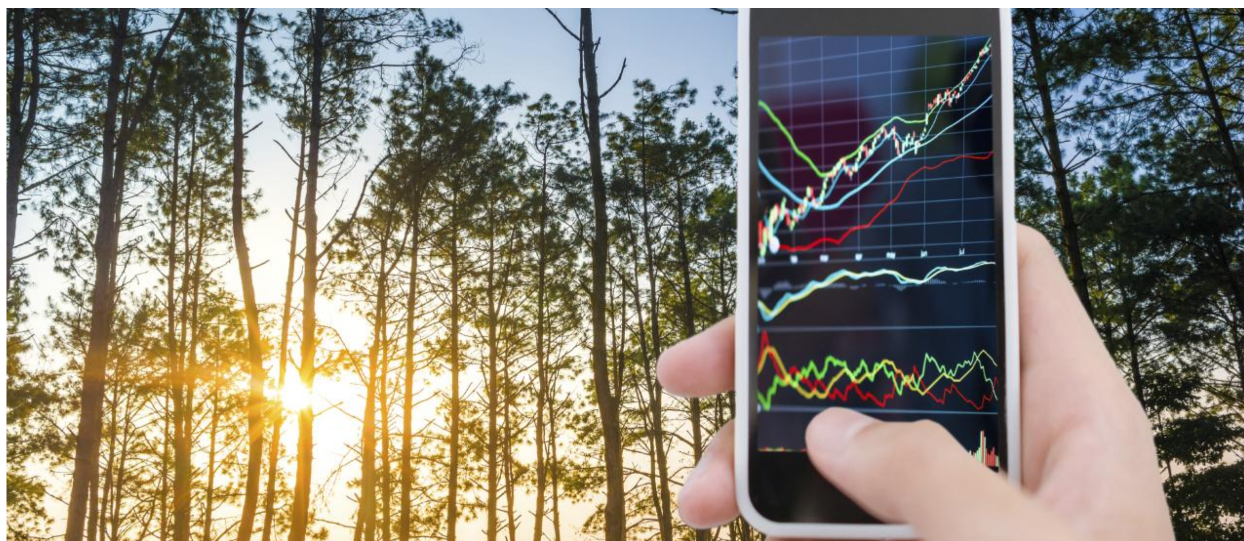
Turning Sustainability into a Value Driver



By Jan Van der Kaaij, Managing Partner and Co-Founder of Between-us

There is a link between sustainability and share price.

When talking to investor relations executives and board members of listed companies about communicating sustainability initiatives, a frequent statement I hear is “why bother? our investors are not interested in sustainability”. This claim is grounded in the observation that there are few questions in shareholders meetings and earnings calls that address the topic. But that doesn’t mean investors are not interested.

In fact, it’s quite the contrary. We can now say that those profitably engaging with environmental, social and governance (ESG) issues are given higher valuations by the market. As we point out in a recent **article**, over the past two years, **Robeco Asset Management** has applied its **“value driver adjustment”** approach in 127 investment cases, which had an average target price impact of five percent on the stocks analysed based on key ESG factors. In 39 percent of cases, this approach led to a positive change in the

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stock's target price and in 13 percent of cases a negative change. Overall, 52 percent of the cases were impacted, with target price adjustments ranging from -23 percent to +71 percent.

The "value driver adjustment" approach consists of a straightforward three-step process as conducted by the sustainability analysts of Robeco:

1. Identify and focus on the most material issues for the industry.
2. Analyse the impact of these material factors on the individual company.
3. Quantify competitive (dis-)advantages to adjust value driver assumptions.

Far from being an obligation, a good materiality analysis and reporting could prove a very worthwhile exercise. Differentiation and significant target price adjustments are a serious possibility.

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Example: Chr. Hansen (November 2014) – ESG highlights competitive advantage

• ESG issue and explanation: Food ingredients manufacturer Chr. Hansen scores low with the ESG rating agencies but this is more a reflection of disclosure than performance. In our view, Chr. Hansen is strong on ESG both from a top-down (health & wellness theme) and a bottom-up perspective (very strong innovation management and strong in health & food safety management and supply chain management).

• ESG segment view: Food ingredients benefit from food manufacturers' needs to battle obesity and reduce their fat, salt and sugar content.

• Impact on investment decision or performance: We think Chr. Hansen enjoys a competitive advantage from the aforementioned ESG factors. This resulted in a positive impact on our value driver assumptions (sales growth and margins) and a 23% higher target price. We bought the stock.

Example: Anglo American (May 2014) – competitive disadvantage from ESG keeps us away

• ESG issue and explanation: Mining company Anglo American has a high score with ESG rating agencies and does indeed score well on many dimensions. However, upon closer inspection it scores rather poorly on highly material issues such as Management of Local Stakeholders, Country Exposures and Occupational Health and Safety.

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• ESG segment view: Metals lose out to chemicals. Within metals, extra caution is

The €6 trillion opportunity

There are **numerous ways** companies can turn ESG issues into profitable endeavours and they'd do well to do so, given the €6 trillion in assets now under management at ESG integrated funds in Europe alone. One way to uncover and leverage ESG opportunities is to use what we call the "materiality matrix" tool.

The concept of materiality is pervasive throughout the business, financial, legal and regulatory communities of the world and accordingly there are many definitions and measures of materiality. Some define materiality as all of a company's actions that impact the environment and society; others say it is those that have a tangible link to the company's financial performance. In short, it enables a company to decide which ESG initiatives to invest in based on a defined and tangible impact.

To make the materiality matrix most relevant to find ESG opportunities and to appeal to the board, it should be reframed in core business terminology, away from green buzz jargon. One possible way of achieving this is developing a "materiality kaleidoscope", which is a decomposition of the original materiality matrix by splitting the impact analysis into three familiar business basics: risk, margin improvement and growth potential.

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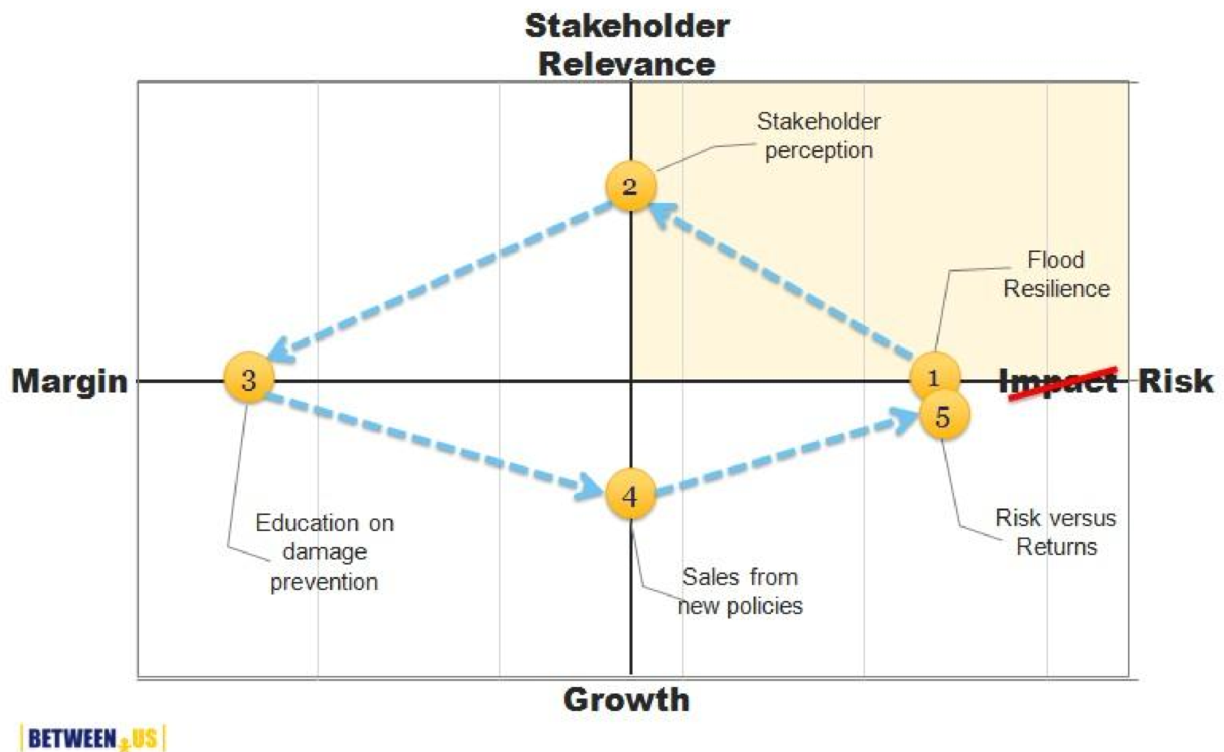

Figure 1: The Materiality Kaleidoscope – example from the insurance industry

1. Risk is all too often occupying the original spot on the "impact-axis", so little change is required here. In the example the topic of flood resilience is an obvious risk for our insurer as they are quite active in the agricultural sector.
2. Stakeholder relevance is represented by the research data on the opinion of key stakeholders on the issue of flood resilience.
3. The margin coming from existing policies can be improved by for instance developing educational tools that enable farmers to take better measures to reduce the effect of floods.
4. Growth can be achieved by developing services with a better market fit and by finding and addressing new niches due to the increased know-how of this market segment.
5. Finally, the risks and returns are compared resulting in a more educated trade-off of sustainability initiatives on this specific material issue.

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The fact that asset management portfolio analysts are subscribing to this broad view on materiality analysis reflects the growing appetite for ESG-driven businesses among investors of many stripes. Consequently the sustainability performance of a company becomes directly linked to how it is valued.

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