WHAT ARE WE TALKING ABOUT?

In the following commentary, guest columnist Stephen Viederman offers his reflections on the debate about industry nomenclature.

Civil rights leader Rabbi Abraham Heschel observed, "Words create worlds." Confusion over terminology describing an investment approach that considers environmental, social and governance (ESG) factors obscures the point of our work linking investing and corporate change. We need to be clearer about what we mean and why it is important.

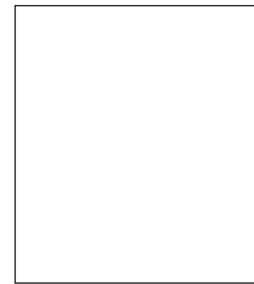
For example, in a recent interview (*Responsible Investor*, 5/2/09) Amy Domini, CEO of Domini Social Investments says she is worried about the semantics of the socially responsible investing (SRI) world gradually shifting towards the concept of "sustainability." Observing that some companies with poor ESG records tout the mantra of sustainability, she suggested that "It's a bit of a marketing term; a comfort word…. Personally I like SRI or responsible investment."

But Corporate America's embracing of sustainability terminology confuses language with practice. No one I know has ever suggested that talking about sustainability or producing a sustainability report is a real measure of a company's sustainability performance. Furthermore, couching the choice of the terms *SRI* or *responsible investing* (RI) as a personal preference makes it easy to disregard important conceptual and methodological differences between those and *sustainable investing* (SI).They share a common goal–achieving long-term shareowner returns and corporate change–but the approaches are different.

The terms sustainable, social, and responsible all suggest that the investment process recognizes there are companies that are better than others and companies that do less harm in comparison to others within or across economic sectors. But the broad-stroke differences, I believe are that:

- SRI/RI is more about investing with personal values; SI is about investing for shareowner value using ESG as a lens to assess a company.
- SRI/RI employs positive and negative screens to identify good or bad companies across economic sectors; SI ranks the best and worst companies within economic sectors. Thus, relatively few integrated oil and gas companies will likely appear in an SRI/RI portfolio, while the best of these companies will appear in SI portfolios.
- SRI/RI methodology is more retrospective, looking at the past performance of a company on social and environmental issues; SI uses retrospective data but emphasizes the capacity of a company's governance structures to respond to likely future trends, such as climate risk, in its particular economic sector.
- SRI/RI promotes shareowner engagement; SI does not.

Clearly this all too brief comparison looks at the ends of a continuum and not to the points in between. But somewhere along the continuum we must acknowledge dissimilar approaches that require terminology that matches so that different investor needs can be met.



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Addressing environmental, social, and governance (or ESG) issues in ways that conventional finance has overlooked as intangible and extra-financial is common to SRI/RI and SI. But it leaves us with the dilemma between the adage "manage what you can measure" and Einstein's wise observation "Not everything that counts can be counted, and not everything that can be counted counts."

What E, S and G criteria are material? Some investors argue that if ESG factors are used, they are by definition material because they are perceived to be linked to financial performance. But to Einstein's point, others argue if something is generally believed to be "right," for example, the subject of internationally agreed upon conventions, but not proven to have financial or operational impact, it should still be included in our investment criteria. An example would be considering workers' rights or a ban on child labor.

I believe that ESG is not simply a descriptor of inputs into the analytical and investment process, but an equation, E + S + g = G. We need to add a small 'g' which assesses the quality of existing corporate governance structures, including the ways they deal with what is material and what is "right." The large "G" is then the sum of the equation, measuring the capability of a company's board and management to deal effectively with future E and S trends.

Investors, their managers and advisers, who share common concerns about the present state of the corporate world and its capacity to change from operating under the principle 'the business of business is business' to a more positive relationship with society, have a variety of options. Differences among these are inevitable and productive if they are aired.

Reactions, critiques and comments are very welcome at s.viederman@gmail.com.