18. Dow Jones Sustainability Indexes

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MISSION: THE CHALLENGE TO INTEGRATE SUSTAINABILITY IN THE FINANCIAL MARKETS

The relevance of sustainability for investors and companies alike is driven by a number of distinct trends such as rapid information exchange, increasing interconnectivity and convergence, heightened awareness for remote geographic regions, severe stress on ecosystems, regional demographic shifts and increasing transboundary interactions. In addition, the relevance of sustainability particularly for investors is driven by the relative financial outperformance of certain sustainability investments and by recent corporate scandals such as Enron, Parmalat and Ahold.

Concurrent with these shifts is the relatively new development that it is not only possible to make macroeconomic policy decisions informed by socio-environmental issues (under the assumptions of imperfect information), but that these analyses can now be complemented by a new ability to make similarly well-informed microeconomic decisions. This is due to an increase in transparency and access to a wider range of different information sources which was previously not available.

The net result of these changes is that sustainability-focused assessments are not only becoming increasingly relevant to both businesses and shareholders, but that these assessments are now also practicable and feasible while contributing to overall policy-making.

Corporate sustainability is a business approach aiming to create long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability leaders harness the market’s potential and demand for sustainability products and services while simultaneously successfully reducing and avoiding sustainability-related costs and risks.

Increasingly, investors regard forward-looking non-financial metrics as important additional indicators to provide a more realistic and comprehensive view of a company’s true value. These metrics provide a broader scope of business-relevant information and insight that goes above and beyond the traditional financial analysis of companies.
Moreover, a wide range of external and internal stakeholders demands greater accountability and transparency from multinational companies on impacts and management of responsibilities to the environment and society at large.

One of the most prominent efforts to assess the sustainability performance of the world’s leading companies by integrating the results into a mainstream financial index are the Dow Jones Sustainability Indexes (DJSI).

This case-study provides an overview of the main characteristics of the DJSI as financial tools that integrate sustainability into mainstream financial markets and highlights some key challenges.

ACTORS INVOLVED AND RESOURCE-DEPENDENCY RELATIONS

The success of financial instruments such as the Dow Jones Sustainability Indexes (DJSI) depends on the involvement of a number of different financially independent players. These players are interdependent due to their respective information needs.

### BOX 18.1 KEY FACTS ABOUT THE DOW JONES SUSTAINABILITY INDEXES (DJSI)*

- Launched 1999
- Starting universe are the 2500 largest companies of the Dow Jones Global Index (DJGI) by free-float market capitalization
- Best-in-class methodology, contain the top 10% leading sustainability companies in each industry
- Methodology focused exclusively on corporate sustainability
- Criteria linked to value creation focusing on environmental, social and economic aspects
- Industry classification adopted from the Dow Jones Global Index (DJGI)**
- No exclusion criteria
- 308 companies in 60 industry sectors
- Benchmarking feedback to all assessed companies
- Number of licences sold 51 (July 2004)
- Performance: Over the last year (December 2002–December 2003) the DJSI World has outperformed the MSCI World by more than two percentage points. The
USD price index value of the DJSI World increased by 33.27% while the MSCI World rose by 30.81%.

Notes:
* For more information see www.sustainability-index.com.
** Industry sector allocation follows Dow Jones nomenclature. For a list of industry sectors see www.djindexes.com/jsp/giClassification.jsp.

The Investors

In order to satisfy market demand for a global, rational, consistent, flexible and, most importantly, investable index to benchmark the performance of sustainability investments, SAM Sustainable Asset Management1, a Zurich-based independent asset manager founded in 1995 and exclusively focused on sustainability and asset management, entered into a cooperation with Dow Jones Indexes to launch the world’s first sustainability index, the Dow Jones Sustainability Indexes, in 1999. Two years later the Dow Jones STOXX Sustainability Indexes were launched.

SAM Sustainable Asset Management employs 55 people, is headquartered in Zurich, Switzerland and is active in the Italian, Spanish, Australian, German, Austrian, US and Nordic markets. SAM has a large and experienced multidisciplinary and cross-cultural research team consisting of 20 analysts focusing on the sustainability and financial analysis of companies.

In this cooperation agreement SAM is responsible for the complete research process. This process includes among others developing, reviewing and setting the complete research methodology and criteria; analysing companies; identifying the leading sustainability companies; providing Dow Jones with a list of the index constituents; and continually monitoring all index members throughout the year. Dow Jones Indexes conducts the calculation and distribution functions for the DJSI. The two companies are financially independent, where Dow Jones Indexes generates revenue through the sale of licences.

The analysis is conducted with the support of a unique sustainability database, which contains corporate, economic, environmental and social information on over 1000 companies worldwide. The research is strengthened by an extensive international network consisting of experts from a broad diverse network including think-tanks, non-governmental organizations (NGOs), industry experts and academia, for example Transparency International (TI), Amnesty International (AI), World Wide Fund for Nature (WWF), World Resource Institute (WRI), the World Conservation Union (IUCN) and Imperial College London.
For both retail and institutional investors the index provides both a benchmark and a universe of large, global companies that embrace the concept of sustainability. Currently 56 DJSI licences are held by asset managers in 14 countries to manage a variety of financial products including active and passive funds, certificates and segregated accounts. In total, these licensees presently manage 2.8 billion euros based on the DJSI.²

The Companies

From a research perspective, companies are the most important stakeholder group. The largest 2500 global companies across 60 industry sectors in the Dow Jones Global Index (DJGI) form the eligible universe for the Dow Jones Sustainability Indexes. Just as sustainability is not a homogeneous concept, so the corporate executives that are dealt with are a heterogeneous group consisting of different positions within the company and of different levels of seniority, for example heads of sustainability, company secretaries, senior managers, human resource managers, environmental managers, risk officers, investor relations and corporate communication to name but a few. The overall responsibility for sustainability often rests with a member of the board of directors with clear operational responsibility delegated downwards. Furthermore, responsibility for sustainability management at a group level is increasingly linked to risk management in a company.

Global benchmarking of sustainability performance as conducted for the DJSI provides valuable insights for companies on how they rank compared to their international peers. This direct benchmarking catalyses the further development and implementation of sustainability within a company.

The Markets

As the market for socially responsible investment matures – in November 2003, the institutional market for sustainability investments stood at 336 billion euros in assets under management (Eurosif, 2003)³ – so the need for mature, robust and reliable information about relevant sustainability issues and impacts also rises. Demand for reliable data and contextual analysis is increasing, requiring companies to disclose significant and material non-financial information that goes above and beyond the traditional reporting scope.

Mainstream socially responsible investment indices have been around since the mid-1990s. Since then, the market has grown and expanded to cover emerging markets as well with local stock exchanges introducing specific indexes incorporating sustainability, for example the Johannesburg Stock Exchange (JSE).⁴ In July 2003, the JSE expanded the listing
requirements to include social, ethical and environmental issues. Companies are now required to report explicitly on non-financial issues affecting their business with the aim of providing greater transparency and therefore an improved opportunity for investors to assess non-financial risks. It is likely that this trend will spread to other emerging market economies across the world.

An index tracking the performance of companies addressing sustainability is valuable when it provides insight into the future financial prospects of a company or industry that conventional analysts are unlikely to incorporate, given a lack of focus on the potential for certain social, environmental and economic issues in society to materialize and affect companies. Such an index addresses both risks and opportunities arising from sustainability in the long run. As traditional valuation metrics and historical corporate information increasingly concede importance to future-oriented, forward-looking indicators of the health of a company and its attractiveness to an investor, indexing the performance of companies addressing sustainability attempts to provide investors with the insights they are increasingly seeking (Funk, 2001). Thus, as an investment insight, equity research in relation to sustainability must be:

- forward-looking;
- based on industry-specific value drivers (as opposed to generic data);
- transparent and easily understood; and
- capable of adding value to existing valuation methods.

Assessing corporate sustainability aims to incorporate the characteristics mentioned above and offers insight across most equity asset classes and investment styles. The hypothesis for the business case for sustainability, interpreted as a portfolio of stocks, is that these stocks will be expected to outperform comparable portfolios, at least in the long run. The reasoning for this expectation can be considered sound. A recent broker report produced by WestLB found that the ‘DJSI was able to achieve a risk-adjusted outperformance’ (Garz and Volk, 2003). The recent growth in number of new financial products integrating sustainability in their core investment strategy – on 30 June 2003 there were 313 green, social and ethical funds operating in Europe which represents a 12 per cent increase over 18 months (since the end of 2001) (SiRi Group, 2003) – provided the impetus for a neutral, rigorous, transparent and easily replicable measurement of corporate sustainability. The challenge facing the indexing industry has been how to measure and quantify corporate sustainability, and how to integrate the results into an investable index that meets the needs of the investment industry while keeping on track with sustainability requirements.
SAM Research’s Corporate Sustainability Assessment™ identifies the leading sustainability companies from the DJSI World investable stocks universe for each of the 60 industry sectors of the DJSI.

The DJSI is made up of 308 companies and reflects changes in valuation of a universe of companies that are leaders in terms of corporate sustainability. The universe of companies embracing sustainability is broader than the DJSI, but the DJSI comprises the leaders in corporate sustainability. Thus, the DJSI not only traces, but also implies, a universe of leading companies with regard to addressing sustainability. Within each of the 60 industry groups, a group of leading companies exist. The inclusion of these leading companies in the indexes endorses these companies publicly, it indirectly ensures access to capital and taps into the competitive nature of markets by benchmarking companies within each industry sector and thus enhances the emergence of a group of leading companies.

**ASSESSMENT AND EVALUATION OF POLICY-RELEVANT OUTCOMES**

The following addresses some of the major challenges encountered in conducting the research for the DJSI and how these are dealt with.

**Challenge: Development of Relevant Generic and Industry-Specific Assessment Criteria**

An index tracking the performance of corporate sustainability leaders first needs to define corporate sustainability and relevant assessment criteria. Criteria representing the challenges deriving from sustainability trends have to be developed and quantified so that the best-positioned companies can be measured and identified.

Selecting relevant and quantifiable criteria to assess corporate sustainability is a major challenge because the quality of the index components depends heavily on this aspect of the assessment process. Assessment criteria should be easy to measure, relevant, understandable, clearly formulated and precise. In addition to quantitative data, corporate sustainability is widely based on assessing qualitative data, so the most significant challenge is to develop quantitative proxies for qualitative data and integrate these into a system that meets the major requirements of indexing (for example, the need for replicability and objectivity). Through the thorough assessment of current and future scenarios of economic, environmental and social driving forces and trends as well as internationally recognized treaties and regulations, corporate sustainability criteria for each
sustainability dimension across all industries are identified. These criteria are defined as either general criteria applicable to all industries or industry-specific criteria that are only relevant to a selection of industries. The number of industry-specific criteria varies from 1 to 14 per industry and differs between industry groups, whereas the 20 general criteria are the same for each industry group. As each industry group faces specific sustainability challenges, there is a tendency to increase the number of industry-specific criteria and their respective weightings in comparison to general criteria in the future. Where possible and feasible, criteria are developed by incorporating widely accepted standards, for example the Universal Declaration of Human Rights (UNDHR) and best-practice examples as well as extensive input from industry and regulatory experts, NGOs and consultants.

General Criteria

Based on the identification of major global sustainability challenges, general sustainability criteria are defined for each dimension and are applied to all industries. They include standard management practices and performance measures applicable to all industries, such as corporate governance, financial robustness, environmental management and performance, human rights, supply chain management, risk and crisis management, and labour practices. The general criteria are weighted 60 per cent in the assessment scheme.

Industry-Specific Criteria

Industry-specific criteria take into account the challenges and trends affecting specific industries. They reflect the economic, environmental and social forces driving the sustainability performance of a particular industry and are weighted 40 per cent in the assessment scheme.

BOX 18.2 CORPORATE SUSTAINABILITY ASSESSMENT™ OVERVIEW CRITERIA APPLIED IN DJSI 2003/04

The assessment is divided into three distinct sections, covering the economic, environmental and social dimensions and including answers from the questionnaire as well as the results from a Media and Stakeholder Analysis (MSA) (see below for more details on the MSA process). Each criterion has a number of sub-criteria which are not listed below but which are explained in the index rulebook:**
Economic
- Codes of conduct/compliance/corruption and bribery (MSA)
- Corporate governance
- Customer relationship management (MSA)
- Financial robustness* (MSA)
- Investor relations
- Risk and crisis management (MSA)
- Strategic planning
- Industry-specific criteria depending on industry (MSA)

Environment
- Environmental policy/management (i.e. overall responsibility for environmental issues, environmental policy and targets, public availability of targets, environmental management systems certification and organizational coverage (MSA)
- Environmental performance (organizational coverage, key performance indicators (KPI) – energy, greenhouse gases, water, waste)
- Environmental reporting* (scope)
- Industry-specific criteria depending on industry (i.e. specific manufacturing and know-how, detailed greenhouse gas emissions management, biodiversity impacts, chemicals in the environment, product stewardship, etc.)(MSA)

Social
- Corporate citizenship/philanthropy
- Stakeholder engagement (MSA)
- Labour practice indicators (MSA)
- Human capital development (MSA)
- Knowledge management/organizational learning
- Social reporting*
- Talent attraction and retention
- Standards for suppliers and supply-chain management
- Industry-specific criteria depending on industry (MSA)

Note:
* Criteria assessed based on publicly available information only.
MSA – Media and Stakeholder Analysis.
The number of industry-specific criteria varies between industries and ranges between 2 and 10 criteria in each dimension.
Challenge: Gathering Corporate Sustainability Information

A major challenge lies in developing a process to gather the correct and relevant information to measure economic, environmental and social performance, the validation of data and the choice of information sources to use. While some global companies publish corporate sustainability reports, the majority of companies are only just beginning to understand and, hence, report on the concept of corporate sustainability. More importantly, not all data are consistent, relevant or comparable.

Research for the DJSI uses four main information sources in the Corporate Sustainability Assessment™.

Company Questionnaire

Online questionnaires specific to each of the DJSI industry groups are distributed to the chief executive officers and heads of investor relations of all eligible companies in the DJSI World investable stocks universe that have agreed to participate in the annual assessment. The online questionnaire is structured along the economic, environmental and social dimension. Each dimension consists of general and industry-specific questions, which are weighted 60 per cent and 40 per cent respectively. The completed company questionnaire, signed by a senior company representative, is the most important source of information for the assessment. SAM Research conducts a major review of the overall methodology and criteria every two years to reflect best practice in each industry sector and to incorporate any major developments in the area of sustainability. It is important to note that the whole field of sustainability is not static but is in constant development. Minor optimization adjustments in the methodology, research and assessment processes are necessary and conducted annually.

The advantages of using a questionnaire-based research approach are that a structured framework and a transparent and consistent research process are applied, allowing for a rigorous and consistent assessment process. The structure allows for a detailed analysis of each criterion, which assists in the continual improvement of the research methodology and process. It is also possible to conduct regression analysis by comparing the historic sustainability performance with the current evaluations.

Company Documentation

The information in the questionnaire is checked by the industry analyst and complemented with further additional information available via publicly
available and internal company documentation. Documents requested from companies include:

- sustainability, environmental, health and safety, social reports;
- annual financial reports, analyst reports;
- special reports (for example on intellectual capital management, corporate governance, R&D, employee relations);
- all other relevant sources of additional company information: for example internal documentation, brochures and website.

**Media and Stakeholders**

Sustainability analysts review media, press releases, articles and stakeholder commentary written about a company over the previous year. This information is integrated into the assessment system as well as serving as a basis for possible downgrading of a company through the ongoing Media and Stakeholder Analysis process in which the prevalence and severity of incidents are evaluated.

**Contact with Companies**

Where necessary each sustainability analyst contacts companies to clarify open points arising from the analysis of the questionnaire, company documents and Media and Stakeholder Analysis (MSA). The results are fed into the company assessment.

**Challenge: Quantification of Corporate Sustainability**

A key challenge in developing an index tracking corporate sustainability is how to quantify corporate sustainability. Given that sustainability trends affect each industry differently, industry-specific challenges arise. As a result, industry leaders need to be identified for each industry group, known as a ‘best-in-class’ approach. Sustainability leaders within each industry group need to be ranked according to their corporate sustainability performance relative to one another. In most cases, sustainability developments are qualitative in nature, so they may inherently lack easy quantification.

While assessing companies’ environmental performance or emission targets may seem relatively straightforward, a consistent and equally quantifiable method is not readily available for many aspects of social and economic development.

The DJSI does not exclude any sectors per se. Even if certain sectors are involved in business activities that do not have a specific positive or negative
impact on the environment, the market or society, it is through the best-in-
class approach with which the leading companies are identified and benchmarks are set in each sector. This approach allows the development of a methodology that is applicable across all sectors and does not make any ‘values-based’ or ‘moral’ judgements on specific business activities, products or services.

The Corporate Sustainability Assessment™ enables a sustainability performance score to be calculated for each company based on all four sources identified above. Reviewing, assessing and scoring all available information in line with the corporate sustainability criteria determines the overall sustainability score for each eligible company in the DJSI World investable universe. The objective of the Corporate Sustainability Assessment™ is to measure and verify the corporate sustainability performance of the companies in the investable universe. A company’s total corporate sustainability score is calculated in SAM’s Sustainability Information Management System (SIMS) based on a predefined scoring and weighting structure set by SAM Research. The specific weighting scheme reflects the strategic relevance of the issue to the industry (for example the issue of climate change is weighted higher in the automotive sector than in the chemicals or pharmaceuticals sector. This relates to SAM’s view that in this sector product-related CO₂ emissions pose a higher strategic threat and/or opportunity than production-related CO₂ emissions). All questions related to each criterion receive a score. Each question has a predetermined weight for the answer, the question, and for the theme and class within the question. The total score for the question is the combination of these weights. Each score is aggregated to arrive at an overall score for each company. Based on these scores the top 10 per cent in each industry sector are selected for inclusion in the DJSI.

Once a company is selected as a member of the DJSI World, it is continuously monitored for its corporate sustainability performance. Corporate Sustainability Monitoring is a crucial and integral part of the ongoing review process.

The objective of the Corporate Sustainability Monitoring is to verify a company’s involvement and management of critical environmental, economic and social crisis situations that can have a highly damaging effect on its reputation. In addition, the consistency of a company’s behaviour and management of crisis situations is reviewed in line with its stated principles and policies. The Corporate Sustainability Monitoring can lead to a company’s exclusion from the index regardless of how well the company performed in the yearly Corporate Sustainability Assessment™. The following issues are identified and reviewed across all industry sectors in the monitoring process:
• Codes of conduct: for example tax fraud, money laundering, antitrust, corruption, bribery.
• Corporate governance: for example balance sheet fraud, insider trading.
• Customer relationship management: for example product recall, customer complaints.
• Financial robustness: for example bankruptcy situation, access to capital.
• Risk and crisis management: for example accidents, fatalities, workplace safety issues, technical failures.
• Supply chain management: for example major price-fixing, unfair competition cases.
• Environmental management: for example ecological disasters, hazardous substances, grossly mismanaged long-term pollution.
• External stakeholders: for example cases indicative of the company systematically exploiting weak governance in emerging countries.
• Labour practice indicators: for example cases involving discrimination, forced resettlements, child labour and discrimination of indigenous people; workplace accidents and occupational health and safety.
• Remuneration, benefits, flexible working schemes: for example extensive lay-offs and strikes.

Media and Stakeholder Analysis (MSA)

Corporate Sustainability Monitoring is based on media reviews using full text database services (for example Factiva, a Dow Jones and Reuters joint venture), and analysis of stakeholder information as well as other relevant publicly available information.

Impact Evaluation

Each of the components in the DJSI World is monitored daily for crisis situations. If a crisis occurs, the impact of this is assessed. The extent of the crisis within the company, the geographic expansion and level of coverage in the media is monitored. As a result, the impact of the crisis on the reputation of the company and on its core business is assessed.

Quality of Crisis Management

If the impact of the crisis is far-reaching, covered worldwide in the media or is an important concern for the company, then an analysis of the quality of the company’s crisis management is conducted. This step comprises a
monitoring of how well the company communicates, informs the public, acknowledges responsibility, provides relief measures, involves relevant stakeholders and develops solutions. In this context, SAM Research weighs the severity of the crisis in relation to the company’s reputation and quality of crisis management.

Review by DJSI World Index Design Committee

If deemed appropriate, SAM Research provides the DJSI World Index Design Committee with a proposal for the company’s exclusion from the DJSI World. The DJSI World Index Design Committee reviews the Corporate Sustainability Monitoring results in line with the company’s track record, political and cultural setting. If the crisis management of an important issue is considered poor from a sustainability point of view, the DJSI World Index Design Committee can decide to exclude the company from the DJSI World, which has not happened in the five-year history of the DJSI.

To ensure quality and objectivity, external audit and internal quality assurance procedures, such as cross-checking of information sources, are used to monitor and maintain the accuracy of the input data, assessment procedures and results. SAM Research does not explicitly verify environmental and social performance data but relies, where available, on externally verified environmental and social reports, which is reflected in the assessment scheme. External verification is viewed as an important step to ensure validity and accuracy of corporate non-financial information. Since inception of the DJSI in 1999 SAM Research’s Corporate Sustainability Assessment™ has been verified annually by PricewaterhouseCoopers (PwC). The error margin that PwC have audited has been below 1 per cent since the launch of the indexes, providing reassurance that the rule-based assessment process is adhered to and replicable.

Challenge: Strengthening Acceptance of the Indexes

The success and acceptance of the research process depends on the quality, relevance, transparency and rigour of the research process.

To ensure transparency of the indexes, the complete methodology is publicly available through the index website and is reviewed annually. As the research methodology depends on both publicly available and company-specific information, participation from companies is a crucial success factor for the indexes. Indeed, analysis of criteria such as environmental reporting collected over several years suggests a correlation between a company’s sustainability performance and overall corporate transparency across all sectors. This can be applied to nearly every criterion – leading
sustainability companies are generally more transparent than their peers. This transparency builds trust among the company’s different stakeholders and allows the company actively to define and respond to the different information needs of its external stakeholders.

A key differentiating factor of these indexes compared with other indexes is that every assessed company receives a detailed benchmarking report highlighting the company’s sustainability performance in each sustainability dimension in comparison to the industry average and the best performance in the industry.

This feedback is a crucial element in strengthening the acceptance of the indexes with companies as it is free, contains industry-specific global sustainability benchmarking information and provides the company with a detailed overview of its sustainability performance. Making this information only available to a select public, that is, participating companies, increases the incentive for companies to participate in the index assessment. As most information companies provide is readily available in the public domain, the index balances information asymmetries. Further, the feedback forms the basis for the ongoing dialogue and engagement with companies.

CONCLUSIONS AND SCORING CHART

Following the description of the main characteristics of the Dow Jones Sustainability Indexes, one can apply the proposed framework of this study to the DJSI to assess whether the DJSI can be judged an effective policy instrument that integrates sustainability into mainstream financial markets (Table 18.1).

The seventh year of existence and the fact that the index has 56 licensees, is testimony to the market success of the DJSI as a global, rational, consistent, flexible and, most importantly, investable index to benchmark the performance of sustainability investments. In addition, the DJSI meets most of the criteria in the proposed evaluation framework – an indication that the indexes are an effective policy instrument integrating sustainability into mainstream financial markets.

Concerning the methodology for assessing corporate sustainability, there are a number of key challenges that have to be addressed. The success of such a product is based on a consistent and robust assessment framework and criteria while simultaneously being flexible enough to adapt and respond to the mega-trends affecting the corporate environment and the evolution of corporate sustainability. Assessment of corporate sustainability is a nascent field and a relatively new concept, and thus a lengthy history on which to base judgements is lacking. The assessment methodology
Table 18.1  Evaluation of Dow Jones Sustainability Indexes

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Questions for Review</th>
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<tbody>
<tr>
<td>Relevance</td>
<td><strong>(C1) Process of problem identification; Pressure to act</strong></td>
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<tr>
<td></td>
<td>Sustainability is an important concept for investors and stakeholders; the DJSI identifies the sustainability leaders in each industry</td>
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<tr>
<td></td>
<td>Need to act is given by broader society and financial markets; recognition that non-financial indicators can effectively add to the traditional financial evaluation of companies</td>
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<td></td>
<td>Companies – see sustainability strategy as a source for business innovation and improved corporate resilience</td>
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<td></td>
<td>Investors – more rigorous assessment of companies</td>
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<td></td>
<td>Civil society – identification of leading companies</td>
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<td></td>
<td>Yes, the DJSI addresses its main actors; however, the process is not strictly stakeholder driven – main focus is the investors’ perspective</td>
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<td></td>
<td>Yes, process incorporates global and regional trends; identification of priority areas focused strongly on issues that are linked to the financial performance of companies, i.e. criteria linked to value drivers</td>
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<td></td>
<td><strong>(C2) Decentral solutions; Possibilities for Compensation</strong>*</td>
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<tr>
<td></td>
<td>Yes, decentral solution by integrating existing and proposed policy developments and market-based solutions, e.g. emissions trading</td>
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<tr>
<td></td>
<td>Yes, the network is diverse and consists of a broad range of different players, e.g. NGOs, experts, think tanks</td>
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<td></td>
<td>Yes, it leads to an exchange; transparent research process requires participation and information from companies; in return companies receive a feedback in the form of benchmark reports highlighting global best practice</td>
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<tr>
<td>Effective-</td>
<td><strong>(C3) Targets and strategies</strong></td>
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<tr>
<td></td>
<td>Yes, the assessment checks both management quality and performance through clearly defined targets and goals in both general and industry-specific criteria; clear and verifiable targets are used</td>
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<td></td>
<td>Where possible criteria are based on accepted international laws and conventions; general criteria apply across industries; industry-specific criteria use industry-specific targets</td>
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<tr>
<td></td>
<td>The goal of the assessment structure is to identify leading companies in a clear, reproducible and consistent manner; the structure allows for issue-specific policy deliberations</td>
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Table 18.1 (continued)

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<thead>
<tr>
<th>Criteria</th>
<th>Questions for Review</th>
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<tr>
<td>Implementation (C4)</td>
<td>Yes, as part of the annual review this is possible. Ideal targets are set just above and beyond the achievable maximum to act as a positive driver for change and not as a disincentive. Annual review of methodology and adaptation of criteria accordingly.</td>
</tr>
<tr>
<td>Efficiency (C5) Cost</td>
<td>Yes, streamlining and optimizing research process is crucial, e.g. automation of data gathering – however, assessment conducted by industry-specific analysts; aim to facilitate participation of companies as much as possible through technical solutions and incentives, i.e. feedback. Completion of questionnaire is resource-intensive (time, manpower) and it is crucial to demonstrate the benefits (benchmarking, logo, inclusion in index) to companies Negative environmental externalities and risks in the economic and social dimension of sustainability are considered in the Corporate Sustainability Assessment™.</td>
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<tr>
<td>Side-Effects (C6) Positive</td>
<td>Transparent research process and feedback to companies ensure critical evaluation of research process; identification and recognition of global sustainability leaders strengthens and fosters discussion and the ongoing development of corporate sustainability Global benchmarking as a driver for advancement; through open communication and the logo to be used in public communication Sometimes difficult to differentiate leading companies in one sector as ‘low-hanging fruit’ have been picked, and sustainability becomes strategic issue Balance between proprietary research and demand for fully transparent research Identification of leading companies</td>
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Table 18.1  (continued)

<table>
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<tr>
<th>Criteria</th>
<th>Questions for Review</th>
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<tr>
<td>Identification of global best practice</td>
<td></td>
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<tr>
<td>透明反馈和开放讨论关于正在进行的发展</td>
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<td>Expansion into emerging markets</td>
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<td>Corporate membership organizations such as the WBCSD exchange information and share knowledge</td>
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<tr>
<td>(C7) Negative side-effects</td>
<td>Critical issue to provide rationale for criteria used to ensure acceptance</td>
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<td>Occasional misunderstanding between socially responsible and sustainability investment</td>
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<tr>
<td>Adaptation flexibility</td>
<td>No, the assessment scheme is set for each industry to ensure comparability and integrity of assessment scheme</td>
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<tr>
<td>Adaptation flexibility</td>
<td>Full flexibility for investors is ensured as the DJSI can be used either as a benchmark or as a universe of companies of sustainability leaders in their respective industries</td>
</tr>
<tr>
<td>(C10) Participation and transparency</td>
<td>Participation in the annual assessment is confined to the 2500 largest companies in the Dow Jones Global Index (DJGI); all companies receive an invitation and a key fact sheet. All eligible companies are invited and relevant external stakeholders are approached as required No. Yes, adjusted annually.</td>
</tr>
<tr>
<td>(C11) Control</td>
<td>Formal control mechanism is the annual audit of the research process conducted by Pricewaterhouse-Coopers (error margin &lt;1% in 2003). Structured weighting scheme ensures consistent application of evaluation scheme. Yes, independent auditors. Annual audit, transparent rule book and feedback to all participating companies. Depending on severity of case identified through the Media and Stakeholder Analysis company can be downgraded or ultimately excluded from the index.</td>
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Note: * This refers to Coase-type negotiation among actors, a possibility which can be seen separately from C1 (referring to a broader set of relevance criteria).
described in this chapter has to evolve continually to capture best-practice corporate behaviour, and improvements to the criteria selection and definition are made to reflect companies’ performance and risk attributions better. Furthermore, regional particularities will be given increasing prominence as specialized regional and emerging market assessment approaches are developed.

Due to the above-mentioned issues, transparency of the research process and assessment methodology is of paramount importance to strengthen the reputation of the indexes among companies and investors.

Moreover, there is a distinct dearth of scientific back-up to many of the tenets of the sustainability-investing hypothesis and approach. Increased collaboration among academia, science and business should be promoted to close this gap. This cooperation between the sciences and the private sector will also provide the background for the much-needed standardization of corporate sustainability reporting.

However, in its relatively short history the DJSI has demonstrated that it is an effective mechanism to introduce and integrate sustainability into the mainstream financial markets.

The scoring chart in Figure 18.1 summarizes the results of the case-study above and scores all 11 criteria.

![Dow Jones Sustainability Indexes](image)

**Figure 18.1  Scoring chart of Dow Jones Sustainability Indexes**
NOTES

1. For more information see www.sam-group.com/
5. Companies embracing global sustainability trends are likely to achieve a higher return on equity (ROE) and/or a lower required rate of return (RRR) than companies that ignore these trends. Higher ROE may result from a better understanding of investment opportunities or from lower non-operating cost, because of a better understanding of risks. Higher ROE may also result from social pressure groups channelling demand into sustainable products. A lower RRR may result from a better understanding and management of risks. The RRR is a function of both operating and financial risks. Companies embracing sustainability trends may reduce their operating risks and, thereby, lower their equity costs. It presumably would also result in lower borrowing costs, leading to lower costs of capital and, again, to higher ROE. Lower borrowing costs may also be the result of investors considering other parameters than just risk and return. High ROE and low RRR result in free cash flow that can be invested profitably when embracing sustainability trends (Flatz, 2001). A portfolio, or an index composed of this type of company, thus will appreciate faster than a portfolio or an index of companies not embracing theoretically profitable investment opportunities. Investments in companies embracing sustainability thus promise higher returns and, due to lower business risk, better risk–return ratios. Based on this hypothesis, better performance can also be expected on a risk-adjusted basis (Flatz, 2001).