RESULTS

Objective:

- Identify CSR rating agencies’ purposes and philosophies on CSR
- Identify differences in CSR rating agencies’ methodologies

Key terms:

- Corporate social responsibility (CSR): a company’s approach to environmental, financial, social and philanthropic actions
- Social investing: considers the social good, as well as profit of a corporation when making investment decisions
- ESG: Stands for Environmental, Social, Governance; categories of CSR factors and a framework used by multiple rating agencies

RESULTS

Comparing Methodologies

Weighting of issues:

FTSE4Good: Exposure-weighted average – “the most material ESG issues are given the most weight when determining a company’s scores.” Exposure = “measures of the relevance for a company of each theme”

MSCI: Risk management requirements to score well vary based on each individual company’s risk exposure.

“Any issue weights are set at the GICS Sub-industry level (6-digit) based on each industry’s relative external impact and the time horizon associated with each risk.”

Data sources:

- Analysis of financial materiality for each industry determines weights of various sustainability criteria

Issue rated:

- FTSE4Good: 11 pillars (ESG), 14 Theme Scores, 350 Indicators, typically 10-20 per theme
- MSCI: 3 pillars (ESG), 10 themes, 37 key issues; “thousands of data points”

MSCI-3 pillars:

- classroom: As of October 2016, a company in a “developed” market needs ≥ 2.0 to be included. A company in an “emerging” market needs ≥ 2.0 to be added and below ≥ 1.8 to be deleted.

- Selling the following excludes tobacco, weapons systems, components for controversial weapons, cluster munitions, anti-personnel mines, depleted uranium, chemical/biological weapons, nuclear weapons, and coal-powered generation. Companies categorized within the Industrial Classification Benchmark Subsector of 1773 Coal.

- Companies involved in nuclear power generation or manufacturing baby formula must meet special requirements.

- A Global benchmark service is being developed (as of October 2016). Companies that have significant changes will not be excluded.

- A score of 200 in a high exposure theme excludes “developed” market companies.

- MSCI: Companies that receive too much revenue from the following are excluded: alcohol, gambling, tobacco, military weapons, civilian firearms, nuclear power, adult entertainment, genetically modified organisms

- A company must have a rating above 88 to be eligible for inclusion. Existing constituents must maintain above a B.

- A company must have an MSCI ESG Controversies Score above 2 to be eligible for inclusion. Existing constituents must maintain above a score 0 to 100 scale (the worst score).

- Dow Jones: Top ranked companies within each industry are included (top 10% for global indices, 20% for regional indices, and 30% for country indices)

- Only the largest companies are eligible

- Companies must have a score not less than 60% of the highest rated company’s score to be included in an index.

- Investors can invest in “Critical exclusion sub-indices” that exclude companies with exposure to alcohol, tobacco, gambling, armaments, cluster bombs, firearms, lead/mercury, adult entertainment, nuclear weapons, nuclear power generation, nuclear power sales, and uranium mining.

Comparing Purposes and Philosophies on CSR:

FTSE4Good:

- Listed purposes:
  - Portfolio evaluation and manager due diligence
  - Engagement and stewardship
  - Risk management
  - Research and analysis
  - Custom benchmarks
  - Active portfolio management
  - Actively encourage companies to address ESG issues

- Not a “Best-in-Class” Index with a narrow and constrained stock universe, but rather is meant to capture a broad universe of companies that are working to manage and improve ESG performance.” Unlike Dow Jones

MSCI:

- To “help investors to understand ESG risks and opportunities and integrate these factors into their portfolio construction and management process.”

METHODOLOGY

Comparing Methodologies:

- I compared methodologies, purposes, and philosophies with material from each CSR rating agency’s respective website.

- I compared three social indexes/sets of indexes: Dow Jones Sustainability Indexes, FTSE4Good Series, and MSCI KLD 400

- Project partly based on “Breaking Down the Wall of Codes: Evaluating Non-financial Performance Measurement” by Aaron Chatterji and David Levine

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To answer the following questions:

- “What is the most significant ESG risk and opportunities facing a company and its industry?”

More specific four key questions:

- “What are the most significant ESG risks and opportunities facing a company and its industry?”

- “How useful is the company to those key risks and/or opportunities?”

- “How well is the company managing key risks and opportunities?”

- “What is the overall picture for the company and how does it compare to its global industry peers?”

A risk is material to an industry when it is likely that companies in a given industry will incur substantial costs in connection with it.” An opportunity is material to an industry when it is likely that companies in a given industry could capitalize on it for profit.” The MSCI ESG Ratings model focuses only on issues that are determined as material for each industry.

- Represents a “best-in-class” approach with strict criteria

Dow Jones:

- Just like MSCI, companies are evaluated based on “financially relevant sustainability criteria.” Questions focus on “factors that are relevant to the companies’ success, but that are under-researched in conventional financial analysis.”

- A family of best-in-class benchmarks for investors,” unlike FTSE4Good, to “ensure a high sustainability profile for index constituents, while maintaining a balance in terms of industry exposure”

- Language on the website heavily emphasizes the financial benefit of CSR.

- Qualifiers when mentioning stakeholders imply CSR is optimal and only relevant for a specific subset of investors.

- “Benchmark for investors who integrate sustainability considerations into their portfolios, and provide an effective engagement platform for investors who wish to encourage companies to improve their corporate sustainability practices.”

CONCLUSIONS

- The most popular social indexes vary widely in purposes, philosophies on CSR, and methodologies

- These differences cause problems, as discussed in the literature

- Specifics of methodology not immediately evident to the average stakeholder nevertheless have large implications for the meaning of these indexes’ results

- These indexes view and advocate CSR as beneficial primarily for profit, rather than ethical reasons.

- Because the Dow Jones Sustainability Indices and MSCI KLD 400 only focus on issues relevant to company profits, they are not reliable measures of a company’s social output outside a financial context.

- Although these indexes have changed throughout the years, problems indicated in the literature a decade ago remain today.

REFERENCES


