In the course of over 200 years of commercial enterprise in the United States, there are perhaps two sure-fire statements to stop a conversation on business and the environment in its tracks. The first is that any effort to attain higher environmental performance creates cost and compromises shareholder value, and the second related comment, is that to compromise shareholder value could lead to litigation. These two threats, share price declines and litigation, are, generally speaking, showstoppers that have been used to great effect in boardrooms across America.

But the winds of change are upon us. I would like to suggest that we are entering an era when it will be unexceptional, and in fact expected because it will increasingly be viewed as necessary, that businesses meet financial and environmental challenges simultaneously. We have not quite reached the stage of suggesting this is like walking and chewing gum at the same time, but we are getting there. The presumption that environmental and financial goals are mutually exclusive suggests a limitation on the ingenuity of corporate management, and a limitation on the quality of innovation in environmental management, that is being debunked with ever increasing frequency.

A growing number of investors, traditionally called socially responsible investors in this country and sustainable investors in Europe, are so committed to this notion, that environmental criteria have been fundamentally integrated into the analytical process when assessing a company for potential as a portfolio holding. A still larger number of investors have taken to heart that reducing environmental liabilities reduces investment risk. These investors view the assessment of corporate social responsibility in portfolio companies as “risk management.” That is a start, and moves us in the same direction. Increasingly, corporations around the world are more likely to adopt the view that environmental protection is not simply a matter of compliance, and that solving environmental problems is more likely to save money than to cost it in the long run.

Certainly, this change is not monolithic. There are, and probably always will be, company managers whose only view of environmental protection is, “What do I have to do?” and whose major question is, “How little can I spend to do it?” But the ranks of companies that are making affirmative commitments to environmental protection, and admitting that this saves them money, are growing. For example, Baxter International estimates that its total income, savings, and cost avoidance resulting from its environmental programs totaled $65 million in 2002, and includes an environmental financial statement in its sustainability report detailing the costs and savings of all its environmental initiatives. DuPont, which launched a global initiative to become a zero-waste company, reported in 2002 that “in most cases the reduction in waste generated and the improvement in energy efficiency have resulted in very positive financial benefits.”
It is crucial to note that both Baxter and DuPont report the results of their progress in financial terms, not just economic terms. There are reservoirs of studies that show the economic benefits of environmental protection, in terms of reduced morbidity and mortality, lowered energy costs, and the like. But in many cases, these benefits cannot be captured by the companies whose actions created the benefits. For healthy environments and economic growth to be viewed as mutually reinforcing, rather than competing values, the corporate financial math must work as well as the economics for society as a whole.

Calvert’s analysis of potential portfolio companies includes a review of a range of corporate practices in the following areas: environmental performance; corporate governance; workplace management, including an examination of the company’s record with respect to women and minority representation on the Board and in senior management; human rights policies and practices in overseas operations; indigenous peoples’ rights; and product safety.

While investors in socially responsible or sustainable investing are frequently motivated by a desire to invest in accordance with deeply held values, it comes as no surprise that these investors have no less an appetite for financial returns than those who believe the numbers alone tell the whole tale. So has this attention to environmental performance translated into superior market performance? The evidence is anecdotal, but compelling nonetheless. Over the three calendar years, 2000 – 2002, Calvert’s domestic equity fund performance ranked in the top ten among all mutual fund families, as reported by Barron’s. Specifically, Calvert’s equity funds ranked 6th among 81 fund families in 2002, 3rd among 87 fund families in 2001, and 3rd among 84 families in 2000.3

On a broader scale, the Social Investment Forum reports that over 70% of the largest socially responsible mutual funds received top marks from Morningstar and Lipper Analytical Services, Inc. A total of 62% of the full universe of social funds earn highest ratings. Of the 53 socially screened funds with a three-year performance record tracked by the Social Investment Forum, 33 (62%) received the highest marks from either Lipper or Morningstar. According to the Forum, 26 (49%) of the funds tracked received an "A" or "B" ranking from Lipper based on one- and/or three-year total returns within their investment categories. A total of 20 screened funds (37%) earned either four or five stars from Morningstar for at least three-year risk-adjusted performance. A number of the funds earned top rankings from both organizations. Both the Lipper and Morningstar analyses are based on time periods ending December 31, 2003.4 Evidence will continue to build from the record of the benchmarks of sustainable company performance that have emerged in recent years, including the Dow Jones Sustainability Index, the Calvert Social Index, and the Domini Social Index.

The prospect of enhanced access to capital markets through superior environmental performance should be an alluring “carrot” for corporate managements, their Boards, and their shareholders, sufficiently appealing to cause them to devote considerable energy to environmental improvements. But while there is some prospect of stepped-up demand for social and sustainable investing worldwide, it is an evolving and slow journey to date. Even sectors one would expect to flock to sustainable investing strategies such as endowments, foundations, and even environmental organizations, have not yet reconciled the contradiction in their missions and their
investment strategies. The amount of capital committed to socially responsible and environmental investing is growing, but not sufficiently fast to provide the incentive of enhanced access to capital markets to management teams that implement environmental improvements.

So if the “carrot” is insufficiently motivating, what about the “stick”? New environmental regulation is unlikely to be forthcoming. Most of our environmental laws were passed in the 1960s and 1970s, with a few in the 1980s. But the ability of the federal government to produce new environmental regulation has slowed to a snail’s pace, often requiring a crisis to precipitate action. So can business leaders be expected to achieve environmental objectives in the absence of mandatory environmental requirements?

Business leaders have demonstrated repeatedly that the answer to this question is an emphatic yes. Between 1997 and 2002, for example, Baxter reduced its emissions of air toxics by 81%, its energy use by 19%, its packaging by 15%, and its water use by 9%.\(^5\) Whirlpool’s line of household products generates sales of over $11 billion while also exceeding energy efficiency standards by 40%.\(^6\) And this was without a regulatory mandate.

Many corporations are also making excellent progress toward the goal of reducing greenhouse gas emissions, the culprit behind climate change, which is the most profound and potentially destructive environmental problem of our age. The ranks of companies that have undertaken and are meeting goals to reduce greenhouse gas emissions include BP, Shell, Staples, DuPont, Ford, Intel, and scores of others, from the world’s largest corporations to some so small that few of us have heard of them.

Almost all of this progress was undertaken on principle, rather than as a result of regulation. Certainly the prospect of future regulation is driving some of these decisions, but corporate values supporting responsible citizenship have been a much more powerful impeller. Some may always need to hear the “business case” for progress, but the examples noted here, and no doubt there are others, demonstrate that corporations can work towards environmental goals that are neither financially rewarding, nor mandated, but are simply the right thing to do.

But is it enough? To that question we must reply with an equally emphatic no. It is unequivocally true that business leaders will always undertake environmental programs that go well beyond the purview of regulation. But there are at least as many laggards as there are leaders, and there is a vast, mushy middle composed of companies that aim merely for compliance.

There is perhaps one force even more powerful, arguably, than that played by government regulation. To the investment community, the pen of disclosure is at least as mighty, if not mightier, than the sword of regulation. Information is the currency of financial markets. The principle of full and fair disclosure is behind our system of financial reporting that, despite the experience of the last two or three years, has served to lubricate the engine of financial markets. In fact, the experience of the recent past, with its notable failures of corporate governance, stemmed as much from people concealing information about their financial dealings as from the nature of the arrangements themselves.
A recent study by Standard & Poor’s supports the notion that disclosure alone has value. According to S&P, investors worldwide will pay a premium for information: corporations that disclose greater amounts of information trade at premium prices to those that do not. Specifically, the study shows a clear inverse relationship between transparency and disclosure rankings and market risk. The negative correlation shows that the lower the disclosure, the less information there is about the company and therefore the higher the market risk and the higher the cost of capital. In addition, the study shows a positive correlation between voluntary disclosure rankings and price-to-book values suggesting that U.S. companies that provide more voluntary disclosure command a higher stock price.7

Disclosure is not without its perils, of course. Corporations are always wary of exposing themselves to potential liability, and after Nike’s recent court experiences focusing on whether their corporate communications about human rights were commercial or protected speech, a few corporations (including Nike) have announced that they will no longer publish sustainability or social reports. The interesting thing is not that some corporations shied away from disclosure; rather, it is far more interesting that so few of them did so.

Unlike financial reporting, corporate reporting of environmental performance is largely optional. Yet growing numbers of companies publish information about their environmental performance, and significantly, about their progress toward quantitative goals, such as reduction in greenhouse gas emissions or hazardous waste production. They do so not because they have to, in most cases, but because such reporting is becoming an admission ticket to the club of socially responsible businesses. That club is more than corporate feel-good. It is about corporate reputations, and reputation, at a time when significant proportions of corporate value are intangible, is very important. A trusted brand can be worth tens or hundreds of millions of dollars of market value to a corporation.

Voluntary reporting initiatives that include environmental metrics (CERES, GRI, and Global Compact) are on the rise, albeit rather more slowly in the United States than in Europe, or even the developing world. But those corporations that issue such reports are rewarded with a more favorable review from social and sustainable investors. Corporations whose brands are exposed to millions of consumers are concerned about their reputations, and are more willing to disclose environmental performance. However, not all corporations are household names. For those companies, environmental progress may only become a priority when the investment community insists on such reporting as a prerequisite to raising capital and attracting long-term equity and debt investment.

One of the most positive steps governments can take, then, is to require disclosure of social and environmental performance, just as financial disclosure is required. Once the initial data-gathering systems are in place, such systems are not terribly costly to companies, and many of those who began environmental reporting skeptically, or even grudgingly, have discovered that they were dealing with far greater costs for cleanup and mitigation than they had ever suspected, and that they have been able to save money by reducing pollution. It is through such efforts that companies like Baxter and DuPont are able to report financial benefits from improving their environmental performance.
For governments, disclosure offers the ability to make progress in protection of citizens without the third rail of gridlock that other new regulation almost always touches. While we may not be able to pass a bill in Congress that would establish regulation of greenhouse gas emissions, we may be able to require disclosure of those emissions. It is at least, worth a good try.

In short, environmental progress need not be a financial ball-and-chain to corporations, particularly if it helps to distinguish those that are nimbler or more innovative from their peers. For DuPont, for instance, the drive to eliminate workplace accidents and become the safest company on earth has not only made the company the platinum standard for workplace safety, but also has spawned a business of safety that is worth $3.5 billion to the company today.8

Financial institutions have a compelling role to play in moving corporations to ever higher levels of environmental performance. The day will soon come when it is no longer “neutral” to determine how, and at what price, we link those with capital to those in need of capital, without consideration of corporate environmental performance.

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5 Baxter International Inc. page 39.
7 Sandeep A. Patel and George Dallas, Standard & Poor’s, Transparency and Disclosure: Overview of Methodology and Study Results—United States, October 16, 2002.