Measure Corporate Environmental Impact to align your Investments with your Values

Investors' interest in companies with environmentally friendly practices is growing, and research shows that returns from these firms are higher. Measuring a company's environmental practices is, though, still quite difficult. While development of better metrics is underway, investors can still figure out whether a company is doing well now by developing their own criteria and using the reporting that already exists.

More Demand for Measurements

Increasing concerns about climate change and a recognition that companies with superior ESG practices perform better is indeed leading to growing interest by investors in companies with sound environmental practices. Investors also want to measure those companies' environmental impacts. Consulting firm EY found, for example, that around 9 out of 10 investors say that nonfinancial performance played a pivotal role in their investment decision-making over the past12 months.

Despite that interest, actual metrics and reporting are limited. A key challenge is that there is currently no agreed-upon way of measuring a firm's "externalities" relating to their environmental impact, according to a team led by Oxford University professor Robert Eccles. As just one example of the challenges, a windmill replacing coal in China has a greater positive impact than a similar windmill in Norway, where energy mostly comes from hydropower.

Frameworks and Metrics are Being Developed

Despite such challenges, companies are progressing towards measuring their environmental impact and other organisations are setting up rating indices or assessment tools.

Nine out of 10 S&P 500 companies reported ESG metrics in 2019, investment management giant Blackrock found, up from two in 10 in 2011. The Sustainability Consortium similarly found that even through the pandemic, more than 1,700 manufacturers performed an assessment of their product and supply chain sustainability using its assessment tool.

On a broader global basis, the World Economic Forum (WEF) observed, genuine environmental impact measurement, valuation and reporting are rapidly maturing and are now performed routinely by a growing number of businesses. "Leading practice environmental impact reporting uses monetised estimates of impact that incorporate contextual information," the WEF said.

Harvard Business School professor George Serafeim told Barron's that he expects that corporations and investors will develop new ways to assess performance, using impact-weighted accounting methodologies that facilitate comparisons among sustainable strategies and make it easier to measure a portfolio's impact.

A variety of organisations are also stepping into the breach.

The Global Impact Investing Network (GIIN) developed *COMPASS*, for example, to build on its efforts to help impact investors integrate impact into decisions across their investment processes. And the Capitals Coalition developed a Natural Capital Protocol that offers a standardised framework for the identification, measurement and valuation of impacts and dependencies on natural capital.

What Investors Can Do Now

While these or other solutions will eventually help investors assess the environmental impact of a company, some are still under development and others are relatively untested. Moreover, there is no standardised set of metrics. Those gaps hinder investors who want information now so that they can make better investments decisions.

What investors can do, though, is to develop their own set of metrics and leverage them wherever possible. Examples from other organisations can help.

The World Economic Forum (WEF), for example, said the core metrics it suggests using to measure climate change include greenhouse gas (GHG) emissions, Task Force on Climate-related Financial Disclosures (TCFD) implementation, land use and ecological sensitivity, and water consumption and withdrawal in water-stressed areas.

Sustainability consultant James Tompkins wrote in *Industry Week* that his top sustainability indicators include:

- The percentage of recycled materials used by a firm.
- Energy saved due to conservation and efficiency improvements.
- The percentage of water recycled and reused.
- Total greenhouse gas emissions and ozone-depleting substances by weight.
- Total water discharged by quality and destination.
- Total weight of waste.

For energy companies, oil giant BP suggests carbon metrics such as the emissions from oil & gas production, financial metrics such as the share of capital expenditure invested in the low carbon and transition business, and governance metrics such as the skills of the board and executive committee to manage the energy transition.

It turns out that some companies have already started reporting at least some of these metrics, making it possible for investors to assess corporate performance.

Cisco said it reduced foam used in packaging by 11.5 percent last year, for instance, and it also provides some metrics for GHG emissions and plastic usage. Adidas, which has targets for energy, water, chemicals, wastewater and decarbonisation, reduced combined net emissions by 55 percent in 2020 compared to 2015 and had accumulated water savings amounting to 48 percent per employee in 2020 compared to 2008. And Starbucks reported an 11 percent reduction in carbon emissions, 4 percent water reduction and 12 percent reduction in waste in 2020 against its 2030 goals.

Investors Need to Work Hard

It can be difficult to measure companies’ environmental impact, and using customised tools can be expensive. And while Harvard’s Serafeim expects that impact-weighted financial reporting will be mainstream by 2030, that’s nearly a decade away.

What investors can do now, then, is to use insights from the lists of metrics that work and information available from companies to develop their own criteria to measure corporate performance. Investors who set up their own metrics and read company or other reports can then decide where to put their money so that they invest in companies that are environmentally friendly and striving to reduce their impact on climate change.