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Letters to the Editor

Who is Rating the Raters?

The growing interest in applying sustainability criteria to investment observed throughout the industrial world has resulted in the creation of numerous sustainability funds. The Dow Jones Sustainability Group Index (DJSGI), which is probably the best-known sustainability index, was presented by Ivo Knoepfel in Issue 8/1 of Corporate Environmental Strategy. In his article, the methodology underlying the DJSGI is said to have had a consistent framework. However, in a recent study we have highlighted some of the major elements upon which the DJSGI is based,[1] and have found evidence to suggest that there might be other factors, unrelated to sustainability, contributing to the apparently superior market performance of the DJSGI, and which may bring its framework consistency into question.[2] This response attempts to illuminate some of these factors.

How Consistent is the Framework?

The DJSGI was launched with much ado in 1999, amidst claims that its market-capitalisation growth outperforms more generalised indexes such as the Dow Jones Global Index (DJGI). Corporations, NGOs and government agencies often refer to the DJSGI to illustrate that integrating economic, environmental and social factors into company operations and management increases value to the shareholder. Our study investigated and compared the structure and transparency of the DJSGI with the DJGI. The results of our study show that the DJSGI focuses more on the technology sector than does the more general DJGI. The average market-capitalisation value of companies listed in the DJSGI was found to be two and a half times the corresponding average for those listed in the DJGI. This raises some legitimate questions. For example, does the superior performance of the DJSGI reflect the greater efforts DJSGI-listed companies are actually putting into sustainability, or is it merely a reflection of asymmetric distributions across company sectors, global regions and/or market capitalisation? Investigation reveals that a considerable portion of the superior economic performance of the DJSGI is attributable to a higher mean market-capitalisation value and an asymmetric distribution across industry sectors.

The historical performance of the DJSGI has been analysed through ''backcasting'' a selection of companies listed in the DJSGI in 1998. The performance of the ''sustainable'' companies selected was tracked from 1998 back to 1993. An inherent risk with this type of selection is that it includes only those companies that survived through to the end of the investigation period and excludes

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those that did not. This in turn impacts on the performance of the index and draws into question the overall consistency of the framework.

Sustainability — Criteria and Assessment

Understanding the criteria and assessment of a sustainability index are essential for its correct interpretation. What are the underlying issues regarded as vital to sustainability, and how are companies assessed accordingly? Companies being assessed can experience difficulty in extracting quantifiable data, which can often result in their drafting external communications of a glossy and wordy nature. Problems arise when this sort of information is used by investors and raters attempting to accurately evaluate the efforts that these companies are actually putting into sustainability. Many indexes are, therefore, rating qualitative information provided by the companies, which can lead to an assessment-credibility problem. This is particularly relevant to the DJSGI, as the first three of the following four sources of information used in the assessment if the DJSGI are provided by the companies themselves: (1) questionnaires; (2) submitted documentation; (3) policies and reports; and (4) public information — where available.

Categorising companies into business groups or sectors is one way to stimulate companies within environmentally harmful sectors to work towards improving sustainability. At the same time, categorising companies by ''the best in the industry'' approach can obscure the forces acting in a dynamic economy shifting investment toward the most efficient players and inadvertently protecting polluting or resource-inefficient enterprises that will never achieve sustainability. An investor in a sustainability fund might well be more concerned with these issues than in protecting established, ageing industry structures.

Perhaps due to its over-dependence on information provide by companies about their own activities and ''the best in the industry'' approach, the DJSGI includes some companies with questionable sustainability, such as Suncor[3] and Nike. For companies manufacturing energy-consuming products (such as motor vehicles), the emissions released during use often correspond to a large portion of the entire product life-cycle emissions (for example 90% for CO_2 emissions). This calls for a scope that covers companies' area of impact and possibilities to make a change. With this in mind, it is somewhat surprising that the car manufacturer BMW is the leading ''sustainability'' company within its industry group, yet it produces cars with high fuel consumption and performance, capable of and perhaps encouraging excessive speeds in comparison with others. One reason for BMW's inclusion is the existence of its innovative prototype hydrogen-powered car (other manufactures are making similar attempts), attracting publicity since 1995. When it will actually be released en masse and make a real environmental impact remains to be seen.

Concluding Remarks

It is pretty safe to say that no rating system is perfect, and that continuous discussion amongst stakeholders ought to be encouraged for the ongoing development of system frameworks. Despite the imperfections alluded to above, we believe that the DJSGI has importantly drawn a lot of attention to sustainability issues through linking them to financial performance. However, we are only at the beginning of the process and more work needs to be done in the area of formulating sustainability criteria for investment, and illuminating their structure. We need to critically highlight these instruments and thereby facilitate their improvement.

Endnotes

1. For more information about ongoing research in the area of corporate environmental management and communications at the Royal Institute of Technology, Stockholm, please contact the authors.
2. Pontus Cerin and Peter Dobers, ''What does the performance of the Dow Jones Sustaina-

bility Group Index tell us?'' Eco-Management and Auditing, Vol. 8, 2001, in press.
3. Peter Fries and Anne Feldhusen, ''So Far, So Good'', Tomorrow: Global Sustainable Business, Vol. XI, No. 2, March–April, 2001, pp.56–60.

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Environmental Accounting: A Pro-Active Role

Li's paper: ''Encouraging environmental accounting worldwide: a survey of government policies and instruments''[1] raises some important issues concerning both the potential role of environmental accounting to support companies in their environmental management, and the potential role of governments in encouraging this.

The most visible and widely-recognised form of ''environmental accounting'' is probably still in external reporting by companies and other organisations on their environmental performance, with increasing numbers of companies choosing over the past decade to do this, reflecting an extended view of corporate accountability to a broad range of stakeholders. The main channel of communication for this has usually been in the form of stand-alone annual reports modelled more or less closely on the financial Annual Report. This process has been valuable in raising the prominence of environmental performance as a business issue, evidenced by the high interest shown in projects such as the Global Reporting Initiative, which aim to improve and standardise practice.

However a greater potential to stimulate improvements in performance may be through the subject matter of this paper, the use of environmental accounting to support management (''environmental management accounting''). This depends on two premises. Firstly, that good environmental performance will become increasingly important to industry as a determinant of its success as measured in conventional financial terms. This depends to a large extent on the vigour and effectiveness with which governments pursue environmental objectives in setting public policy, whether by traditional command-and-control or more sophisticated incentive-based instruments. Secondly, that the use of accounting and financial techniques can be part of the armoury of methods with which companies can respond to this environmental challenge.

Much of the interest in environmental management accounting to date has been to identify those costs which are in some way environment-related, on the premise (well-founded, as the paper indicates) that these are frequently more substantial than generally recognised, often because of deficiencies in conventional accounting systems and practices. The question of defining and measuring an ''environmental cost'' is problematic, and some would argue ultimately unhelpful. Outlays on negative costs such as fines, penalties, remediation and compensation claims are clearly environment-related and easily identifiable, but in themselves are no more than symptoms that past performance has been poor and that the company is now paying the price. More difficult is to attempt to distinguish clearly between the environmental and non-environmental elements of, for example, the total cost of investment in a cleaner production technology, or in the redesign of a product to minimise its total environmental impacts over its life. In these situations, provided the company's management accounting systems are adequate to recognise and analyse all the relevant aspects of the proposal, the change may be justifiable in the conventional business terms of reducing costs and improving profits and