

**Dialogues with the European investment community on the challenges of mainstreaming Environmental, Social and Governance (ESG) issues in investment decisions**

*Summary of findings from focus group discussions in:  
Rome, Frankfurt, Paris Stockholm, and Utrecht*

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This working paper is part of the 'Corporate Responsibility, market valuation and measuring the financial and non-financial performance of the firm' research project. This is a joint project between Cranfield School of Management, SDA Bocconi and Vlerick Leuven Gent Business Schools, on behalf of the European Academy for Business in Society (EABIS). The research project is supported by the founding corporate partners of EABIS: IBM, Johnson and Johnson, Microsoft, Shell and Unilever; and by Lloyds Banking Group and Telecom Italia.

The research team is co-ordinated by Prof David Grayson and includes Dr Kenneth Amaeshi, Hager Jemel, Prof Celine Louche, Prof Francesco Perrini and Prof Antonio Tencati. Additional authors for individual working papers are recognised on each working paper. The final report of the research team will be published in September 2009."



**EABIS**  
European Academy  
of Business in Society



**Microsoft**

*Johnson & Johnson*



**Lloyds TSB**



#### WORKING PAPERS:

- Non-financial performance metrics for corporate responsibility reporting revisited - Malcolm Arnold (2008)
- The Challenges of mainstreaming Environmental, Social and Governance (ESG) issues in Investment Decisions A survey of practitioners' reports Kenneth Amaeshi, David Grayson (2009)
- Going beyond a long-lasting debate: What is behind the relationship between corporate social and financial performance? Francesco Perrini, Angeloantonio Russo, Antonio Tencati, Clodia Vurro (2009)
- The integration of ESG information into investment processes: Toward an emerging collective belief? David Bourghelle, Hager Jemel, Céline Louche (2009)
- Dialogues with the European investment community on the challenges of mainstreaming Environmental, Social and Governance (ESG) issues in investment decisions: Summary of findings from focus group discussions in: Rome, Frankfurt, Paris Stockholm, and Utrecht – Kenneth Amaeshi (2009)

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[A contribution to the Valuing Business Project]

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## Executive Summary

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*As part of the Valuing Business Research project, five focus group discussions were held with the European Investment Community between September 2008 and January 2009 in Rome, Frankfurt, Paris Stockholm, and Utrecht, to tease out some of the challenges standing in the way of mainstreaming Environmental, Social and Governance (ESG) issues in investment decisions. These focus group discussions were held under the Chatham House Rule to encourage open and free sharing of information. The focus group sessions were facilitated and observed by members of the Valuing Business Research project. This document is an analysis of the reports that came from the various focus group discussions.*

*The main points arising from the different sessions are:*

- 1. ESG issues are evolving in complexity*
- 2. Investors are not a homogenous group*
- 3. ESG selection variance across actors, regions and countries*
- 4. Limitations of models and ESG objective priority management*
- 5. Misaligned Reward System and Strategy*
- 6. Unconsolidated and disparate ESG research initiatives*
- 7. Ineffective Firm-Analyst engagement and discourse*
- 8. Credibility Gap of Rating Agency outputs*
- 9. ESG Materiality is interdependent*

## **Background**

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Why are Environmental, Social and Governance (ESG) issues not frequently represented in mainstream investment decisions? There is a growing awareness that investment decisions and the financial markets do not appropriately value ESG issues, despite the fact that these issues could be fundamental to understanding the performance of firms. In order to understand why ESG issues are not easily mainstreamed, this study engaged with practitioners – investors, investment consultants, fund managers, accounting firms and other market actors – in Europe through focus group discussions. These focus group discussions were held in Rome, Frankfurt, Paris, Stockholm and Utrecht, to give a good coverage of the Continent, between September 2008 and January 2009. The lists of participants at each of the focus group sessions are presented in the appendix section of this document.

This study is part of a broader research agenda on Valuing Business – a research project coordinated by The Doughty Centre for Corporate Responsibility at Cranfield University, United Kingdom, on behalf of the European Academy of Business in Society (EABIS) and the European CSR Alliance. The Valuing Business project focuses mainly on non-financial – or extra-financial – performance measures that influence investment decisions. A key concern of this research project, therefore, is to understand if the link between environmental, social and governance issues and long-term business performance is understood and used. For details, please visit: <http://www.investorvalue.org/>

## **Approach/ Process/ Analysis**

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The focus group discussions were facilitated by a group of experts drawn from the academia and industry. Given the sensitivity around ESG issues – especially with regards to competitive, regulatory and civil society pressures – these discussions were conducted in a ‘safe’ environment to encourage honest conversations – i.e. openness and sharing of information. The focus group discussion sessions were governed by the

## *Dialogues on the challenges of mainstreaming ESG issues in investment decisions*

Chatham House rule<sup>1</sup> and as such, were not recorded – but notes were taken by the experts from academia and industry who observed the different sessions.

### *Focus Group Session Observers*

<b>Focus Group Sessions</b>	<b>Academics</b>	<b>Institutional Affiliations</b>	<b>Business</b>	<b>Affiliation</b>
Rome	Antonio Tencati  Francesco Perrini	SDA Bocconi School of Management	Paolo Nazzaro	Telecom Italia
Frankfurt	Antonio Tencati	SDA Bocconi School of Management	Paolo Nazzaro	Telecom Italia
Paris	Hager Jemel	Lille	Jan Noterdame	CSR Europe
Stockholm	Celine Louche	Vlerick Leuven Gent Management School	Paolo Nazzaro	Telecom Italia
Utrecht	David Grayson  Celine Louche	Cranfield School of Management  Vlerick Leuven Gent Management School	John Swannick	Lloyds Banking Group

The notes generated from the focus group sessions were then qualitatively analysed by Nvivo – a qualitative research analysis software. Presented below are the findings from this analysis.

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<sup>1</sup> The Chatham House Rule reads as follows:

**"When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed".**

The world-famous Chatham House Rule may be invoked at meetings to encourage openness and the sharing of information.

<http://www.chathamhouse.org.uk/about/chathamhouserule/> visited March 26, 2009

## **Summary of the main findings**

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The main points of the focus group discussions could thus be summarised:

### **1. ESG issues are evolving in complexity**

It was thought that ESG issues were increasing with complexities that were difficult to track in investment decisions. The market does not like complexities and as such tends to shy away from them. A buy-side analyst in the Utrecht focus group session highlighted the challenges associated with the changing nature of the CR agenda:

Also that field is evolving: "look at the speed with which some environmental issues are becoming mainstream and mature." (Utrecht Focus Group Discussion)

These complexities could lead to the contestations of ESG issues within and across professional groups in firms and the general public. For instance, a company representative at the Stockholm focus group session noted that:

People in companies have different views about their own CSR performance. For us, SRI analysts help us to legitimise our own activity inside the company. CSR manager and SRI analysts kind of [sic] team up against the rest of the managers. (Stockholm Focus Group Discussion)

### **2. Investors are not a homogenous group**

There can be a tendency to talk of investors as if they were a homogenous group. This tendency appears to stand in the way of mainstreaming ESG issues in investment decisions. A participant in the Utrecht focus group session drew attention to the fact that: "We should be careful here to recognise that investors are not an [sic] homogenous group. They are different and have different needs and therefore require different approaches".

Investors could also be differentiated in terms of their analytical inclinations – e.g. either quantitative or qualitative oriented – as well as their professional identities. These analytical inclinations and differences in professional identities are themselves enough sources of contestation. For instance, one of the focus group sessions explored the example of Unilever, which has conducted global employee satisfaction surveys. The company found that they could link strength of motivation to strength of performance in individual operating units. They further found three main drivers of motivation: (1) perceived quality of leadership; (2) cluster of issues about how the individual employee felt about out job: relations with peers, superiors, and support given; and (3) responsible business behaviour by employees. The immediate reaction to the case from a participant, in relation to the quantitative vs. qualitative orientation divide, was:

“...quantitative investor / analyst[s] would say that [they] can’t use Unilever data because [they] could not compare cross-sector – whereas [with] qualitative-based [data] one would treat [it] as interesting insight into [the] quality of management”. (Utrecht Focus Group Discussion)

### **3. ESG selection variance across actors, regions and countries**

One of the vexing concerns around ESG issues is the quality of the data produced and the context of its production. This quality is reflected in many different ways – including their quantification, comparability and consistency across actors, regions and countries. This latter point was highlighted in the Paris Focus Group Report:

It has often been highlighted that, depending upon the sector, the maturity of the company, its size and its context (locality, events, regulation, environment) the stakes linked to ESG dimensions can be very different. For example, environmental considerations would be very secondary for banks but of high importance for manufacturing industry. However, not all manufacturing industries are exposed to the same environmental problems and responsibility in this field can present themselves in differing ways with different types of technology and levels of investment. The same for those who have to formulate CR policy – they vary according to the company, its sector, time etc. (Paris Focus Group Report)

#### **4. Limitations of models and ESG objective priority management**

This in a way is linked to the quantification challenges. The issue here is that even some of the attempts made to quantify or measure the materiality of ESG issues appear to oversimplify the issues and at best appear to exhibit poor understanding of the measurement challenges involved in such tasks. In this regard, one of the focus group participants, with particular reference to the model developed by the lab, said:

For some, the model worked on by the Lab appears interesting from a pedagogical point of view but all insisted that this should only be seen as one possible vision and in no way should it claim to be universal or complete. The links between the various elements are sometimes debatable. .... an ESG analyst ... has reservations about models of this type which seem to him/her to be very questionable and simplistic in the face of a complex reality. (Focus Group, Paris)

Another focus group participant, but in this instance referring to the broader metrics community, said:

There is a lack of general measurement strategy. Measurement is a problem as we don't know exactly what we are measuring and we don't know what company the company wants to communicate. What's needed going forward? Not more work on metrics, but how to integrate financial and non-financial performance data. (Stockholm Focus Group Discussion)

But there is a possible wrong assumption underlying the view that a business case means a good investment case. Both possible sources of wrong assumptions are highlighted in the comments below from the Utrecht focus group session:

“Not only a problem of company but also about the assumption on how investors will use the information: ‘We should be able to use ESG information like financial information’, while it is not true” (Utrecht Focus Group Discussion)

“Another problem is that the business case is different from the investment case. A good business case does not necessarily means a good investment case” (Utrecht Focus Group Discussion)

This oversimplification is also reflected in the communication artefact used and the research questions being asked. Commenting on this a focus group participant said: “There are often problems with questionnaires sent out to companies: Often the questions are difficult to understand; and the questions are not always appropriate to the company’s sector” (Paris Focus Group Discussion). Even where this is not the case, it was noted that ESG issues normally are the least prioritised within the investment analyst’s decision making process. A participant at Utrecht focus group discussion aptly captured this challenge in this statement: “ESG is perhaps at the end of the analyst’s process when I push back my chair and ask myself what all the data tells me about this company”.

It was noted that one way to overcome this challenge was through a more comprehensive ESG analytical skills programme:

It is accepted that ESG can create financial value. But the demand needs to come from the clients/investors. Today the demand is still limited. Next to that there is a need to provide education on the fact that ESG creates value. ....Investors need to prove that they take ESG into account and that ESG factors have in impact on value creation. (Focus Group Report, Stockholm)

## **5. Misaligned Reward System and Strategy**

The misalignment between a company's employee reward systems and ESG issues is one of the barriers towards mainstreaming ESG issues. However, in recognition of this challenge, it was mentioned that:

"Some companies have put in place programmes which encourage their staff to take CR into account. Most of the time this consists of motivation based on percentage of salary (bonus, profit-share). For example, getting part of the bonus could be linked to achieving CR objectives set by the sustainable development management" (Paris Focus Group Discussion)

Another possible solution mentioned was the need to contextualise and integrate ESG issues into corporate strategy. That way, it is easier to align corporate performance measures to ESG issues.

"Contextualisation is very important. We need a framework to make sense of the information provided. Investors are in a different world than the CSR report. Their language is different –just compare the opening letter of the CEO in the annual report with the one in the CSR report, you will get two different views on the same company. More over CSR is never put in the context of the strategy of the company." (Utrecht Focus Group Discussion)

"Nearly all of the G250 companies used the Global Reporting Initiative's Sustainability Reporting Guidelines to compile their CR disclosures." (KPMG) Yet GRI believes that weakest part of companies' adherence to GRI Guidelines is explaining sustainability in terms of business strategy. (Utrecht Focus Group Report)

In this regard, it was suggested that: "One of the most valuable outcomes from Lab and research might be by showing how some companies are making the link between the various non-financial performance drivers and financial performance drivers, this might encourage more companies to improve the connection of sustainability strategy and overall strategy" (Focus Group Report, Utrecht).

## **6. Unconsolidated and disparate ESG research initiatives**

There appears to be a growing sense of fatigue with ESG initiatives and this point mainly came through the focus group reports.

Mention was made of the multiplication of research projects on this subject, especially in France, and the benefits of bringing the different teams together and having the researchers work on a common project (an interesting but utopian idea) (Paris Focus Group Report)

There are many different initiatives in this broad space of CR/ESG, reporting and investors – as the initial scoping of the meta-analysis of recent reports demonstrates. Some warnings in focus group about initiatives fatigue and dissipation of efforts through too many fragmented initiatives. How to get more cohesion and reinforcement between these often similar initiatives? For example, Holland Financial Centre (public-private partnership to promote Holland as a financial centre): one of its priorities is Sustainability and Finance (although defining sustainability only in environmental terms – and specifically on availability of finance for clean technologies). (Utrecht Focus Group Report)

## **7. Ineffective Firm-Analyst engagement and discourse**

It was mentioned that one of the challenges in the way of mainstreaming ESG issues in investment decisions is the ineffective engagement and dialogue culture between firms and financial analysts. As evidence of poor engagement and dialogue practice, a focus group report uncovered that:

The delegates didn't have a clear idea of what investors did with the ESG information they were given. Some knew it was definitely important to SRI investors. The majority of them knew the percentage of capital detained by SRI funds. On the other hand, they weren't sure that mainstream investors really made use of this information. That was in the main explained by the distance between financiers and those responsible for CR. The majority stressed that in their own company the finance department and the investor relations department had no idea what the CR and sustainable development departments did. (Paris Focus Group, Report)

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In a somewhat rhetorical fashion, this is also in line with the point on ineffective engagement and dialogue culture between the investment community and firms. One of the focus group delegates asked:

Do leaders of companies committed to CR ever talk to their own company's Pension Fund trustees about incorporating CR /ESG into their mandates to their Pension Fund Managers? Is this a lever to pull? GRI work two years ago with some GRI-using companies. Typical reaction from companies was either that they were not allowed to talk to their Pension Fund trustees or that the responsibility for Pension Funds was outsourced. Topic was, therefore, put in a "too difficult" category. (Utrecht Focus Group Discussion)

To further underpin this point:

"The importance of ESG to understand a business has increased. It is also important to be able to communicate about ESG. But there is still a gap or a frustration between investors and companies on communicating these issues." (Utrecht Focus Group Discussion)

"It is not a problem of measurement or coming out with indicators. Fundamentally, the questions are 1) how the information is communicated and presented and 2) how is the information received and understood. (Utrecht Focus Group Discussion)

... there is a strong focus on scientific evidence related to ESG matters. As if investors want scientific evidence. If we would have waited for scientific evidences we would never have had bubbles, crises, etc. Investors are smart at showing they are scientists. But actually they go by stories, what is hot. Next, if there is scientific evidence, how do you bring the information to the managers? Investors don't need scientific evidence, they need the stories. (Utrecht Focus Group Discussion)

## **8. Credibility Gap of Rating Agency outputs.**

The focus groups have identified an apparent lack of complete trust in the analytical outputs of rating agencies, relating to the methodologies employed and the competency to provide a comprehensive analysis.:

The companies represented all expressed a disappointment in and lack of confidence with the social rating agencies .... Several examples and explanations were put forward:

1. Most of the time the rankings were based on a questionnaire completed by the company. Might it not be better to use other sources of information and certainly sensible to do a more in-depth audit including face-to-face meetings with senior people in the company. Written communication alone prevents proper interaction between the analyst and the company.
2. The analysts who work for the agencies are not always competent:
  - They are often quite junior people who don't know a lot about the world of business and have limited experience as analysts.
  - There is a high rate of staff turnover in the agencies because their limited resources don't allow them to establish loyalty with their employees or to improve their knowledge.
  - They have to study a large number of companies so don't have the time to do their work properly (on average 2 or 3 days for a company).
  - ESG analysts are not always specialists in that sector (as is the case with financial analysts).

Consequently companies have trouble getting their staff to respond to questionnaires sent by agencies and the time spent doing so is seen as time wasted (Focus Group, Paris)

As indicated, this aspect is not necessarily an inherent issue for the ESG analytical approaches, and is perhaps more of a systemic issue of external company assessment, i.e. includes financial and potential risk assessments organisations generally.

## **9. ESG Materiality is interdependent**

All the previous ESG factors and thematic issue should not be observed as discrete un-connected aspects. Instead it should be assumed that a number of the issues identified are taking place simultaneously which describes the added complexity and ambiguity surrounding the ESG performance issue. They are often combined in different permutations so as to impact on the relevance and reliability of ESG issues in the investment decisions of different investor organisations. This perspective was re-enforced by a well-informed participant at the Utrecht focus group session:

Lab interim report: report implies that difference between book and market values is ESG – “most investors would not agree...would lose part of audience...you don’t need that link for the argument so skip it....does ESG drive financial performance or does financial performance drive ESG? Causality issue....missing element in model: how financial performance is priced and putting a price on risk perceived going forward viz. company may have good financial performance but if it is perceived to be a high risk going forward, the valuation will be affected – and plenty of ESG factors affect risk.” (ex-equity analyst-Holland: Utrecht Focus Group).

## **Conclusion**

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Despite the barriers highlighted above, participants at the different focus group sessions were optimistic that the ESG issues would be mainstreamed in investment decisions in the near future. This view is aptly and eloquently stated by a participant at the Stockholm focus group session:

“SRI and mainstream will merge in the future. There is a clear need to work together, learn from each other, [and] integrate it in the investment models and in KPIs”. (Stockholm Focus Group Discussion)

It is important to reiterate that the views contained in this document are mainly from the Continental European Investment Community; and it is recognised that these views might be different in other economic regions.

## **Appendix – Lists of Focus Group Participants**

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### **Rome / Milan**

INTESA S.PAOLO  
KPMG  
PWC  
ENI  
ENI  
AIAF – EFFAS  
Legambiente  
ETICA SGR  
WWF  
TITAN CAPITAL  
VIGEO Italia  
Confindustria SIT  
ENI  
BANCA AKROS  
LUCCIOLA & Partners  
MPS  
Telecom Italia SpA  
ITALIA LAVORO SpA  
PWC

### **Frankfurt**

#### **Company**

Allianz Global Investors KAG  
Bankhaus Lampe  
BASF SE  
DVFA GmbH  
DWS Investment Gesellschaft mbH  
Ernst & Young AG  
European Commission  
Hewlett-Packard GmbH  
PricewaterhouseCoopers AG  
SAP AG  
SDA Bocconi / Bocconi University  
Telecom Italia SpA  
Universität Hamburg, Dep. Wirtschaft und Sozialwissenschaften

### **Paris**

#### **Company**

Air France  
Axa  
Caisse d'épargne  
CSR Europe  
Fortis  
L'ORSE

**Company**

La Banque Postale  
La Française des Jeux  
Le Crédit Coopératif  
Le Medef  
Lille, France  
Société Générale  
Thalès  
Vivendi

**Stockholm**

**Company**

Åhlénsgruppen  
Amnesty  
Aviva Investors  
Axfood  
Boliden  
Center for Samfundsansvar, Danmark  
CSR Europe  
Ethix SRI  
KPA Pension  
Nordea  
SEB  
Sveaskog  
Svenska Spel  
Telecom Italia  
Vattenfall  
Vlerick Leuven Gent Management School

**Utrecht**

**Company/Organization**

21C  
ABN AMRO  
APG Investments  
ASN Bank  
Canon Europe  
Chairman of the UNGC Netherlands  
Cranfield University  
CSR Europe  
Epson Europe  
GRI  
Holland Financial Centre  
ING  
Kempen Capital Management  
Lloyds TSB  
Ministry of Economic Affairs, Netherlands

**Company/Organization**

PWC

SNS REAAL

State Street

Vlerick Leuven Gent Management School

VNO-NCW