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Sustainability Ratings: Time for a Common Framework

Breakout Session Summary

Thursday, November 4, 2010 | 10:15-11:15 a.m.

Speakers

- **Steven Lydenberg,** Chief Investment Officer, Domini Social Investments
- **Marcela Manubens**, Senior Vice President, Global Human Rights and Social Responsibility Program, Phillips-Van Heusen Corporation
- **Michael Marx,** Executive Director, Corporate Ethics International
- **Allen White**, Vice President and Senior Fellow, Tellus Institute (moderator)

Highlights

- Sustainability ratings need fewer indicators even if those indicators are both qualitative and quantitative. At the end of the day, a few specific qualitative indicators can be of greater value than a raft of quantitative indicators.
- A lack of transparency of how indicators are measured prevents companies from taking steps to react to their scores and improve their sustainability practices.
- Thought leaders, corporations, NGOs, investment firms, and rating companies must combine efforts to determine a coherent and relevant set of indicators that can be globally adopted.

Memorable Quotes

"We have to say that the field of rating is dynamic; it's fluid, it's controversial, and in its best form, it could be extremely valuable in driving the sustainability agenda." —Allen White, Tellus Institute

"The drive to score pressures agencies to focus on areas where scoring is easy to do and easy to measure. What we give up are areas where measuring is hard, but the issues are important." —Steven Lydenberg, Domini Social Investments

"Ratings are not sufficiently performance based. There needs to be bottom line performance measurements from sustainable sourcing to processing to the final product." —Michael Marx, Corporate Ethics International

Overview

Recently, corporate sustainability ratings have gone through a period of both expansion and consolidation. The number of indicators and areas of focus have expanded to encompass social, environmental, and financial processes, among others. At the same time, a series of consolidations among ratings agencies have occurred. During this period of expansion and consolidation, it is imperative that the framework for sustainability ratings works to enhance and elevate sustainable business practices rather than confuse and discourage them.

During the session, panelists were asked a series of four questions. The first question was on the purpose of ratings. Manubens responded that ratings hold corporations accountable and help them identify best practices and specific areas for improvement. Lydenberg believes that ratings allow investors to assess the relative performance of corporations vis-à-vis their peers and to give stakeholders the tools to first distinguish among companies and then reward those that are acting responsibly. Lydenberg also emphasized that rating systems promote dialogue and discussions among corporations, NGOs, and regulators on sustainability as well as encourage innovation. Marx supported Lydenberg's points emphasizing the educational purpose of rating systems. It is imperative that corporations recognize the path toward sustainability. Marx also pointed to the fact that rating systems play into the inherent competitive nature of companies, enabling them to compete not only for shareholders but also overall sustainability improvement.

The panelists next addressed the primary deficiencies in the sustainability ratings field. Manubens discussed the lack of coherence and transparency among ratings systems. Without an understanding of the specific metrics that were used to measure an indicator, companies cannot improve. Furthermore, there is a need for a coherent definition of sustainability and agreement on the weight each factor of sustainability should hold. Lydenberg addressed the tendency to have too many indicators and to rely too heavily on scores. Too many indicators are difficult to manage and are confusing for companies. Rather, ratings should focus on 10 specific issues that are most relevant to the company and to their sustainability approaches.

Lydenberg also discussed how scoring provides a false sense of precision. Rather than promoting innovation, scores can discourage companies from thinking outside of the box. Frequently, the drive to score pressures agencies to focus on indicators that are easy to measure rather than indicators that are the most telling of a company's sustainability performance. Marx added to the discussion by focusing on how ratings are not sufficiently performance based. There is a lack of total performance measurements that take into account sourcing, processing, and the final product.

Finally, panelists identified the next steps necessary to correct some of the deficiencies in sustainability ratings. Manubens recommended that ratings agencies promote transparency by giving higher scores to companies that identify their own sustainability challenges and indicate ways that they are trying to overcome them. Companies should not be penalized for not yet having all of the solutions. Lydenberg added three additional steps for a next-generation rating systems: ratings systems must reduce the number of indicators, include innovation as an indicator, and attempt to evaluate a corporation's culture and values when possible. As a catalyst for achieving the above goals, Marx encouraged corporations, thought leaders, NGOs, investment firms, and rating companies to join together to determine the most relevant indicators and then pilot the indicators before companies adopt them globally.

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