

## Word from the Street: Toxicity and Health

Issues of toxicity and health have become areas of concern for the financial community, leading to more engagement between investors and companies on toxic chemicals in products. Science, media attention, regulatory changes and environmentally preferable purchasing are just some factors that have contributed to this change. While scientific studies continue to uncover potential health risks in certain consumer goods, public concern is growing as a result of recent media attention to toxic toys, toothpaste and pet food. Overall, investors are concerned that companies face litigation, reputation damage and market exclusion (“toxic lockouts”), all to the detriment of long-term shareholder value.

This brief includes a framework companies can use to evaluate their level of risk exposure to issues surrounding toxicity and health in order to respond to the growing community of institutional investors, investment advisers and investors who have incorporated environmental, social and governance (ESG) criteria into their investment decision-making.

### Risk and Benefits

There are numerous examples of diminished shareholder value when companies fail to appropriately account for toxicity and health criteria. RC2’s experience with recalls of its lead-tainted “Thomas & Friends” toys is a very public example of how quickly these issues can impact a company’s financial health. RC2’s stock price was trading at above \$40 in June 2007 before dropping to below \$30 by August 2007 following recalls of its toy trains. By February 2008, when RC2 announced its full-year financial results, recall costs totaled \$17.6 million, the stock traded below \$20 per share, and RC2 earned 2 cents a share from continuing operations, compared with 44 cents a share a year earlier.

The table below summarizes the broad risks and benefits that can impact corporate financial well-being by failing to take into consideration toxicity and health factors in business risk assessments.

| Risks  | Benefits <sup>i</sup>  |
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| <p><b>Litigation:</b> By the end of 2002 U.S. companies paid \$70 billion in response to 730,000 personal injury claims for asbestos exposure, and at least 73 companies were driven into bankruptcy by mid-2004.<sup>ii</sup></p>   | <p><b>Cost Savings:</b> Reduced insurance costs; cost savings from waste reductions and energy efficiencies associated with process changes; easier financing/reduced cost of capital.</p> |
| <p><b>Reputation:</b> Lead paint on toys eroded consumer confidence and trust in Mattel and other toy companies facing recalls.</p>  | <p><b>Reputation:</b> Enhanced consumer confidence and trust; avoidance of adverse publicity, consumer boycotts and abandonment of products over fears of toxicity.</p>                    |
| <p><b>Toxic Lockout:</b> In 2001, Netherlands authorities banned the sale of Sony PlayStation consoles because the cadmium in accessory cables exceeded regulatory limits. Sony’s lost sales and costs to rework its product totaled about \$150 million.<sup>iii</sup></p>  | <p><b>Human Resources:</b> Improved worker safety; increased corporate productivity associated with lower occupational risks and reduced employee turnover; lower recruitment costs.</p>   |
| <p><b>Regulation and Compliance:</b> For many industries, regional and local regulations and business procurement specifications are often more stringent than federal standards, so businesses should be aware of the toxicity of their products and any relevant regional requirements in order to stay competitive.</p> | <p><b>Regulation and Litigation:</b> Reduced regulatory hurdles and expedient time to market; less vulnerability to toxic torts litigation.</p>  |

Source: see References

For many sectors such as personal care products, multi-line retail, healthcare equipment and supplies, and household durables, corporate management of toxic hazards is an indicator of overall management quality. It can affect a company's core revenue stream and capacity to increase market share, and has implications for corporate reputation and brand trust. Investment professionals are asking new questions as part of their general risk assessments to determine differences among firms operating within the same sectors.

## Business Risk From a Toxicity and Health Perspective

Although toxicity and health factors are not per se a primary area of consideration when making investment decisions, they are increasingly becoming integrated into ESG evaluation criteria. Increasingly, companies are under pressure to redefine their approach to product stewardship.

Various frameworks have been created for financial institutions to bring evaluation of toxicity and health concerns into the mainstream assessment process. The list below consolidates the major evaluation criteria from four frameworks<sup>iv</sup> and can be used to evaluate business risks from a toxicity and health perspective.

### Corporate Commitment

- CEO-issued statement about the company's commitment to lowering product toxicity through elimination of known or suspected high-priority toxicants and substitution of safer chemicals or non-chemical methods
- Reductions in product toxicity as an explicit factor in employee compensation

### Strategy and Responsibility

- Senior management level processes to identify business risks posed by chemical safety and sustainability concerns
- Identification and tracking of chemicals in the supply chain and final products
- Active application of product stewardship principles to new and existing chemical products
- Risk or hazard assessments conducted on all chemical products
- Phase-out and/or substitution of chemicals of concern where feasible
- Avoidance of chemicals of concern in the development of new products where possible
- Business-to-business partnerships with downstream users to develop "green" alternatives or substitutes

### Research and Development

- R&D linked to "green" chemicals innovation
- Use of lifecycle analysis in the design and development of chemical products

### Reporting and Dialogue

- Public reporting of chemicals of concern that are produced and/or used
- Disclosure of risks posed by chemical safety and sustainability concerns in Annual Report and Accounts
- Stakeholder engagement and dialogue on the management of chemicals
- Systems to communicate chemical product risks along the product value chain

### Internal Capacity Building

- Information, training and incentives to help identify, research and implement safer alternatives

Institutional Shareholder Services (ISS)<sup>v</sup>, the largest proxy advisory service in the United States, has updated its proxy voting guidelines, potentially broadening its support for shareholder resolutions that request corporate reviews regarding toxic chemicals. In the 2006-2007 proxy season, ISS recommended votes in favor of resolutions at DuPont, Bed Bath & Beyond and Hasbro. These resolutions received the highest votes among all toxic chemical resolutions introduced by shareholders that went to a vote: 45 percent at Hasbro, and 22 percent at DuPont and Bed Bath & Beyond.<sup>vi</sup> Additionally, companies such as TIAA-CREF and Domini Social Investments reference either “Product Responsibility” or “Toxic Chemicals” as part of their Proxy Voting Guidelines.

As the risks to profits and market share associated with toxicity and health concerns become quantifiable, financial institutions will increasingly include these criteria in their mainstream analysis. Proactive companies have an opportunity to make strategic choices about how they will manage toxic chemicals and maintain their competitiveness in an increasingly transparent global marketplace.

For more information on BSR’s work with companies, NGOs and investment advisors on the emerging guidelines for toxicity and health-related risks, please contact BSR’s Environmental Research & Development Manager, Linda Hwang at [lhwang@bsr.org](mailto:lhwang@bsr.org) or +1-415-984-3278.

## References

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<sup>i</sup> Liroff, Richard. 2005. “Benchmarking Corporate Management of Safer Chemicals in Consumer Products.” *Corporate Environmental Strategy*. 12(1). Available at [http://iehn.org/documents/CESBenchmarkingarticle\\_000.pdf](http://iehn.org/documents/CESBenchmarkingarticle_000.pdf).

<sup>ii</sup> RAND Corporation. 2005. “RAND Study Finds More Than 730,000 People Have Filed Asbestos Injury Claims in the U.S., Costing Defendants More Than \$70 Billion.” May 10, 2005 press release. Available at <http://rand.org/news/press.05/05.10.html>.

<sup>iii</sup> GEMI. 2004. “Forging New Links: Enhancing Supply Chain Value Through Environmental Excellence.” Available at <http://www.gemi.org/supplychain/resources/ForgingNewLinks.pdf>.

<sup>iv</sup> The 4 frameworks are: EIRIS. 2006. “Beyond REACH – Chemical Safety and Sustainability Concerns.” Available at <http://www.eiris.org/files/research%20publications/seeriskbeyondreach.pdf>; IEHN. 2007. “Fiduciary Guide to Toxic Chemical Risk,” Appendix 1. Available at <http://www.rosefdn.org/toxicrisk.pdf>; Richard Liroff. “Benchmarking Corporate Management of Safer Chemicals in Consumer Products.” Appendix A: Product Toxicity and Safer Alternatives — Governance Benchmarking Framework. Available at [http://iehn.org/documents/CESBenchmarkingarticle\\_000.pdf](http://iehn.org/documents/CESBenchmarkingarticle_000.pdf); and Innovest. 2007. “Cross Cutting Effects of Chemical Liability from Products.” Available at <http://iehn.org/publications.reports.crosscutting.01-07.php>.

<sup>v</sup> Institutional Shareholder Services serves more than 1,600 institutional investing clients worldwide and makes proxy voting recommendations for more than 35,000 companies.

<sup>vi</sup> Liroff, Richard. 2007. “Toxic Chemicals in Products” newsletter. December 2007.