ESG Reporting Uptake in S&P/NZX 50 Index and Investor Perspective 2019

NZX & Wrights Communications, 2019

NZX NEW ZEALAND'S EXCHANGE
WRIGHT COMMUNICATIONS

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"Behaviour follows capital, shift the criteria to access capital and you will shift behaviour."

– Julia Jones, NZX

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Foreword

Economic growth is important. As businesses and as a country we must continue to pursue it and measure it.

However it does not in itself guarantee the improvement in the wellbeing of our people, our communities or environment. Our first Wellbeing Budget in May helped underscore our approach.

New Zealand has solid rates of GDP growth relative to our peers but we must ensure we develop the quality of that economic activity. The Budget focused on priorities to improve well-being across our New Zealand communities and the environment - while supporting economic growth.

We must also make the most of new opportunities, which will grow exports and lift New Zealand's productivity. The world is in the midst of a technological revolution. Mobile positioning systems, sensors, robotics, big data, the internet of things and artificial intelligence are disrupting many occupations and business models. This technology will also help us achieve better environmental and social outcomes.

Businesses and Government must work together and help ensure economic growth contributes to social and environmental outcomes.

Globally we are faced with significant environmental, social and economic challenges, be they climate change, modern day slavery, trade tensions, or the slowing of large economies such as the United States and China.

Speaking in my role as Minister for the Environment, some of you may have heard me say before that I believe the economy is a wholly owned subsidiary of the environment not the other way around. This is especially so in New Zealand where our two largest sectors - tourism and primary production - clearly rely upon our natural capital. I made that point strongly, recently, when I launched our plan to stop the degradation of our waterways and restore them to good health over a generation.

Just as we measure the financial performance of a business we must also measure the environmental and social impact that comes from achieving financial performance.

Environment, Social Governance funds globally have about US$31 trillion invested, demonstrating that a new wave of investors are looking for returns beyond financial reporting.

These ESG tools are used by the wholesale investment community both locally and internationally to access the value beyond return on a capital movement. Now global rating agency Standard and Poor's has acquired Truecost (which is a case study in this report) ensuring that the ratings placed upon organisations have a holistic focus.

I welcome NZX and Wright Communications' part in leading a discussion about the value of ESG in strengthening the place of responsible investing in New Zealand.

I would encourage all business to look beyond their strictly financial reporting when measuring their success and fully integrate environment and social wellbeing as well as governance capability into their strategic plans.

Hon. David Parker
Minister for the Environment, and Trade and Export Growth

Introduction

Mark Peterson
Chief Executive Officer
NZX Ltd

A vital role for any stock exchange is to ensure capital can be invested with confidence into companies that provide opportunities for sustainable growth.

Today, investor confidence is increasingly driven by alignment with personal values and non-financial considerations. And, the ability of businesses to prosper over the long-term is materially reliant on a broader range of factors such as their stewardship of natural resources, looking after the wellbeing of their people and how they respond to customers' needs - matched with a high level of transparency and best-practice governance.

At NZX, we believe our success as an exchange operator and frontline regulator is defined by our ability to run an efficient marketplace, and by our commitment to ensure high standards of corporate governance, and social and environmental stewardship.

This is an important consideration for investors, and people in retirement savings schemes like KiwiSaver - who are wanting a deeper understanding about the business operations and the behaviours of companies.

Around the world, and here in New Zealand, we see opportunities opening up for businesses that are responding with quality Environmental, Social and Governance (ESG) reporting and positively addressing "what matters most" to investors.

As a listed company in our own right, NZX is open to analysis by international agencies which monitor exchanges from an ESG point of view. We welcome this scrutiny, and see it as a priority to consistently assess, manage and report to our shareholders and other stakeholders on material risks and potential we see for our business.

We also actively encourage and support listed issuers to report on environmental and social impacts, initiatives and risks via the NZX Corporate Governance Code. In 2016, the Sustainable Stock Exchanges initiative (SSE) invited NZX to be a partner exchange and make a voluntary public commitment to encourage our issuers to promote ESG disclosures.

In releasing this report, we hope to promote greater awareness of the value of ESG reporting and showcase examples of how businesses are responding to this opportunity.

Nikki Wright
Managing Director
Wright Communications

Sustainability reporting in New Zealand is becoming the norm, with increasingly high quality non-financial information published alongside an organisation's strategy and financial results.

There is no doubt ESG reporting ensures more purposeful communication about an organisation's economic, environmental and social impacts, as well as its performance.

We produce Sustainability Reports for a range of organisations and it's great to see more companies using gold standard reporting frameworks such as the Global Reporting Initiative (GRI) and/or Integrated Reporting <IR> to improve the quality and completeness of report content.

However, we strongly believe that New Zealand companies are lagging well behind their peers in Europe, North America and Australia when it comes to acknowledging and reporting on their exposure to environmental and social risks. A few are doing a great job in disclosing their approach to climate change, for example, but most are either sticking to the basic reporting metrics of carbon emissions or ignoring carbon and waste altogether.

As well as NZX-listed companies now being required to report on non-financial information, there is increasing recognition across all organisations about the value of sustainability reporting. It helps establish a reputation as a responsible business and contributes to brand positioning.

Wright Communications is proud to help organisations ensure their sustainability reporting is relevant and meaningful.


INVESTOR
ISSUER

The use of Environmental, Social and Governance disclosure is becoming more important in relation to investment decisions alongside other financial and strategic information.

Through an ESG report, issuers can show investors that they are equipped for the long term and are ready to respond to risks and take advantages of opportunities.

An ESG report is also particularly useful for communicating an organisation's environmental and social impact and management approach to a wide range of stakeholders including customers, employees and regulatory authorities.

In this first report on ESG reporting we look at the state of ESG reporting within the S&P/NZX50. We ask what or who is driving non-financial performance reporting, what are the barriers to best practice and provide a number of case studies that provide insights into the world of ESG reporting.

For this report we reviewed the ESG content of the most recent - 2018 or 2019 - annual reports or standalone ESG reports for all companies in the S&P/NZX50. Just as ESG reports are often a work in progress, it is conceivable that the 2020 ESG Report will be expanded to cover a larger group of equity issuers or non-listed organisations.

Additionally, to gain insights into the drivers for ESG reporting, we surveyed the Company Secretaries of the S&P/NZX50. Again, given the modest response to the survey (one third), we intend to extend this survey in 2020.

This 2019 ESG Report was prepared jointly by NZX and Wright Communications. For reasons of comparability and consistency with international markets, both organisations have a desire to see a wider take up of ESG disclosure and reporting in New Zealand.

State of the nation

September 2019: It has been 22 years since Shell first introduced the world to the concept of a triple bottom line reporting with a sustainability report entitled People, Planet and Profit.

But after more than two decades of development, of talk, of new frameworks being created, how far has sustainability or ESG reporting really come in New Zealand?

In this survey on ESG reporting in New Zealand, we found that, in general, companies have shown some improvement in identifying non-financial topics that matter to investors and the metrics that most accurately measure progress and performance.

Our survey of the S&P/NZX50's most recent annual reports and standalone ESG reports found a wide variety of disclosure levels, frameworks and approaches to sustainability reporting. There was no one dominant approach or framework deployed. Although some industries are providing a greater level of information, others are either struggling to find relevance or gather information, or have determined that ESG reporting is not a priority for them.

Until recently, the need to report on a company's environment and social impact has been driven either internally by sustainability managers or externally by stakeholders such as regional councils who require a public record of compliance disclosure or NGOs who, ultimately, accede to a social license to operate.

But increasingly, there are new pressures on companies to improve their non-financial performance, their progress on social and environmental impact and their reporting on these matters.

The pressures are coming from investors around the world who are expecting more detailed and useful reporting of non-financial performance information. A responder to our survey of Company Secretaries said increasingly, "investors are looking for proof points of delivery against our strategy and more data". Another said shareholders wanted more information on waste management, energy consumption ($), corporate governance standards and gender equality.

28/50

We found that in the past year, 28 out of the S&P/NZX 50 Index companies reported on climate change risk.

181

CEO members of the US Business Roundtable recently committed on paper to "lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders."

40+

of the top 50 companies reported on a range of social issues from gender diversity to pay equality and modern slavery.

$181b

Responsible investment in New Zealand continues to grow with $181 billion of associated assets under management, representing 72% of total professionally managed assets of $261 billion.

17

Of the 50 reports analysed for this survey, acknowledged the use of the Global Reporting Initiative.

95%

of KiwiSaver investors think ESG factors should be considered when investing.

Increasingly, access to capital via investors is being accounted for by the perceived environmental, social and governance risk to a business. A responder to the survey said there was a focus on climate-related financial disclosures.

There has been a marked shift in investor awareness of ESG issues, there is space for further improvement in New Zealand compared with other capital markets

Responsible investment in New Zealand, for example, continues to grow with $181 billion of associated assets under management, representing 72 percent of total professionally managed assets of $261 billion. This is a threefold increase in the $58 billion invested in responsible funds only five years ago.

If further evidence of investor interest is required, the Responsible Investment Association Australasia (RIAA) recently assessed 25 New Zealand investment managers for their approach to ESG integration. Eight were applying a leading approach. A 2016 RIAA KiwiSaver study found that 95% of KiwiSaver investors think ESG factors should be considered when investing. As a result, more KiwiSaver products to meet investor ESG preferences have been released in the past year.

The business benefits of ESG reporting, according to the survey of Company Secretaries, included providing a single source of truth for stakeholder inquiries and creating eligibility for participating in ESG-rated indices.

Pressure is also being applied by customers and suppliers. For example, the New Zealand Government's sustainable procurement policy is explicit regarding environmental outcomes. It has a goal that all vehicles it buys should be emissions free by 2025.

While dairy may no longer be New Zealand Inc's single largest export revenue earner, the country's agribusiness remains a vital part of the economy. Although New Zealand's food production is often painted here as a global player, in reality this country produces a tiny fraction of the world's food and its customers can go elsewhere.

Consumers of New Zealand's food are increasingly asking questions about its provenance and sustainability. Many of our primary producers know that the more sustainable their product, the greater dollar value it can derive. Alternatively, a poor environmental or social record could result in those customers looking at other suppliers for their dairy or meat protein.

New Zealand companies – and those particularly exposed to international markets – are generally not operating independently.

Most are part of a complex supply chain between a natural or manufactured resource and the end consumer. How a company interacts with its suppliers, how it sources its raw material and how it processes those resources are of increasing interest to investors, suppliers and customers.

Global markets appear to be in a heightened state of fragility. From trade wars between the US and China, the rise of nationalism in Europe and a seeping economic downturn, domestic economies are under pressure.

Gaining a deeper understanding of a company manages its ESG risk is behind many of the questions now being asked at investor presentations. Investors are interested in decision-making related to supply chain, human rights and climate change risks. In particular the impact of climate change on business is one risk that is now drawing the attention of investors.

However, in our survey, we found that in the past year, only 28 out of the S&P/NZX 50 Index companies reported on climate change risk and, in most cases, the disclosure was focused on carbon emissions targets and initiatives to reduce emissions from operating activities.

Few companies have yet to explore and explain the longer-term risks to their business from climate change and potential climate change regulations. However, 34 companies said they had a target to reduce carbon emissions.

A smaller number still (19) were a signatory to the Climate Leaders Coalition – a group of New Zealand companies that have committed to carbon emission reduction targets.

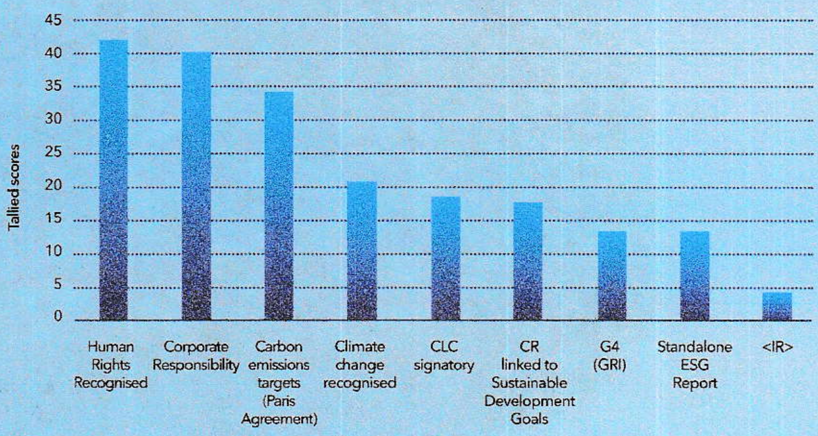
The purpose of a business is also under scrutiny. For many consumers and young investors, the ultimate purpose of a company is broader than delivering annual profit and dividend growth to shareholders.

In a radical departure from the principle that the paramount duty of directors is to shareholders, 181 CEO members of the US Business Roundtable recently committed on paper to "lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders". Significantly, the list included Exxon Mobile, Walmart, Boeing and Amazon.

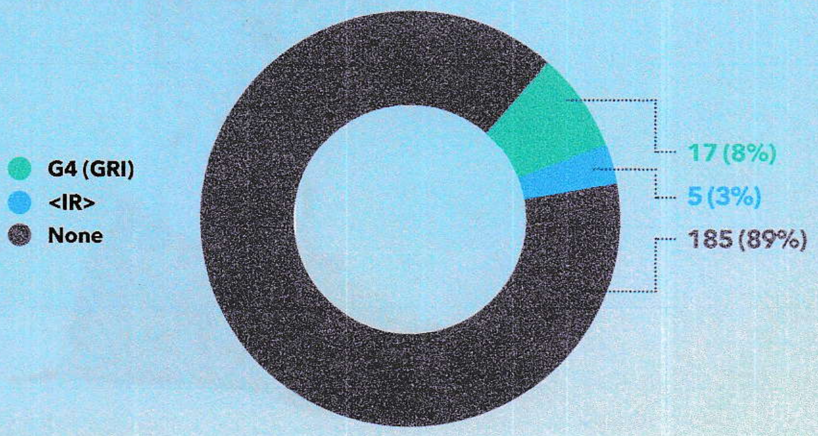
The 2019 reporting activity of the S&P/NZX 50 Index reflected a similar thinking in New Zealand corporations. More than 40 of the top 50 companies reported on a range of social issues from gender diversity to pay equality and modern slavery.

Most companies now report on the gender diversity of their boards, senior management and employees. Gathering and publishing this data is straightforward and has become normalised for most reporting companies.

ESG Metrics – Number of ESG topics within the reviewed reports



The percentage of S&P/NZX 50 Index using the recognised GRI or IR Framework for ESG reporting



On the other hand, a more troublesome disclosure is in the area of pay equality and remuneration. The NZX Corporate Governance Code recommends companies to report Director's fees and Chief Executive remuneration.

Chief Executive salary levels receive annual attention from New Zealand media, and the reporting is often incomplete or without appropriate context. In 2018 one Chief Executive decided to take the plunge and provide more information on his and the executive team's remuneration (see Z Energy case study page 16). Part of his reasoning for providing more remuneration detail was related to timing; incentive payments were often paid in years following the incentive period and did not necessarily reflect the current performance of the company.

Sector specific trends

While the surveyed group of 50 large companies is a relatively small sample (compared to all listed companies or all businesses in New Zealand) it was possible to discern a higher interest in ESG reporting in specific sectors.

The energy sector – dominated by Mixed-Ownership Model (MOM) companies and former State-owned companies – tended to produce higher levels of disclosure across all ESG metrics.

Operating mostly with substantial renewable assets, often on the fringes of National Parks and wilderness regions, the four largest so-called Gentailers have, for a long time, reported in detail on their environmental impact and compliance with resource consents. As a result of the MOM process they have also set a high bar on governance reporting.

Banks and other companies operating on both sides of the Tasman also had comprehensive ESG content in their reports. The Australian owned banks have been producing highly-detailed ESG reports for more than a decade and are good examples of ESG disclosure.

At the other end of the scale, two industry groups (with a few notable exceptions – See Kiwi Property case study page 14) stand out with a large opportunity to improve engagement of ESG reporting. These are software companies and multi-functional property companies, including retirement village/aged care operators.

Recognised standards

For the most part, large New Zealand companies are finding their own way when it comes to structuring or organising their annual and ESG reports. Of the 50 reports analysed for this survey, only 7 acknowledged the use of the Global Reporting Initiative (GRI) standard and five were prepared according to the Integrated Reporting framework.

There is an array of international standards, guidelines and frameworks that have been created by various bodies, including the International Integrated Reporting Council (IIRC); the GRI, based in Amsterdam; the Climate Disclosure Standards Board; and the Task Force on Climate-related Financial Disclosures.

But without one globally accepted set of standards for all forms of non-financial information, investors are not always in a position to compare companies on a like-for-like basis. If companies are disclosing different types of data and using different measurements, it makes it almost impossible to establish comparisons or to identify trends. In many instances, governance risk is better reported than social and environmental risk.

A higher adoption of globally-recognised standards or frameworks such as GRI or IR makes sense. Investors who are increasingly aware of ESG-related risks are more likely to view companies that comply with these international standards more favourably than those that are less than transparent about how their business is governed and their environmental and social impacts and commitments.

In the long term, it may be normal for investors to sell down those assets that do not comply with international disclosure and reporting standards.

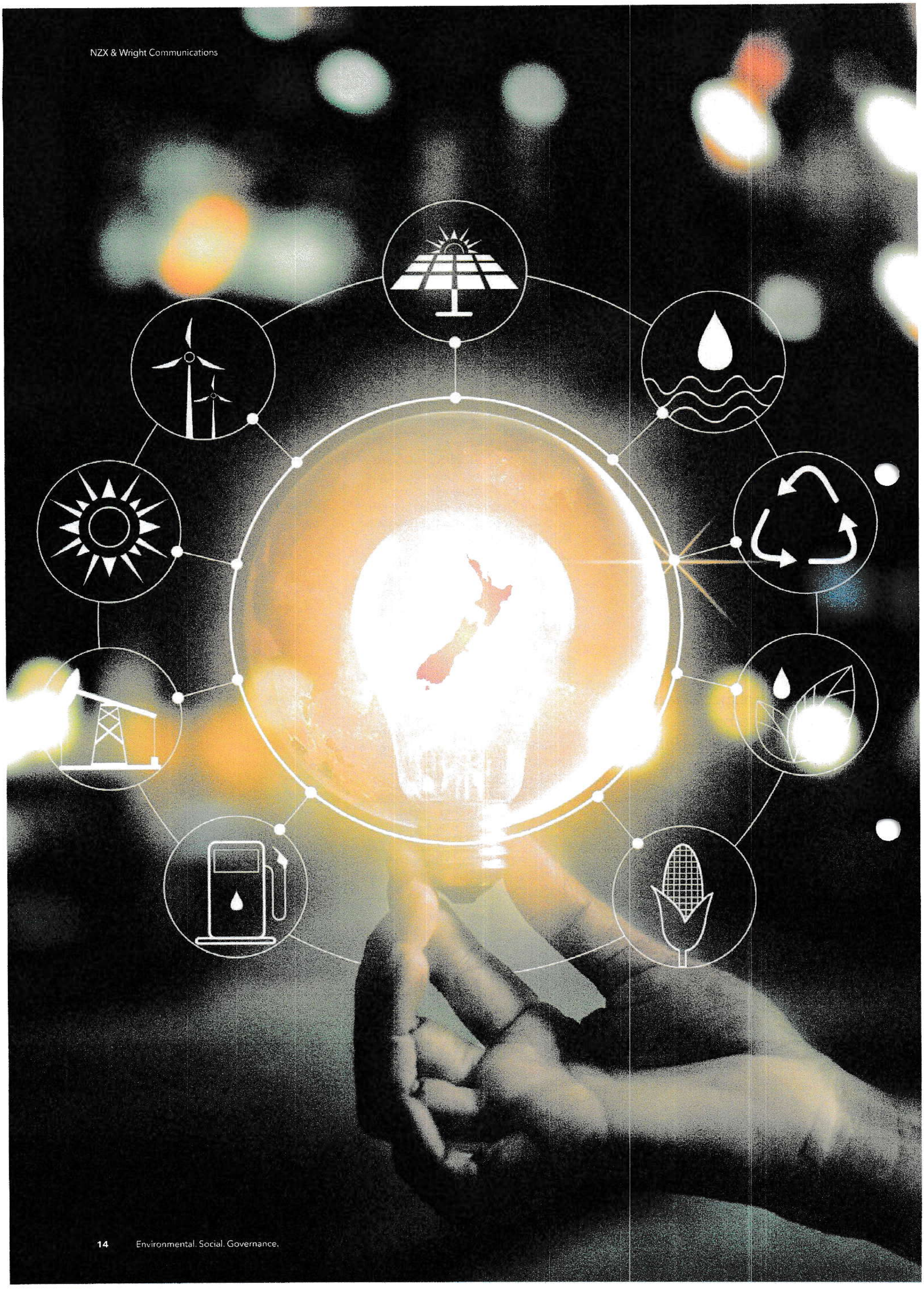
More ESG disclosure?

With the wide range of ESG disclosure levels currently provided by S&P/NZX 50 Index companies, the opportunity exists for many to provide more relevant information to investors and stakeholders.

The investor focus on ESG represents a long-term transition, rather than a short-term trend. Leading reporting companies recognise there is a pathway towards best-in-class reporting and are prepared to take a long-term view.

Globally recognised standards are likely to play a part in investors' decision-making. Nobody would question that a company that understands its material risks is going to be a better-run company than one that does not. ESG risk is a fundamental part of this equation and if a business fails to pay sufficient attention to it, it is unlikely to be successful in the longer term.

Today's annual report fulfils a number of important tasks – to communicate a company's business strategies, its governance and management of risks, its approach to environmental and social impacts and, of course, present an accurate and fair statement of its financial performance. As we expand the reporting focus the target audience grows beyond shareholder and analyst to a wider stakeholder group.



Talk to us about your ESG reporting requirements

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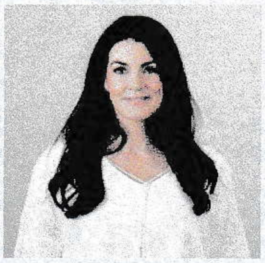

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