
Featured Domain

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In late May, the highly regarded Ceres organization, which advocates for sustainability leadership, partnered with BlackRock, the world's largest asset manager, to issue "21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions." Cornerstone Capital is proud to have contributed to this publication. Our article is reprinted below and the full report can be found [here](#).

"...the reality is that the very best investment analyses start with a question investors are struggling with in the context of their decision-making processes ... a pivotal question about which analysis will give greater predictive insight into investment decisions and economic outcomes."

The smartest people we know, know how little they themselves know. That includes Wall Street sell-side analysts, strategists and economists. In fact, Socrates taught that "the only true wisdom is knowing that you know nothing." That might sound a bit harsh, but the reality is that the very best investment analyses start with a question investors are struggling with in the context of their decision-making processes, and a pivotal question about which analysis will give greater predictive insight into investment decisions and economic outcomes. The bottom line is that great sell-side research is often "a question of questions."

Most analysts are trained to start their stock calls to portfolio managers and analysts with their "conclusion first." They start by telling investors what to do with their money. From our standpoint, why would investors possibly listen? We argue that analysts have to "earn the right" to offer advice—the right to be heard above the barrage of noise.

More specifically though, it's not just research into any questions that matters. It's research into the most pivotal, difficult, complex, global, sector- and macro-based issues that need to be addressed at any given time. In other words, what is truly "material"— such that a reasonable investor needs to absolutely consider it in the context of making a buy or sell decision? There is a vast distinction between questions that are related to the "here and now," and questions that offer critical insights into longer-term corporate strategies, tactics, and ultimately stock price performance.

We circle back to the problem of retraining Wall Street analysts to not focus on sharing all that they know, but rather to be transparent and constructive about what they don't know. What they don't know, they might try to obfuscate or simply avoid. Respectfully, we argue that this is a poor strategy. It will be found out by savvy investors who, collectively, represent much of the information that's already reflected in the price of a stock.

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From where does that information advantage come? In our view, it could come from the earnest, objective analysis of the broad swath of subjects covered in seeking environmental, social and governance excellence, or lack thereof, in the corporate sector. In fact, that enhanced version of investment analytics captures almost everything one can think of when making an investment decision. We argue that a lack of the systematic analysis of ESG factors implies poor due diligence in the investment process deployed by the analyst—an inadequate evaluation of risk-adjusted returns to express to investors.

With regard to understanding precisely which ESG factors are most critical to a particular company, we would suggest that an industry-based or sector-based approach is essential. The book is still being written with regard to the establishment of “standards” for the disclosure of these factors, notably by organizations such as SASB (the Sustainability Accounting Standards Board) in the US. This critical piece of “infrastructure” is a starting point for inquiry in what matters most, by sector, to analysts and investors.

The bottom line though, is that just because an analyst can't yet answer pivotal questions doesn't mean they shouldn't try. Shouldn't analysts at the very least look at scenarios of possible share value destruction associated with stranded assets for oil and gas companies if a carbon policy were put in place to deal with climate change? Isn't it worth noting which companies can best articulate the value of optimal employee engagement, succession planning and great corporate governance? Wouldn't it be valuable to know which companies are optimally evolving their business models to embrace the potential of social media, big data, and demographic shifts? Absolutely. In fact, we state again that the best investment research is indeed a “question of questions.”

So, without attempting to be all-inclusive, we turn to some sectors and specific questions below that can be posed by investors and analysts to build a more robust and comprehensive understanding of risk and value creation—those questions that raise even more important questions that analysts should be exploring.

Moreover, we would argue that all these questions might better be posed in a more systematic way than is currently the norm. The questions, and others that are beginning to become part of the dialogue in the mainstream of the capital markets, represent a material enhancement to the current analytical process. They represent a more nuanced basis from which to triangulate the answer to the question of whether to buy, sell or hold.

Key Questions to Ask by Sector

OIL, GAS AND MINING

1. Has the company modeled scenarios that include low-carbon public policies and impacts on demand and supply? How does the company evaluate the risks of assets becoming stranded because of potential climate regulation, water risks, or other factors affecting demand and price? How has the company's evaluation of new exploration activities changed in light of this analysis?
2. Given the uncertainties surrounding the company's long-term investments, how does executive pay incentivize an appropriate balance of short-term performance and long-term strategic orientation?
3. How does the company identify the risk of local community opposition? How does the company account for the costs should such opposition occur? Which operations are located in regions where they may face these risks and how are you addressing them?
4. What has the company learned from the numerous safety and emissions events in the extractives sector over the last several years, and how have you enhanced safety processes and governance in response?
5. What emerging forms of corruption concern you? How do you identify new forms of corruption and adapt your compliance training and practices? How are managers incentivized to prevent corruption?

BANKING AND FINANCE

1. What analyses has the bank undertaken to assess its broad social and economic impact in the communities in which it operates? Which lines of business are most affected by these assessments? What is the process for incorporating these concerns into financing decisions?
2. How does the bank ensure that customers always receive services that are appropriate for their situations and understand the nature of the risks they are taking?
3. What are the key factors influencing customers', regulators' and business partners' trust in the bank and how is the bank managing these factors?
4. What are the bank's policies on the environmental impacts of its lending activities?
5. How does the company factor in long-term social and environmental trends, especially rising climate change, into its enterprise risk management systems? What is the process of board and management oversight of this?
6. Given the breadth of the bank's/financial institution's global business lines, how does its governance structure address concerns about complexity risk?
7. How does executive compensation create incentives for long-term performance at a reasonable level of risk? How do the company's compensation policies for ordinary employees create incentives for appropriate risk taking?

INSURANCE

1. How does the company factor in climate change into its enterprise risk management systems, actuarial analyses, underwriting, or investment strategies? What is the process of board and management oversight of these?
2. How is the company minimizing the risk of misuse of “big data” when using large data sets to better assess, price or create products?
3. Given that the insurance sector has more detailed and personal information on individuals or customers than most industries, how does the company assess the quality and adaptability of its cybersecurity measures? How often are your plans for security refreshed or re-evaluated?
4. How has the company developed strategies to create future products or coverage to attract a wider range of customers spanning a broader socio-economic spectrum? What are the company’s long-term plans for growing market share in an environment where major risks continue to put at risk the affordability and availability of insurance products?
5. How does the company ensure timeliness and ease of claim processing, as well as transparency of policies? How do the company’s products incentivize healthy, safe, and/or environmentally conscious behavior? (e.g., promote energy efficiency and low carbon technology?)

INFORMATION TECHNOLOGY

1. How does the company analyze and mitigate concerns about cybersecurity? What policies are in place to protect the reasonable privacy rights of its customers and business partners? How does the company think about balancing privacy rights with reasonable expectations of transparency?
2. How has the company assessed water-related risks to operations and in the supply chain?
3. How does the company assess the potential physical impacts of climate change to its infrastructure? How is the company addressing this?
4. Does the company source any raw materials from conflict-affected areas (or does the company trace its supply chain back to conflict-affected areas)? How do you assess and manage the risk of supply chain disruptions from these areas?
5. How does the company measure the productivity of its human and intellectual capital? How does the company assess the diversity of its workforce? What steps is the company taking to improve diversity?
6. How is the company addressing shortages in the science, technology, engineering, and math (STEM)-trained workforce?

ELECTRIC UTILITIES

1. Has the company assessed the physical risks to its infrastructure posed by extreme weather events and other climate impacts? How does the company assess emerging water-related risk? How does this analysis impact the company's investments in system upgrades?
2. How is the company positioned relative to public policies designed to ensure a reliable and affordable energy supply, possibly at the expense of profitability?
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3. How does the company analyze and mitigate security threats, including cybersecurity and potential threats to physical assets, including substations and nuclear plants?
4. Is the company adapting its business model in response to increased demand-side efforts to mitigate climate change, such as energy efficiency and plug-in hybrids? How is the company addressing the growth of distributed renewable energy generation?
5. How is the company affected by the secular decline in renewable energy prices, and related advancements in distributed energy?

APPAREL AND RETAIL

1. What emerging or potential natural resource constraints concern you the most? How does this company evaluate its water-related risks? How are you adapting your supply chain management systems in response?
2. What steps have you taken to incorporate principles of sustainable product design?
3. How is the company positioned with regard to taking advantage of increased buying power in middle-income countries? What impact do rising wages have on the company's procurement practices?
4. How does the company evaluate its risks of high profile safety or other negative labor-related events in its supply chain? How is the company evolving its procurement practices in response?

TRANSPORT

1. How are you modeling the impact of potential climate change regulation on market demand or pricing? How does the company's long-term business strategy position the company for uncertainties related to future climate policy? How do rising energy prices affect your manufacturing and distribution strategies?
2. What emerging or potential natural resource constraints concern you most? How are you adapting your supply chain management systems in response?
3. How is the company positioned to supply mobility in the emerging megacities of the developing world?
4. How does your governance structure support a culture of safety within the firm? How are executives incentivized to ensure that safety remains a priority throughout the economic cycle?

FOOD AND BEVERAGE

1. How does the company assess water-related risks in its supply chain? How is the company assessing its need to adapt to the physical impacts of climate change? More generally, what is the company's assessment of the impact of growing relative scarcity of agricultural commodities on its business?
2. How has the company assessed the impact of potential future climate change mitigation policies on its supply chain, including transportation costs? How is the company addressing the physical impacts of climate change on its supply chain?
3. How does the company assess the risk associated with increasing relative scarcity of agricultural land and pressures on biodiversity?
4. What is the impact of rising incomes in the developing world on the company's business, from both a supply and a demand perspective?
5. With regard to its own employees, what is the company's strategy for maximizing the productivity and motivation of its workforce, particularly customer facing employees? How does the company manage reputational risks associated with a possible high profile labor event (such as a safety failure or discovery of forced labor) in its supply chain?
6. How does the company assess the impact to its business of rising concerns in the United States about nutrition and health? How is the company managing the potential impacts of these shifting attitudes?

HEALTHCARE AND PHARMACEUTICALS

1. What are the key factors influencing the trustworthiness of the company from the perspective of patients, healthcare providers, and regulators? How is the company managing these factors?
2. What steps has the company taken to ensure that its products are marketed in an ethical way? How do you assess whether these steps are effective? What bribery controls are in place?
3. How will changing demographics, including the aging of populations in developed countries and rising incomes in developing countries, affect product demand? How is the company positioned for these changes?
4. How does the company's executive compensation policy create incentives for excellence in patient outcomes?
5. How is the company making efforts to improve access to medicines? What are the strategic objectives of these efforts and how do you measure their effectiveness?
6. With regard to its own employees, what is the company's strategy for maximizing the productivity and motivation of its workforce, particularly customer facing employees?

