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PERSPECTIVE

2015 was the year that the framework of the Sustainable Development Goals(SDGs) to be attained by the year 2030 was created. Unfortunately already in 2017 (just 2 years after the introduction of the SDGs) the term 'SDG washing' was coined. The term relates to marketing campaigns and CSR reports that with full dedication describe the contribution to the realisation of the SDGs. The existence of the term alone should be a sign for investors and asset owners that reviewing the reports and marketing materials that describe the SDGs, is necessary. It's time to check if actions indeed speak louder than words.

Greenwashing, the deceptive use to promote the perception that an organization's products, aims or policies are environmentally friendly, already gained notoriety amongst consumers and investors alike. Most illustrative and one of the earliest examples that greenwashing could have corporate benefits is the 1985 Chevron's "People Do" campaign, which was specifically targeted to enhance the company's image. The campaign focused on their "good work", for example restoring marshes once used for oil exploration. Cunningly leaving out that most of these "good deeds" were required by law. The campaign had a clear effect, surveys showed that people in California trusted Chevron more than other companies to protect the environment. And while the public has become aware of these practices, companies still use the same practices whether it be related to the environment("green washing"), water("blue washing") or the SDGs (SDG washing).

IDENTIFICATION OF THE PROBLEM

Typically fraud can be described as the actions intended to deceive others, typically by unjustifiably claiming or being credited with accomplishments or qualities. The same can be said about SDG washing: claims or accomplishments about contributions to these sustainable goals, that do not fully reflect reality, seem to have many similarities with this definition. It is therefore essential that companies have a clear picture of their actual contributions to the SDGs and are not tempted to claim these contributions to the SDGs on the basis of existing policies and processes.

So what are the underlying causes for companies to be more inclined to report comprehensively of their good deeds (not yet judging the validity of their claims) in their reports, websites or other external communication? The most important cause that can be identified is the increased interests in ESG from the public, investors followed by data providers for these two groups (such as rating agencies and journalists). The rise of CSR reports by the S&P 500 is a good example of this phenomenon; in the last 6 years companies that issued CSR reports rose from 20% to a whopping 85%. It's often stated that this increase is related to the higer standards of the regulator, however contrary to the EU, the US rules and regulation regarding CSR are less stringent and do not account for most of this increase.

The increased disclosures and reporting of companies is a good thing: more disclosure means more information for making investment decisions or to judge whether you would want to buy products from a company. However, due to the fact that there is no clear regulatory framework yet on what should be reported and what shouldn't, this increase in ESG reporting across all companies, increases the risk of misrepresentation or misinterpretation.

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European regulators are aware of this risk however and the European Commission through the High Level Expert Group (HLEG) is working on this exact problem regarding the SDG taxonomy and regulation on CSR reporting. The prospected proposals from the HLEG should be completed still this year, upon which implementation in Europe can be started by fund managers and European companies. This should give guidance for European entities, however due to the European nature of this framework and the lax stance of US regulators on this topic, this only solves part of the problem.

With the increase of ESG reporting in general, the willingness of corporation to also incorporate novel and key global subjects like the SDGs in their reports has also increased. However, just as the SDGs themselves the practice of reporting on ones SDG contribution has just started. Without clear guidelines for these reports, SDG reporting is open for interpretation. What should be important here is that companies should be critical in what they report. Moreover, reporting on the SDGs requires companies to be transparent not only on their positive impact but also shed a light on what they should improve or what business practices could harm the attainment of the SDGs. Companies only reporting on the good, with a potential to be involved in business practices that do harm to the SDGs, could be engaging in SDG washing.

The misrepresentation resulting from SDG washing leads to wrong/partial information for investors. Therefore, asset managers and asset owners should be aware of this and should critically analyse the companies and their contributions to the SDGs for the benefit of their investment decisions.

The justification to invest in the SDGs goes beyond having good intentions as a company; the SDGs also provide possibilities for risk management as well as investment opportunities. When companies do not take into account the sustainable development goals in their policy, it is very likely that they will have to pay for the costs. It is not inconceivable that companies with a negative contribution face fines, taxes or lost subsidies. This has far-reaching consequences for the shareholder value. This insight is therefore a form of risk management if this is used to anticipate in a timely manner. In addition to risk management, the SDGs also offer opportunities for investors: companies that explicitly contribute to the sustainable development goals will often be rewarded for this. This can be in the form of increased demand for the products that are offered, policies that support the SDGs in the form of positive tax constructions or simply in the form of subsidies. Next to the beforementioned investment risks and opportunities the SDGs provide, there is also the factor of reputational risk: asset managers and asset owners could be at risk when investing in companies that practice SDG washing. A focus on net-contributors should be apparent within their portfolios, not with non-contributors or net-detractors.

SDG REPORTING: CONTEXT & SIGNIFICANCE IS KEY

Context (relating to the topics on which SDGs are reported) and significance (relating to the actual core business of a company) of SDG contribution are two pillars in judging whether a company's SDG reporting truly reflect material contribution.

Two categories of SDG washing can be seen in practice: so-called net-detractors and non-contributors that both claim to contribute.

Net-detractors

Companies tend to highlight their "positive" and try to downplay their "negative" practices. Relating to SDG washing, this would mean that their positive contributions to the goals are specifically highlighted and their negative contributions (net detractions) would not be mentioned at all. We have categorized companies as 'net detractors' when their actions have a greater negative impact on the SDGs than the positive contribution that is being made to achieve these objectives.

Examples

McDonalds

McDonalds claims to contribute to a number of SDGs, including zero hunger (SDG #2), decent work and economic growth (SDG #8) and climate action (SDG #13). However, the main business of McDonalds is selling fast-food in big quantities to society. The benefits from its use of business activities focused on SDG #2 (a.o. through resilient agriculture) and the other SDGs, in the end does not outweigh the negative impacts it has by contribution to unhealthy eating standards around the world as a core activity. Netting them would make McDonalds a net detractor, due to the greater impact through the role it plays in supplying cheap unhealthy food compared to the impact it has on the supply side.

Glencore

Glencore has mapped all the SDGs to its internal policies and are in effect communicating to the outside world that it is contributing to all of them. In essence, Glencore is a commodity business including production, refinement and processing of metals and minerals. Glencore has a miserable track record regarding sustainability in general and is involved in a great deal of controversies relating to environmental pollution (including river pollution),labor rights and workers' safety. Tallying up all the positive and the negative impacts, Glencore scores as a net-detractor to the SDGs due to the nature of the company and the actual impact it says it has (only internal policies) and due to the negative influence it has.

In general, positive contributions for most of the SDGs are straightforward to identify. For instance: producing cheap staple foods in emerging economies or providing cheap ultra-nutrient rich foods to the people who need it most and don't get enough. Although these examples are proxies, they give an indication of positive contribution to the SDGs. However, detractions on a number of the SDGs are hard to identify. On SDG #2 (zero hunger) for instance, you can hardly make the argument that any company is intentionally preventing their employees or the public consuming sufficient calories. However, it can be established that a company does not contribute because it provides products or services that do not directly contribute to SDG #2. Therefore, positive contributions to SDG #2 automatically outweigh detractions (as negative contributions cannot be identified directly).

For other SDGs it is easier to identify actual detraction and contribution. For instance SDG #13 (climate action), is one for which positive impact (for instance increased use of solar power) and negative impact (CO_2 emissions) can easily be linked to this goal. Whether a company is a net contributor or net detractor, significance of their reported contribution (and the actions attached to the reported values) is essential. The biggest oil companies all report on their (positive) “contribution” to achieving the SDGs. These oil companies mostly report on multiple SDGs including SDG #13, which would suggest they contribute to a better environment. These companies report for instance on an increase of efficiency and decrease of emissions. And although the R&D budget of big oil are necessary in the actual energy transition, looking at the significance of their contributions with respect to their core business, we must conclude they are ultimately net-detractors of the SDGs.

Non-contributors

Net detractors are companies for which their detractions outweigh their positive contributions in achieving the SDGs. When a company does not make any contribution at all and therefore does not detract, it is considered a 'non-contributor'. When do we know when a company does not actually contribute to the SDGs? Significance and context are again focal points within the identification of these companies. Significance relates to the core activities and the policy on which a company reports on the SDG contribution. For instance, a company reporting on the SDGs when in actuality this is a negligible part of their business, this should be reflected in their reports (or that it must be explicitly stated that the emphasis has shifted within the company and that the SDGs will form a more significant part of their business in the future). Claiming to contribute to women's equality by providing an increasing number of mortgages to women in a western country or the amount of women in the workforce, could just have to do with demographics. It is likely that in emerging markets these activities are less linked to the demographic developments of a country and are probably more the result of a targeted strategy. These contributions are therefore easier to confirm.

Example

Bpost

Bpost is the former government owned post-delivery company responsible for delivering mail in entire Belgium. Bpost reports on their contribution on good health and wellbeing (SDG #3), reduced inequalities (SDG #10), climate action (SDG #13) and quality education (SDG #4) amongst others. In its internal policy, Bpost states that it ensures the health and safety of employees and highly valuates integrity and makes a direct link here that a contribution is made to both SDG #3 and SDG #10. This is a good example of a non-contributing company: although Bpost is doing well by adjusting the fleet and has good intentions regarding the well-being of their employees, the core activity is limited to delivering mail. This has - looking at the SDGs identified by Bpost - no real influence.

SIFTING THROUGH THE DIRT

In the previous segments we focused on what asset owners should be aware of, but how should asset owners in practice assess whether a fund is aligned with the SDGs and actually contributes to the realization of these SDGs? There have been initiatives that have tried to create a framework in order to measure impact, such as the SDGI's or the current HLEG research. Only time will tell whether unified adoption standards for SDG reporting can be created. Both HLEG and the SDGI's are work in progress (both for companies and regulators). From our point of view a number of elements is definitely essential for a correct assessment by the asset managers: access to qualitative analysis, quantitative data and a good frame of reference. Asset owners on their part should be able to access these multiple resources in order to ensure that they are used in the right way.

In order to judge whether a company can be included in a SDG fund, an asset manager should use these essential basic elements. First of all the asset manager should have a frame of refence clearly detailing what is meant by an SDG contribution/detraction. In addition to this frame of reference, a policy specifying their criteria on inclusions and exclusions of an investable universe should be in place. This policy should include elements like context, goal and significance.

This way inclusion of SDG companies can be monitored and asset owners can avoid funds that seemingly randomly add companies (without any scrutiny on reporting SDG contribution). The criteria of in- and exclusion are largely based on data and data analysis. Therefore, whether qualitative or quantitative, this is another element that is essential for every SDG fund. And although both data analyses have their own advantages and disadvantages, this reinforces the final assessment when both analyses and various sources are used. Ultimately a fund manager should have vetted every company in a SDG fund using their data and judging whether the company satisfies all criteria specified.

Asset owner should be able to challenge the fund manager on each of the basic elements and fund managers should be able to justify all their decisions.

The final in- or exclusion must be substantiated on the basis of a number of criteria, all of which are based on analyses. Moreover, these analyses and elaboration must be replicated and checked. Important for these criteria is that it should include some form of context and significance of contribution to the SDGs in order to guarantee that actions speak louder than words. This will help to reduce the risk of SDG washing.

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