



Does investor engagement deliver corporate change?

Around £300 billion of equities are now managed on a socially responsible basis in the UK. Many investment managers, including Insight, deliver their commitments to being a responsible investor through, among other things, proactive engagement with companies. Our rationale is that regular, constructive engagement can deliver substantial change in the way companies manage their key social and environmental impacts and risks, thus protecting and enhancing shareholder value. However, some observers have quite rightly questioned whether such engagement actually drives corporate change.

Over the last three years, Insight has been working hard to try to answer this question. We have developed and tested engagement tools that allow us to demonstrate clear results: systematic and significant improvement in companies' management of governance, social, ethical and environmental issues.

One tool that has yielded very good results is benchmarking. To date we have benchmarked extractive and utility companies' management of biodiversity-related risks; retail sector companies' management of supply chain labour standards; and UK house-builders' management of sustainability issues. Here we explain how we undertake benchmarking analyses by describing in detail the latter exercise and the results we have achieved using this approach to engagement.

Benchmarking the UK's leading house-builders

In January 2004, in partnership with WWF, Insight published a benchmarking study evaluating how well the UK's leading listed house-builders were managing and reporting on sustainability issues. We tackled this subject because sustainability is becoming an increasingly strategic and important topic in this sector due to significant policy and market developments.

The government has introduced a series of policies and commitments, backed up by new legislation and regulation intended to deliver more cohesive, successful and sustainable communities over the long term. In May 1999, the UK government published 'A better quality of life' – its strategy aimed at demonstrating its commitment to sustainable development throughout the country. The strategy included

a set of 147 sustainability indicators focusing on issues specific to people's everyday quality of life concerns. Seventy indicators are linked to housing and community issues. In February 2003, Deputy Prime Minister John Prescott launched the Government's Sustainable Communities Plan, which set out a vision for housing and community development over the next 20-30 years. In addition, the Government has introduced the Sustainable and Secure Buildings Act and changes to building regulations and planning guidance. Surveys have also shown that home-buyers are also increasingly concerned about sustainability issues from climate change to recycling and are looking to house-builders to play their part in addressing their concerns.

Results of the first benchmarking study

The first benchmarking study aimed to assess how well companies were managing sustainability issues. Working with WWF – the global environmental charity – and Upstream, specialist consultants, we first sketched out what we considered to be best practice in each of three key areas: governance and risk management, managing environmental impacts and managing societal impacts. We then established a set of 18 criteria against which we evaluated each company's performance.

Companies were first assessed on the basis of their publicly available financial and sustainability reports and material on their websites. We then met with each company to review that analysis and discuss its practices and performance on each of the issues in question. Companies were then given additional time to provide further evidence of their work on sustainability issues in order to achieve as good a score as possible.

The final results of the study revealed that, while the house-builders had begun to recognise the growing importance of sustainability issues to their businesses, few had well-developed strategies, policies and practices to address them effectively. The two companies that came closest to meeting best practice were Countryside Properties and The Berkeley Group. However, most lagged far behind best practice. The analysis also revealed that public disclosure of information on sustainability issues was also quite poor and inconsistent. In addition, our research yielded a wealth of detailed information about the nature and quality of each company's management of individual sustainability issues,

from climate change to waste management and health and safety.

John Prescott, the Deputy Prime Minister, warmly welcomed the report. He stated:

"I welcome this report as I believe it will be an important tool in the development and mainstreaming of sustainable communities. It will provide a useful insight into how far house-builders are already incorporating sustainability into their work. I hope it will also assist them in recognising which aspects of sustainability they are not, and should be considering if they are to remain at the forefront of today's market".

Supportive, ongoing engagement

Following the publication of the benchmarking report, Insight and WWF continued to engage with the house-builders through meetings with senior management, explaining our analysis of their strengths and weaknesses, and suggesting improvements they could make. In addition, we:

- Invited all of the companies to take part in the HSE's new health and safety index, CHaSPI (June 2004).
- Hosted a meeting for the developers with Keith Hill, the then housing minister, to discuss sustainability in the housing sector (November 2004).
- Produced a comprehensive tool-kit to provide companies with detailed guidance on resources available to manage all of the issues evaluated in the benchmark (March 2005).
- Kept companies informed of key research and initiatives (Ongoing).

Results of the second benchmarking study

In order to assess whether companies had made any progress on managing and reporting on sustainability issues, we repeated our analysis during 2005 and published the results of the follow-up benchmark in September.

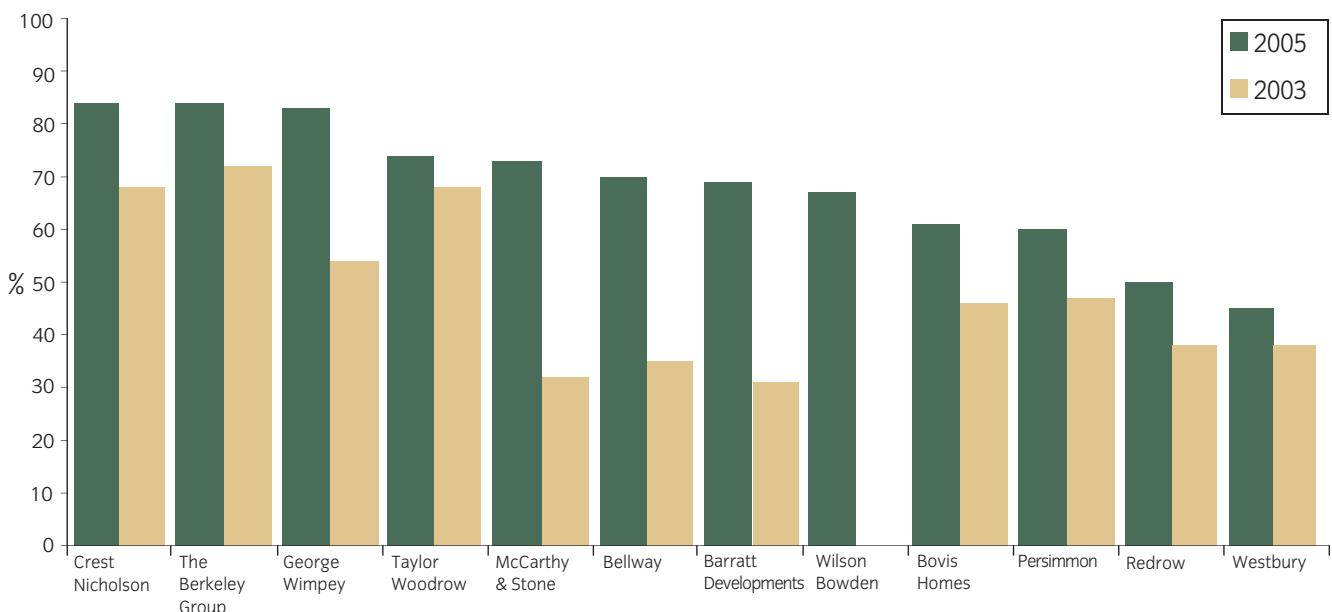
The results show substantial improvement in the reporting and performance of ALL of the companies with which we engaged. All companies substantially improved their management of sustainability issues, as shown in Figure 1. Crest Nicholson, The Berkeley Group and George Wimpey emerged as the leaders; others – McCarthy & Stone, Bellway, Barratt and Wilson Bowden – demonstrated substantial improvement. In most cases, the companies have implemented many of the specific recommendations we made to them. Further, several senior executives have written to us to welcome the exercise and to thank us for our helpful suggestions.

Further, the analysis demonstrated that all of the companies had improved their reporting on sustainability, although their disclosure is still not comprehensive and, thus, does not paint a complete picture of the work they are doing on sustainability.

An Insight effect?

Clearly, Insight's engagement is not the only factor at work here. Government, market and other trends and pressures are also driving change. The fact that we worked with WWF, a highly credible environmental organisation with specialist knowledge in this area undoubtedly contributed to the success of this project. Nevertheless, most companies have greatly improved their management and reporting of many

Figure 1: Improvement in companies' scores between 2003 and 2005



suggestions we made to them. We are therefore confident that our engagement, and the benchmarking process specifically, was a major factor in effecting these changes. Feedback from the companies also reinforces this view.

In discussion, several of the companies noted that their performance on sustainability is helping to deliver business benefits – from winning planning permission and contracts with government agencies to cost savings through waste management programmes and tighter risk management. Some are also beginning to realise that fully integrating sustainability into their businesses can deliver differentiation and other reputational benefits.

For Insight, the improvement demonstrated by these companies means that we have a greater level of confidence that they are managing their social, ethical and environmental risks effectively and beginning to reap business benefits.

We are in the process of doing a similar evaluation of the effectiveness of our engagement on biodiversity in the extractives and utilities sectors. Early indications are that a similar picture of improvement and effectiveness will emerge. We will report on this exercise in due course.

Conclusion

Insight is convinced that properly planned engagement by investors, using rigorous and effective analytical tools, can deliver substantial, demonstrable improvements in companies' governance and management of key social, ethical and environmental issues. Benchmarking, based on careful research and engagement, helps companies, government and investors to identify leaders and laggards in the sector, to identify companies' specific strengths and weaknesses and to highlight the improvements that companies have made over specific time frames.

Moreover, benchmarking helps to clarify best practice and make clear to companies what investors expect of them on particular issues. We believe that benchmarking exercises motivate change in companies' management and reporting, present clear evidence of change and demonstrate the effectiveness of engagement. It can also help to inform equity and credit investment analysis of this sector.

We also hope that this type of analysis will contribute to the Government's understanding of how the private sector is responding to its policies as well as helping other stakeholders to understand how the construction sector is addressing sustainability. We believe – and hope – it might be used by agencies such as English Partnerships and The Housing Corporation to inform their decisions about which developers to fund or partner with.

The full report and executive summary are available at: www.insightinvestment.com/responsibility/project/one_million_sustainable_homes.asp.

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