Linkages between sustainability and corporate financial performances

Increasingly, academic studies have shown linkages between sustainability performance and corporate financial performance. In fact, a positive relationship is generally found between environmental, social and governance factors, and corporate financial performance.

As a result of this phenomenon, legal theorists have posited that it is permissible for fund and asset managers to integrate sustainability factors in their investment decision-making, as there is a link to financial performance. Arguably, when an even stronger correlation is developed or found, it could even be a requirement for principals to take into account sustainability factors, so as to reliably predict financial performance in an investment analysis.

Investor demand for information

Perhaps as a result of the phenomenon of the linkages, investor interest in sustainability has also increased. The United Nations Principles for Responsible Investment (PRI) is a coalition of signatories that have pledged to use responsible investments to enhance returns and better manage risks. The size of the assets under management of signatories has grown significantly through the years, from less than US$7 trillion in 2006 with 63 signatories, to over US$73 trillion in 2017 with over 1700 signatories.

As there is greater demand for such information from investors, it becomes more pertinent for securities regulators to require listed companies to put out sustainability information to satisfy investors.

Focus on disclosure

In a capital market that operates under a disclosure-based regime, the mandate of the securities regulator is focused on disclosure. The essence of the disclosure philosophy is the belief that the market is better placed than securities regulators to evaluate the merits of transactions. The mass of investors and analysts are best able to judge the merits of an investment for themselves.

Disclosure is important for several reasons. To be able to make sound investment decisions, investors must be equipped with the necessary information. Disclosure also mitigates bad behaviour, by removing the misplaced hope that wrongdoing could remain undetected.

Sustainability reporting

Consistent with the role of making information available to investors, Singapore Exchange (SGX) has focused its efforts in improving the state of sustainability reporting by listed companies.

A voluntary reporting guide was first published in 2011 to encourage listed companies to report on their sustainability performance. After intensive engagements with investors and listed companies, and a public consultation, the guide was upgraded to a listing rule requirement in 2016.

Listed companies are asked to produce a sustainability report, with the following five primary components:
(1) **Material environmental, social or governance factors**, describing the reasons for and process of selection, taking into account their relevance to the business, strategy, business model and key stakeholders;

(2) **Policies, practices and performance** in relation to each material factor, providing descriptive and quantitative information on each factor, with performance described in the context of previously disclosed targets;

(3) **Targets** for each material factor for the forthcoming year;

(4) A **sustainability reporting framework** to guide reporting and disclosure, which should be appropriate for and suited to the industry and business model; and

(5) A **board statement** on the board having considered sustainability issues as part of its strategic formulation, determined the material factors and overseen the management and monitoring of the factors.

Reporting is required on a ‘comply or explain’ basis; if a listed company cannot report on a primary component, it must explain what it does instead and the reasons for doing so.

In identifying material factors, a listed company should report both risks to the business, as well as opportunities that may be presented as a result of the factors.

**Implementation**

The sustainability reporting requirement takes effect for financial years ending on or after 31 December 2017. Issuers may decide to progressively improve their reporting, focusing on a few primary components in the initial year, with plans to expand reporting in subsequent years.

It is recognised that sustainability reporting is a journey for listed companies and the market. The focus has been on sharing the benefits of sustainability reporting and encouraging listed companies to embark on this journey.

In this endeavour, the regulator does not act alone. Company directors must be on board with the agenda to set strategic direction for companies. Internal staff must prepare for reporting. Qualified sustainability professionals must be available to provide expertise, if needed. Investors must communicate their informational needs to companies, so that relevant sustainability information is reported.

On SGX’s part, briefing sessions were conducted for chief executives and directors of listed companies to update them on developments. Sustainability reporting workshops by consultants have also been offered to listed companies who wish to prepare their own reports, at rates subsidised by SGX. More online resources would also be made available to companies to assist in the preparation of reports.

**Sustainability ecosystem**

The focus on disclosure drives the focus on the sustainability of business. The impact of sustainability factors on companies, and the effects that companies have on the environment and society, are equally important. Sustainability reporting serves not just shareholders, but also other stakeholders in the value chain, including suppliers, customers and the community at large. As awareness of sustainability grows, so too will the focus on sustainability.